HM Treasury

2014-15 Convergence Programme for the United Kingdom:

submitted in line with the Stability and Growth pact

March 2015

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Foreword

In 2010, unemployment was at 8% and the budget deficit was over 10% of GDP – the largest deficit in post-war history. One pound in every four the government spent was being borrowed. Since 2010, the government's long-term economic plan has delivered the stability and security needed to build a resilient economy. The UK had the fastest growth among G7 economies in 2014, employment has reached its highest ever level, and inflation is at a record low. Debt as a share of GDP is now forecast to start falling in 2015-16 – meeting the debt target set out in 2010. Public sector net borrowing is lower in every year to 2018-19 than at Autumn Statement 2014, and the deficit as a share of GDP is forecast to have halved by the end of 2014-15. In 2015-16, Office for Budget Responsibility (OBR) forecasts show that only one pound in every ten spent by the government will be borrowed.

Now the government needs to finish the job. The deficit remains too high and productivity too low, there are still long-standing structural weaknesses in the economy, and the gap between the economic performance of London and the rest of the UK remains too wide. The government is continuing to take decisive action for the long term in order to reduce borrowing, create full employment and secure a truly national recovery. The government's ambition is to build a stronger economy and a fairer society, and for the UK to become the most prosperous major economy in the world by 2030.

The UK economy and public finances: GDP grew 2.6% in 2014, the strongest annual growth since 2007, and the fastest in the G7. Debt is forecast to be falling as a share of GDP in 2015-16, meeting the debt target set out by the government in 2010. Borrowing is forecast to be lower in every year to 2018-19 than at Autumn Statement 2014, and the public finances are forecast to achieve a larger surplus in 2018-19. Falling debt and improving borrowing mean that consolidation can end a year earlier than planned, and that spending will grow in line with GDP in 2019-20. Budget 2015 builds on existing reforms to create a dynamic, regionally balanced and stronger economy.

Growth: At the end of 2014, employment was at its highest ever level with 1.85 million more people in work since the current government came to power. Business investment has increased by 25.6% since Q1 2010, and the UK will have the joint lowest rate of Corporation Tax in the G20 from April 2015. Budget 2015 sets out a significant package of measures for a truly national recovery by investing in infrastructure, housing, science and innovation across the whole of the UK, and building a Northern Powerhouse. Fuel Duty will be frozen for another year, the government will substantially reduce oil and gas taxes to improve competitiveness in the North Sea, and further support for energy intensive industries will begin in 2015-16. A comprehensive review of Business Rates has been launched, and there will be a radical simplification of the tax system by abolishing the annual tax return.

Fairness: The government's plan is underpinned by a firm commitment to support those who want to work hard and get on, and to ensure that the most vulnerable receive the care and services they need. The richest households continue to make the biggest contribution to reducing the deficit, both in cash terms and as a proportion of their income. Budget 2015 builds on the government's priority of helping families and making work pay with further substantial increases to the personal allowance to £11,000, passing on full gains to higher-rate taxpayers. Saving will be supported by a new tax free Personal Savings Allowance and the Help to Buy: ISA.

Budget 2015 also invests in mental health services for children and young people and sets out further action to tackle tax evasion and avoidance.

1 Introduction

1.1 The Stability and Growth Pact (SGP) requires Member States to provide information on economic developments in their country for the purposes of the multilateral surveillance procedure under Articles 121 and 126 of the EU Treaty. Member States submit either annual Stability Programmes (euro area countries) or annual Convergence Programmes (non euro area countries) setting out their medium-term fiscal policies.

1.2 The UK is not a member of the single currency and cannot face sanctions under the EU's SGP. The UK's obligation under the SGP is to "endeavour to avoid an excessive government deficit" as a result of its Protocol to the EU Treaties (Protocol 15). The Convergence Programme sets out the UK's medium-term fiscal policies.

1.3 Major fiscal events since the last Convergence Programme have been Autumn Statement 2014 and Budget 2015. This Convergence Programme draws on those publications, particularly Budget 2015.

1.4 The forecasts for the economy and public finances included in the UK's Convergence Programme are prepared by the independent Office for Budget Responsibility (OBR), information on which is set out in Chapter 5. The forecasts set out in the Convergence Programme are from the OBR's March 2015 Economic and fiscal outlook, which was published alongside Budget 2015.

1.5 Under Section 5 of the European Communities (Amendment) Act 1993, Parliament is required to approve the government's assessment of the UK's medium-term economic and budgetary position. This forms the basis of the UK's Convergence Programme. The UK presents copies of assessments of its Convergence Programme to Parliament.

Structure of the Convergence Programme

1.6 The first 5 chapters of this Convergence Programme set out the government's policy on the fiscal position, sustainability of the public finances and the macro-economy, as required by the Code of Conduct.

1.7 Reflecting the establishment of the independent OBR, detail on their economic and fiscal forecasts is set out separately in Annex A of the Convergence Programme, drawing upon the OBR's March 2015 Economic and fiscal outlook and 2014 Fiscal sustainability report.

1.8 Annex B provides details of the financial impact of Autumn Statement 2014 and Budget 2015 policy decisions. Annex C provides supplementary data.

2 Overall policy framework and objectives

The UK economy and public finances

2.1 In 2008 the UK was hit by the most damaging financial crisis in generations and in 2010 the government inherited the largest deficit since the Second World War and rapidly rising debt. Since 2010 the government's long-term economic plan has laid the foundations for a stronger economy and a fairer society. The UK had the fastest growth among G7 economies in 2014. The Office for Budget Responsibility (OBR) has revised up its forecasts for UK growth in 2015 and 2016. The deficit is forecast to have fallen by a half as a percentage of GDP from its 2009-10 peak in 2014-15 and the deficit is forecast to be lower in every year from 2015-16 than forecast at Autumn Statement 2014. Debt is forecast to start falling as a share of GDP in 2015-16, a year earlier than the OBR expected at Autumn Statement 2014. This is the first time public sector net debt has been forecast to fall as a share of GDP in 2015-16 since Budget 2012.

2.2 The government's long-term economic plan is delivering stability and growth, in the face of rising instability around the world. At the end of 2014 the employment rate was at its joint highest level ever and in January 2015 inflation was at its lowest rate on record. Now the government must finish the job. The deficit remains high, productivity too low and the UK is not immune to the problems being experienced in Europe and other parts of the world economy. The government will go on taking the difficult decisions needed to secure a truly national recovery and to build a stronger economy and a fairer society that provides opportunity for all. The government's ambition is to create the most prosperous major economy in the world by 2030, with prosperity widely shared.

UK economy since 2010

2.3 The government's balanced programme of deficit reduction has restored fiscal credibility, allowing activist monetary policy and the automatic fiscal stabilisers to support the economy. This has been supported by far-reaching reform of the financial system, a comprehensive package of structural reforms and investment in infrastructure.

2.4 The UK economic recovery is now well established and growth is broad based across the main sectors of the economy. GDP in 2014 was 2.6% higher than in 2013, the strongest annual growth since 2007.[1] Manufacturing, construction and services all grew by 2.5% or more in 2014.

2.5 UK GDP exceeded its pre-crisis peak in Q3 2013 and in Q4 2014 was 3.4% higher than the pre-crisis peak in Q1 2008. The Organisation for Economic Co-operation and Development (OECD) in the 'Economic Survey of the United Kingdom 2015' set out that "against the background of subdued growth in the euro area, the (UK) recovery has benefitted from the cumulative impact of wide-ranging domestic policies. These included highly-accommodative

[1] All UK economy data from Office for National Statistics (ONS) unless otherwise stated. Further detail can be found in 'Budget 2015 Data Sources'.

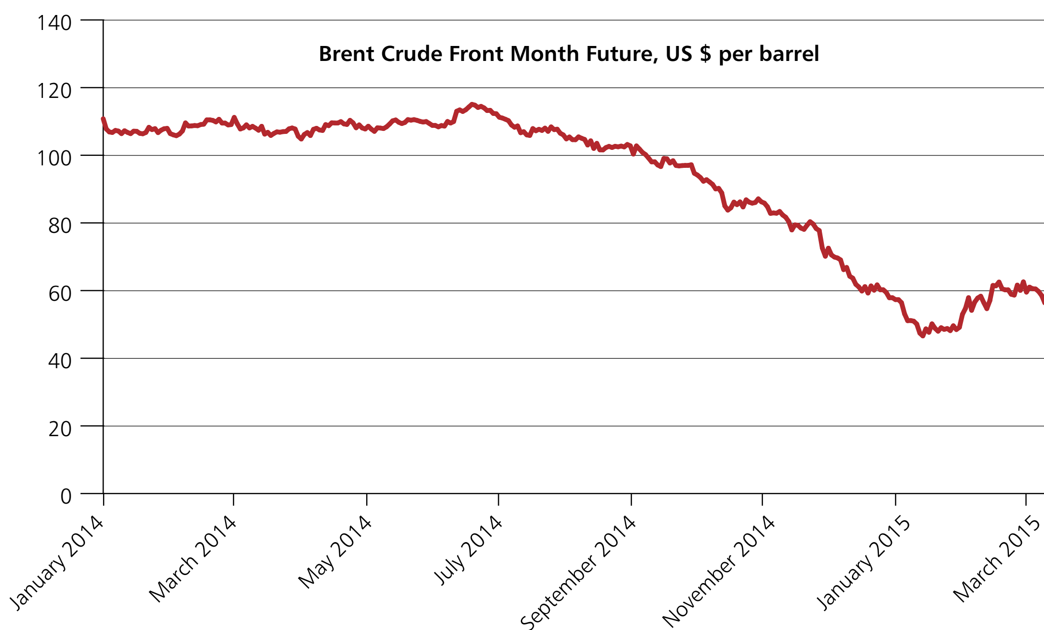
monetary policy and measures to support lending and revive the housing market".[2] As the OECD Secretary-General set out "Britain has a long term economic plan, but it needs to stick with it".[3]

2.6 CPI inflation was 0.3% in January 2015, down from 0.5% in December 2014. The low inflation recently experienced by the UK has mostly been driven by global factors, notably the sharp fall in oil prices and the decline in food prices. The Governor of the Bank of England has set out that three-quarters of the movement in inflation relative to the 2% inflation target has been caused by food, energy and other goods prices.[4] Box 2.A sets out the impact of lower oil prices on the global and UK economy.

Box 2.A: Impact of lower oil prices on the global and UK economy

Between 2009 and 2011 global commodity prices rose rapidly, resulting in higher-than-expected inflation in the UK, which peaked at 5.2% in September 2011. This in turn impacted the UK economy by reducing real incomes and raising business costs. In the second half of 2014 the oil price fell significantly. From a 2014 peak of $115 a barrel in June, the price of oil fell to a low of $46 a barrel in January.[5] It has since picked up, but the OBR's medium-term assumption is around 17% lower than in December. The OBR judges that the fall in oil prices reflects both lower-than-expected global demand and higher-than-expected global supply of oil.[6]

Chart 2.1: Crude oil (Brent) price since January 2014



Source: Thomson Reuters Datastream.

[2] 'Economic Survey of the United Kingdom 2015', Organisation for Economic Co-operation and Development (OECD), February 2015.
[3] Remarks by Angel Gurria at the press conference for the 'Economic Survey of the United Kingdom 2015', OECD, February 2015.
[4] Governor of the Bank of England, oral evidence to the Treasury Committee, Bank of England Inflation Report hearings, 24 February 2015.
[5] Thomson Reuters Datastream.
[6] 'Economic and fiscal outlook', Office for Budget Responsibility (OBR), March 2015.

The OBR expects the decline in the oil price "is likely to affect economic activity in a number of ways: boosting real household incomes and thereby consumer spending and, to a lesser extent, encouraging business investment, but weighing on North Sea production and investment".[7] The OBR expects the fall in the oil price since Autumn Statement 2014 to increase GDP growth by around 0.4 percentage points across 2015 and 2016, more than offsetting the effect on net trade of a further deterioration in the outlook for the UK's export markets.

At the global level, lower oil prices can support aggregate demand if oil consumers increase their spending by more than oil producers cut theirs. In the February 2015 'Inflation Report' the Bank of England estimate that "the fall in oil prices since mid-2014 could boost the level of UK-weighted world GDP by around 0.8%, offsetting some of the negative news in world demand since the summer, and helping to support UK exports".[8] There is a considerable margin of uncertainty around the global impact.

Low inflation driven by the fall in global oil and food prices is good news for households. At Budget 2014, the OBR forecast that UK CPI inflation in 2015 would be 2.0%. The OBR's revised forecast for CPI inflation in 2015 is 0.2%. Lower inflation means that on average the cost of running a household in 2015 will be £450 cheaper than was forecast a year ago.[9]

The fall in oil prices has supported household budgets. Due to petrol pump prices falling by 19p per litre since March 2014, the cost of filling up a tank for the typical motorist has fallen by £11 since Budget 2014.[10] The government has made very clear that it will watch industry to ensure that savings from the fall in oil prices are being passed through to consumers.

Employment, earnings and productivity

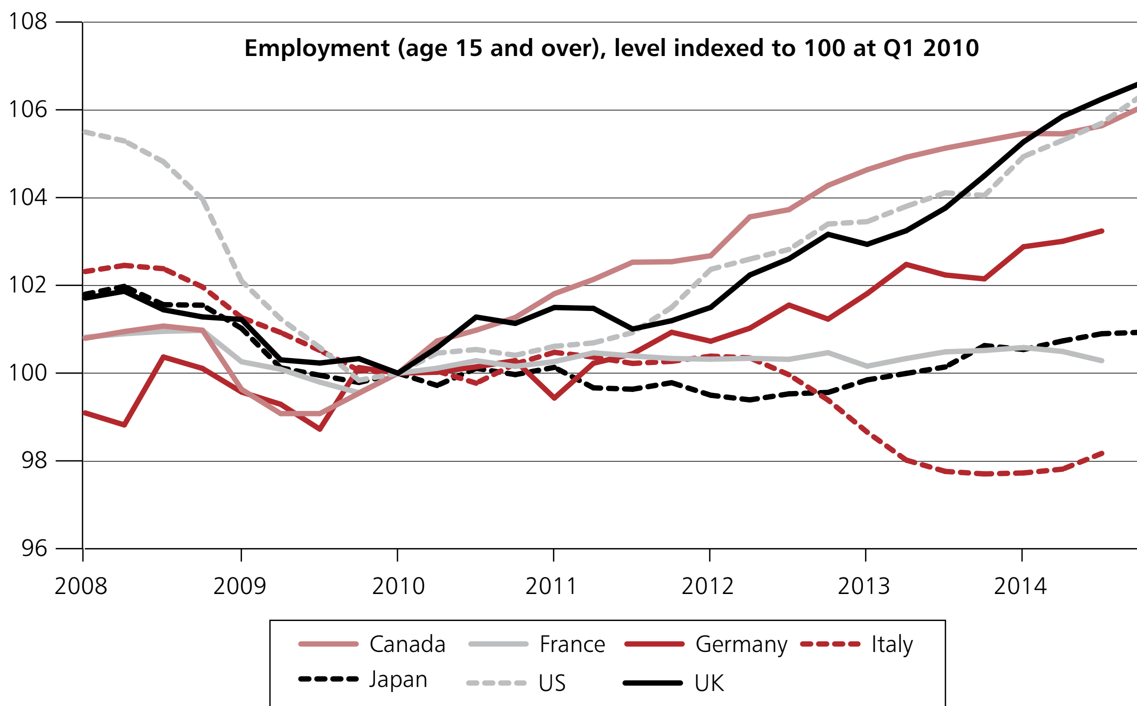
Employment

2.7 The UK labour market has continued to strengthen. At the end of 2014 employment was at its highest level ever at 30.9 million, more than 1 million above its pre-crisis peak, and up 1.85 million since the current government came into power. The employment rate was 73.2% for the 3 months to December 2014, the joint highest level since records began. In 2014 the annual increase in the employment level and the annual decrease in the unemployment level were the largest since 1988. At the end of 2014 youth unemployment had fallen by a fifth compared to a year earlier.

2.8 Employment has increased faster in the UK since Q1 2010 than in any other country in the G7, as shown in Chart 2.2.[11] Over the last year the UK government has come closer to achieving its full employment ambition to have the highest employment rate in the G7. The internationally comparable employment rate for the UK was 72.0% in Q3 2014, the fourth highest in the G7.[12]

[7] 'Economic and fiscal outlook', OBR, March 2015.
[8] 'Inflation Report', Bank of England, February 2015.
[9] HM Treasury calculations based on March 2014 and March 2015 OBR forecasts for the consumer expenditure deflator, March 2015 OBR forecasts for private consumption, ONS household statistics and Department for Communities and Local Government (DCLG) household projections.
[10] 'Weekly road fuel prices', Department of Energy and Climate Change (DECC), as of 10 March 2015.
[11] 'Short-Term Labour Market Statistics: Employed Population', OECD, March 2015.
[12] 'Short-Term Labour Market Statistics: Employed Population', OECD, March 2015.

Chart 2.2: International comparison of employment



Source: Organisation for Economic Co-operation and Development.

2.9 The overall growth in employment predominantly reflects increases in the number of people employed in high and medium-skilled occupations. In the 4 years since Q1 2010 more than two-thirds of the increase in employment has been in high-skilled occupations.[13] Since Q1 2010 over 70% of the increase in employment has come from full-time workers, including self-employed workers, and nearly 60% of the increase in employment has come from full-time employees.

2.10 Participation has also increased, with the working age participation rate at levels last seen in the early 1990s and 1.2 million more people in the workforce at the end of 2014 than when the current government came into power. The growth in the number of women joining the workforce has helped drive this increase. Since 2008, over 70% of the increase in working age participation has come from women. This has led to the gender gap in participation rates reaching a record low at the end of 2014. Older workers are also playing a greater role in the labour market, with the participation rate in 2014 for those aged over 50 at its highest since records began.

Earnings

2.11 Earnings growth has been strengthening, with total pay up 2.1% in the 3 months to December 2014 compared to a year earlier. In the year to December 2014 real pay growth was 1.9%, marking the fourth month of positive real wage growth. The OBR forecasts real terms growth in average earnings for all years of the forecast.[14]

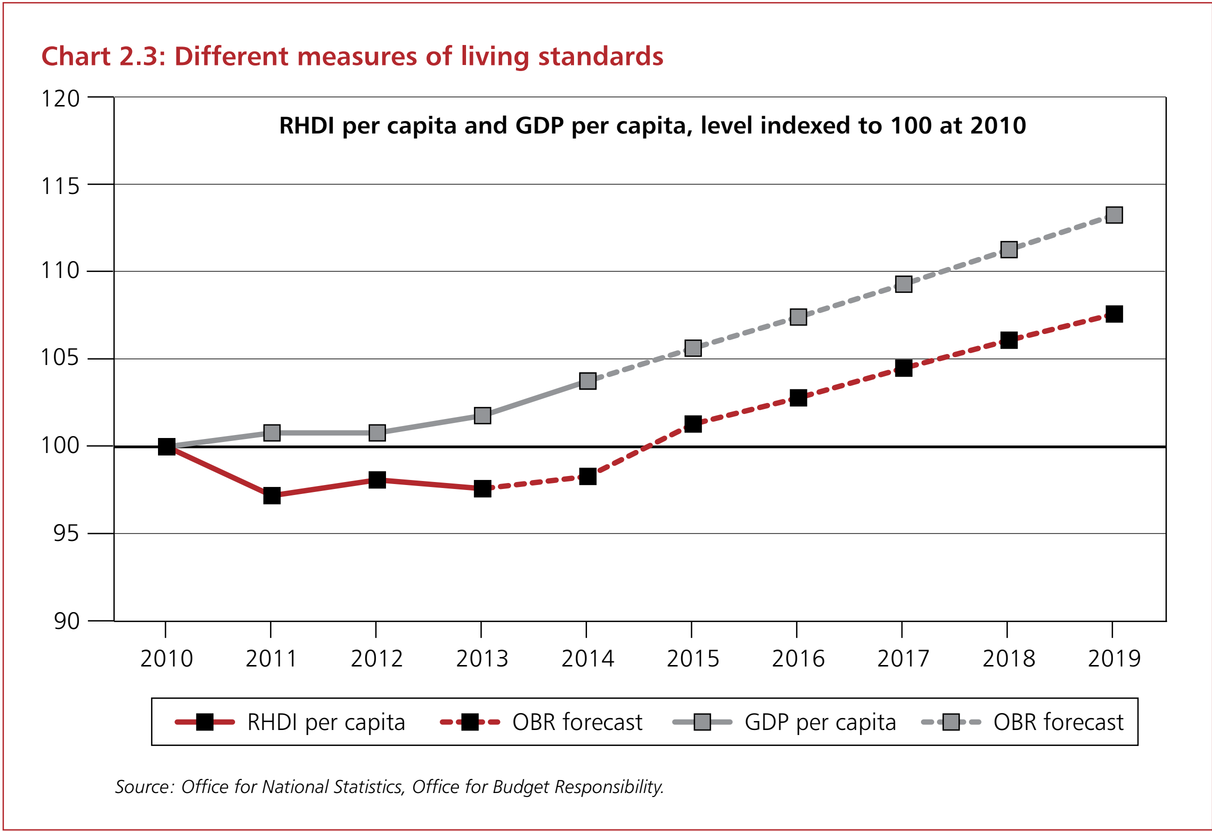
2.12 Lower fuel and food prices are welcome news for households, boosting real household incomes and helping family budgets stretch further. Real household disposable income (RHDI) per capita is the most up to date and comprehensive measure of living standards, used by the OECD, the Office for National Statistics (ONS) and its use welcomed by the UK Statistics Authority, as it takes into account employment levels, the effects of tax and benefits, as well

[13] High and medium-skilled occupations as defined in 'Economic Review', ONS, December 2014.
[14] All forecasts refer to the OBR 'Economic and fiscal outlook', March 2015, unless otherwise stated.

as inflation.[15] The OBR forecasts imply that in 2015 living standards, as measured by RHDI per capita, will be higher than in 2010 or any previous year and will continue to grow strongly every year for the rest of the forecast period. The OBR forecasts that in 2015 RHDI per capita will grow at its fastest rate for 14 years at 3.1%. This will mean that on average households will be £1,100 better off in 2015 than 2014 and around £900 better off in 2015 than in 2010.[16] The Institute for Fiscal Studies (IFS) have nowcast households below average income (HBAI) to 2014-15, and on current trends median income in 2015-16 is likely to be higher than in 2010-11.[17]

2.13 GDP per capita is forecast to be over 5% higher in 2015 than in 2010. Chart 2.3 shows the projected path of GDP per capita and RHDI per capita.

Chart 2.3: Different measures of living standards



Source: Office for National Statistics, Office for Budget Responsibility.

Productivity

2.14 Poor productivity growth has been a long-term issue affecting the UK economy. Since the financial crisis UK productivity performance has been weak. Factors related to the nature of the financial crisis are likely to be having a persistent impact on the level of productivity.

2.15 The latest data has been mixed and shows output per hour productivity grew by 0.6% and output per worker productivity grew by 0.4% in Q3 2014 on the previous quarter. Productivity in the public sector has been increasing steadily since the financial crisis. Between 2010 and 2012 public sector productivity increased by a total of 3.7%.[18] The OBR forecasts productivity growth picking up to 0.9% in 2015, 2.1% in 2016 and 2.5% in 2017.

2.16 The UK is not alone in having weak productivity growth recently and the relationship between pre and post-crisis productivity in the UK is qualitatively similar to that of other

[15] The UK Statistics Authority (UKSA) recently welcomed "Greater use of the estimates of Household Disposable Income (a component of the ONS National Accounts) to give insight into household income at both the aggregate and individual level". Monitoring Review 1/2015 – 'The Coherence and Accessibility of Official Statistics on Income and Earnings', UKSA, February 2015.
[16] HM Treasury calculations based on March 2015 OBR forecasts for Real Household Disposable Income (RHDI), ONS household statistics and DCLG household projections.
[17] 'Living standards: recent trends and future challenges', Institute for Fiscal Studies (IFS), March 2015.
[18] 'Public Service Productivity Estimates: Total Public Services, 2012', ONS, February 2015.

developed countries.[19] The recent weakness in productivity has occurred alongside strong employment growth. Since Q1 2010 the UK has seen the fastest growth in employment of all the G7 countries.

2.17 Productivity growth is the main factor determining average living standards in the medium term. The government has implemented far-reaching structural reforms to improve the UK's long-term productivity. The OECD Secretary-General in February 2015 set out that the "United Kingdom has made tremendous progress in recovering from the largest economic crisis in 80 years. And this progress has laid the foundations for further reforms needed to boost productivity and inclusiveness".[20]

UK rebalancing, investment and trade

2.18 As the recovery has become established, growth has been broadly balanced across sectors, and it is also becoming more balanced across the UK. There has been widespread growth across all major sectors since the start of 2013, including manufacturing, construction and services.

2.19 Business investment has been a key factor driving the recovery. Business investment has increased 25.6% since Q1 2010 and is 5.3% above its pre-crisis peak in Q2 2008. Business investment in 2014 saw the largest annual growth since 2007. Since Q1 2010, business investment has grown 4 times faster than household consumption. The OBR forecasts 2.6% household consumption growth in 2015, alongside continued strong business investment growth of 5.1% in 2015. Budget 2015 announces a package of measures to support investment in the oil and gas sector. The OBR's assessment is these measures will boost the level of oil production by 2019 by 15%, equivalent to around 0.1% of GDP.[21]

2.20 This government is committed to rebalancing growth across the regions and nations of the UK and is committed to the creation of a Northern Powerhouse. The latest data shows that output per head in the North West, North East, West Midlands and Wales all grew faster than London in 2013. In addition, in the year to the end of 2014, employment in the North East, North West and the East Midlands all grew faster than in London.

2.21 The UK is one of the most open economies in the world, with significant trade and financial links with other countries. UK exports performance is highly dependent on the economic performance of the euro area, the UK's largest trading partner.

2.22 The UK's current account deficit widened to 6.0% of GDP in Q3 2014. Chart 2.4 shows the income balance has declined since early 2012, reflecting lower income received from investment abroad. Weaker euro area growth and global prospects have seen UK investments abroad yield lower returns while, in contrast, as the UK economy has continued to recover, the payments made on foreign holdings of UK investment have increased. The OBR forecasts that the current account deficit will diminish over the forecast period from 4.3% of GDP in 2015, to 3.2% in 2016 and 2.3% in 2019.

2.23 Weak euro area growth has meant goods exports to EU countries have been subdued. But UK exporters have continued to expand in other markets and the volume of goods exports to non-EU countries has increased by 24% since Q1 2010. The UK's trade deficit in the 3 months to January 2015 was £4.4 billion, the lowest deficit since October 2000. The narrowing of the deficit in the 3 months to January 2015 reflected a fall of £1.2 billion in UK imports and an increase in exports of £2.4 billion.

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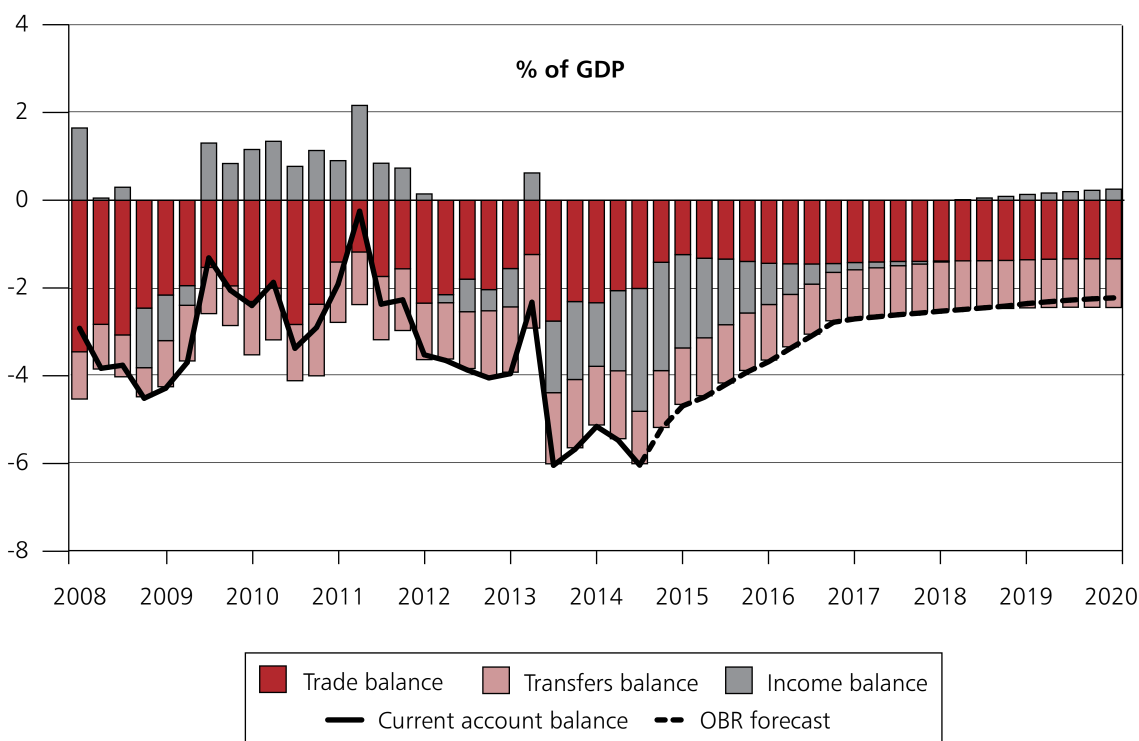
[19] 'The UK productivity puzzle: an international perspective', speech by Martin Weale, December 2014.
[20] Remarks by Angel Gurria for the 'Economic Survey of the United Kingdom 2015', OECD, February 2015.
[21] 'Economic and fiscal outlook', OBR, March 2015.

Chart 2.4: Current account



Source: Office for National Statistics, Office for Budget Responsibility.

2.24 There continue to be signs of normalisation in the housing market with indicators suggesting continued increases in house building and moderating house price growth. Housing starts were up 10% in England in 2014 and house prices grew by 9.8% in the year to December 2014, down from 12.1% in the year to September 2014.[22] Effective mortgage rates fell to 2.8% in January 2015, the lowest rate on record.[23] Lower effective mortgage rates should make it easier to service a mortgage and support housing demand. Budget 2015 announces the Help to Buy: ISA to help first-time buyers realise their aspirations of homeownership.

Global developments and risks

2.25 Abandoning the government's long-term economic plan would represent the most significant risk to the UK economy. A sustained improvement in productivity growth is critical to delivering the OBR's forecast for the economy. The global economic recovery remains uneven and the UK is not immune to the severe problems being experienced in Europe and other parts of the world economy.

2.26 In January 2015, the International Monetary Fund (IMF) again downgraded its global growth forecast for 2015 to 3.5%.[24] In the euro area, recovery remains slow and inflation has turned negative. The IMF expects euro area growth of 1.2% in 2015. In contrast, the US economy is forecast to continue to recover strongly and the IMF projects growth of 3.6% in 2015. In Japan, growth is forecast to be just 0.6% in 2015. Chinese growth continues to moderate as the government implements an ambitious reform plan to rebalance the economy and control credit growth, and is expected to fall below 7% in 2015. Across emerging and developing markets, the IMF expects growth to slow to 4.3% in 2015.

[22] 'House Building in England: October to December 2014', DCLG, February 2014.
[23] 'Effective interest rates: January 2015', Bank of England, February 2015.
[24] 'World Economic Outlook Update', International Monetary Fund (IMF), January 2015.

2.27 The UK economy faces a number of external risks from key trading partners. These include a prolonged standoff between Greece and the euro area, weak growth and disinflationary pressure in the euro area and Japan, risks to growth in key emerging markets, and the situation in Russia and Ukraine.

2.28 The Greek government has indicated that it wishes to discuss the terms of its current loans from the euro area. Greece and the euro area need to work together to identify a sustainable way forward and ensure economic and financial stability. In that context, the UK welcomed the agreement in February towards extending the euro area's existing financial assistance for a further 4 months while these discussions continue. A prolonged or turbulent stand-off between Greece and the euro area would represent the biggest external risk to the UK economy. Although the UK's direct economic and financial links with Greece are limited, the UK is highly exposed to wider market instability.

2.29 Commodity exporting countries face pressures from recent falls in the price of oil and other commodities which could lead to external and public-sector financing challenges. Separately, risks remain around the market impact on some emerging economies of monetary policy normalisation in some advanced economies, but those which have pressed on with reforms appear increasingly well-prepared to maintain market confidence.

2.30 Finally, geopolitical uncertainty raised by the tensions between Russia and Ukraine is likely to create uncertainty in global markets, particularly if the situation deteriorates. Support from the IMF, EU and other partners is necessary to address Ukraine's urgent financial needs while the Ukrainian government undertakes essential economic reforms. The UK welcomes approval, by the IMF Board, of new IMF financial assistance. The UK's direct economic links with Russia and Ukraine are limited and sanctions have been targeted to ensure that the impact on the UK and the rest of the EU is limited.

Economic outlook

Table 2.A: Summary of the OBR's central economic forecast[1]

	Percentage change on a year earlier, unless otherwise stated						
			Forecast				
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
GDP growth	**1.7**	**2.6**	**2.5**	**2.3**	**2.3**	**2.3**	**2.4**
Main components of GDP							
Household consumption[2]	1.7	2.0	2.6	2.7	2.5	2.3	2.2
General government consumption	-0.3	1.5	0.8	-0.7	-0.9	-0.2	1.5
Fixed investment	3.4	6.8	4.3	6.2	5.6	5.7	4.4
Business	5.3	6.8	5.1	7.5	6.5	6.4	4.4
General government[3]	-8.1	7.3	2.3	1.9	1.6	1.5	2.8
Private dwellings[3]	6.2	6.6	3.5	5.4	5.5	6.2	5.2
Change in inventories[4]	0.3	0.2	0.1	0.0	0.0	0.0	0.0
Net trade[4]	0.0	-0.5	-0.1	-0.4	-0.2	-0.2	-0.2
CPI inflation	**2.6**	**1.5**	**0.2**	**1.2**	**1.7**	**1.9**	**2.0**
Employment (millions)	**30.0**	**30.7**	**31.1**	**31.4**	**31.5**	**31.7**	**31.9**
ILO unemployment (% rate)[5]	**7.6**	**6.2**	**5.3**	**5.2**	**5.3**	**5.3**	**5.3**

[1] All figures in this table are rounded to the nearest decimal place. This is not intended to convey a degree of unwarranted accuracy. Components may not sum to total due to rounding and statistical discrepancy.

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

[3] Includes transfer costs of non-produced assets.

[4] Contribution to GDP growth, percentage points.

[5] International Labour Organization.

Source: Office for Budget Responsibility, Office for National Statistics.

2.31 The OBR has revised up its forecasts for UK growth in 2015 from 2.4% to 2.5% and in 2016 from 2.2% to 2.3%. The OBR forecasts growth of 2.3% in 2017, rising to 2.4% in 2019. The OBR forecasts employment to be 31.1 million in 2015, rising to 31.9 million by 2019. The OBR has revised down its forecast for the unemployment rate in 2015 from 5.4% to 5.3%. The OBR forecasts unemployment of 5.2% in 2016 and 5.3% for the remainder of the forecast period.

2.32 The output gap represents the amount of spare capacity in the economy. Higher GDP growth in 2015 and 2016 means that spare capacity in the economy will be reduced more quickly than expected at the time of Autumn Statement 2014. The OBR therefore forecasts remaining spare capacity in the economy to be used up by late 2017, a year and a half earlier than forecast at Autumn Statement 2014.

2.33 The OBR forecasts business investment growth of 5.1% in 2015 and 7.5% in 2016. The OBR expects private dwelling investment to grow by 3.5% in 2015, 5.4% in 2016 and 5.5% in 2017. The OBR forecasts exports growth of 3.9% in 2015 and 4.0% in 2016 and growth of over 4.0% over the remainder of the forecast.

2.34 CPI inflation is forecast to be below target in 2015 and remain below target before returning to 2.0% in 2019.

The government's plan

2.35 The government's long-term economic plan builds a stronger, more competitive economy, a fairer society, and secures a better future for Britain by:

- reducing the deficit to deal with the UK's debt, safeguard the UK economy for the long term and keep mortgage rates low
- cutting income taxes and freezing fuel duty to help hardworking people be more financially secure
- creating more jobs by backing small business and enterprise with better infrastructure, lower job taxes and a long-term industrial strategy
- capping welfare and controlling immigration so the economy delivers for people who want to work hard and play by the rules
- delivering the best schools, skills and apprenticeships for young people so the next generation can succeed in the global race

2.36 In order to safeguard the economy for the long term, the government is continuing to take decisive action through: monetary activism and credit easing, deficit reduction, reform of the financial sector, and a comprehensive package of structural reforms.

Monetary policy

2.37 Monetary policy has a critical role to play in supporting the economy as the government delivers on its commitment for necessary fiscal consolidation. The government has ensured that monetary policy can continue to play that role fully by updating the UK's monetary policy framework and remit for the Monetary Policy Committee (MPC) at Budget 2013.

2.38 The MPC has full operational independence to set policy to meet the inflation target. **Budget 2015 reaffirms the inflation target of 2% for the 12-month increase in the CPI, which applies at all times.** This target is symmetric meaning deviations below the target are treated the same way as deviations above the target. Symmetric targets help to ensure that inflation expectations remain anchored and that monetary policy can play its role fully. **The government also confirms the Asset Purchase Facility (APF) will remain in place for the financial year 2015-16.**

2.39 Inflation fell markedly to 0.5% in December 2014 and 0.3% in January 2015, triggering the first open letter for inflation falling more than 1 percentage point below target, published on 12 February 2015.[25] In its February 2015 'Inflation Report', the MPC forecast that inflation is likely to remain low for the next year or so, mostly reflecting the recent falls in commodity and food prices, before returning to target in 2 years' time.[26] The Chancellor's open letter to the Governor of the Bank of England welcomed "that the MPC remains vigilant to both upside and downside risks to its forecast and stands ready to act if these risks materialise".[27]

Credit easing

2.40 Since its introduction, the Funding for Lending Scheme (FLS) has helped to reduce bank funding costs to historic lows and improve credit conditions for households and businesses, including small and medium-sized enterprises (SMEs). As of end-Q4 2014, participants have £55.7 billion of borrowing outstanding in the scheme to support lending to the real economy.[28]

2.41 In December 2014, the Treasury and the Bank of England announced that the FLS would be extended by 1 year to 29 January 2016. This extension will maintain support for lending where it is most needed – for SMEs – and will provide certainty over cheap funding to support lending, even in the event of negative shocks to bank funding conditions.

Deficit reduction

Fiscal strategy

2.42 The government inherited the largest deficit in post-war history as a result of the Great Recession and unsustainable pre-crisis increases in public spending.[29] The IMF estimates that the UK entered the Great Recession with the largest cyclically-adjusted deficit of any major advanced economy, at 5.3% of GDP in 2007.[30] Unchecked, the historically high level of borrowing could have undermined fairness, growth and economic stability in the UK. In 2010, the government set out medium-term fiscal consolidation plans to return the public finances to a sustainable path.

2.43 The government is making significant progress in delivering its fiscal consolidation. Public sector net borrowing as a percentage of GDP is forecast to have halved between 2009-10 and 2014-15.[31] The latest data from the IMF shows that, between 2010 and 2013, the government reduced the structural deficit by more than half. The structural deficit fell by 4.6% of GDP over this period, a larger absolute reduction than any other country in the G7.[32] When this government came into office around 1 pound in every 4 being spent was borrowed.[33] In 2015-16 the Office for Budget Responsibility's (OBR) forecasts show that only 1 pound in every 10 spent will be borrowed.[34]

2.44 The government is forecast to meet its new forward-looking fiscal mandate in the third year of the forecast period, which is currently 2017-18, having reduced the cyclically-adjusted current budget deficit from its peak of 4.8% of GDP in 2009-10 to 2.6% of GDP in 2013-14.[35] The supplementary aim for public sector net debt to fall as a share of GDP in 2016-17 is forecast to be met a year early with debt falling as a share of GDP in 2015-16. This is the first time public sector net debt has been forecast to fall as a share of GDP in 2015-16 since Budget 2012.

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[25] Open letter from the Governor of the Bank of England to the Chancellor of the Exchequer, February 2015.
[26] 'Inflation Report', Bank of England, February 2015.
[27] Open letter from the Chancellor of the Exchequer to the Governor of the Bank of England, February 2015.
[28] 'Funding for Lending Scheme usage and lending data publication – Q4 2014', Bank of England, February 2015.
[29] 'Public Sector Finances', ONS, January 2015.
[30] 'World Economic Outlook', IMF, October 2014.
[31] 'Public Sector Finances', ONS, January 2015; 'Economic and fiscal outlook', OBR, March 2015.
[32] 'World Economic Outlook', IMF, October 2014.
[33] 'Public Sector Finances', ONS, January 2015.
[34] 'Economic and fiscal outlook', OBR, March 2015.
[35] 'Public finances databank', OBR, March 2015.

2.45 Since Autumn Statement 2014, the fiscal position has improved across the forecast period. Higher receipts in 2014-15 and lower debt interest costs across the forecast period are reflected in an improved path of public sector net borrowing. The overall surplus on public sector net borrowing in 2018-19 is higher than at Autumn Statement 2014. Public sector net debt as a percentage of GDP is forecast to fall one year earlier than at Autumn Statement 2014 and is lower in cash terms and as a percentage of GDP from 2015-16 than was forecast previously. The faster pace of debt reduction in this forecast, largely due to the sale of financial sector assets in 2015-16, will improve the sustainability of the public finances and means that Total Managed Expenditure (TME) is able to grow in line with GDP in 2019-20, when it will be 36% of GDP and when public sector net debt will fall by 3.2 percentage points of GDP.

2.46 The government remains committed to restoring the public finances to a sustainable position and getting public sector net debt onto a declining path as a share of GDP. The latest forecast from the OBR shows that the cyclically-adjusted current budget will be in balance in 2017-18, with an overall surplus from 2018-19. Getting to grips with the public finances will speed up the process of debt reduction, reducing the burden on taxpayers and strengthening the ability of future governments to respond to economic shocks.

Consolidation in this Parliament

2.47 The government has to date delivered £83 billion of the £98 billion planned discretionary reductions in spending and £106 billion of the £121 billion planned total discretionary consolidation by the end of 2015-16, as set out in Table 2.B.

Table 2.B: Total consolidation plans over this Parliament

	£ billion		
	2013-14	**2014-15**	**2015-16**
Policy inherited by the government	**56**	**70**	**–**
Spending[1,2]	38	48	–
Tax[2]	18	21	–
Spending share of consolidation (%)	*67*	*69*	*–*
Total discretionary consolidation	**92**	**106**	**121**
Spending[1,2,3]	67	83	98
Tax[2,3]	24	23	23
Spending share of consolidation (%)	*74*	*78*	*81*

[1] Spending consolidation is attributable to 3 factors: (a) reductions in Departmental Expenditure Limits (DEL) are calculated by assessing nominal DEL totals against a counterfactual of growing DEL from 2010–11 in line with general inflation in the economy, as set out in Table 4.8 of the OBR's pre-Budget forecast (June 2010); (b) reductions in Annually Managed Expenditure (AME) due to the net effect of policy changes announced since the June Budget 2010; and (c) estimated debt interest savings, updated for market interest rates consistent with the OBR's March 2015 'Economic and fiscal outlook.' This calculation excludes the impact of financial transactions in Capital DEL.

[2] This takes account of the latest costings.

[3] Where costings do not go out to 2015-16, they have been grown in line with general inflation in the economy.

Source: Office for Budget Responsibility and HM Treasury calculations.

2.48 Public spending control is central to the government's commitment to reduce the deficit. As a result of good financial management and firm spending control, departments have been able to exceed the consolidation targets that have been set for them. Since 2010 departments have underspent against plans by an average of over £5 billion a year, with the OBR forecasting further underspends for 2014-15 of £3.5 billion.[36]

2.49 Since Autumn Statement 2014, the government has made good progress in driving efficiency across a number of areas. **Budget 2015 confirms that proposals have been agreed with all departments to abolish progression pay across the Civil Service.**

[36] 'Public Expenditure Statistical Analyses', HM Treasury; 'Economic and Fiscal Outlook', OBR, March 2015.

Financial sector and other asset sales

2.50 During this Parliament the government has made substantial progress in selling assets it no longer needs to hold, and in getting taxpayers' money back from the bank bailouts. Total sales of corporate and financial assets since May 2010 amount to over £19.9 billion.[37] As set out in the OBR's March 2015 'Economic and fiscal outlook', this government has recovered from its financial sector interventions:

- nearly £9 billion through selling shares in Lloyds Banking Group, which has reduced the government's shareholding to below 23% – Lloyds' announcement on 27 February 2015 of a dividend payment will further contribute at least £100 million to the Exchequer
- in excess of £9.5 billion in fees from Lloyds Banking Group and Royal Bank of Scotland (RBS) relating to government support and participation in government intervention schemes – all of which are no longer required
- more than £21 billion in repayments from the sale of Northern Rock plc, and the ongoing wind-down of NRAM plc and Bradford & Bingley
- over £1 billion in respect of the Dunfermline Building Society administration
- over £2.6 billion in repayments from the Landsbanki LBI (Icesave) estate in Iceland
- a total of £11 billion from the Financial Services Compensation Scheme, from the estates of failed banks, and fees from the wider banking sector in respect of the Credit Guarantee Scheme and Special Liquidity Scheme (not including RBS or Lloyds)

2.51 Chart 2.5 sets out the calculated impact of previous financial sector interventions on net debt over 2007-08 to 2015-16. The government remains determined to complete the state's exit from ownership of banks, delivering value for money for the taxpayer, boosting competition in the financial sector, and paying down the debt. Having de-risked the financial sector and returned the economy to a stable and sustainable path, the government is now in a position to set out the next steps in reducing the taxpayers' exposure to the financial sector.

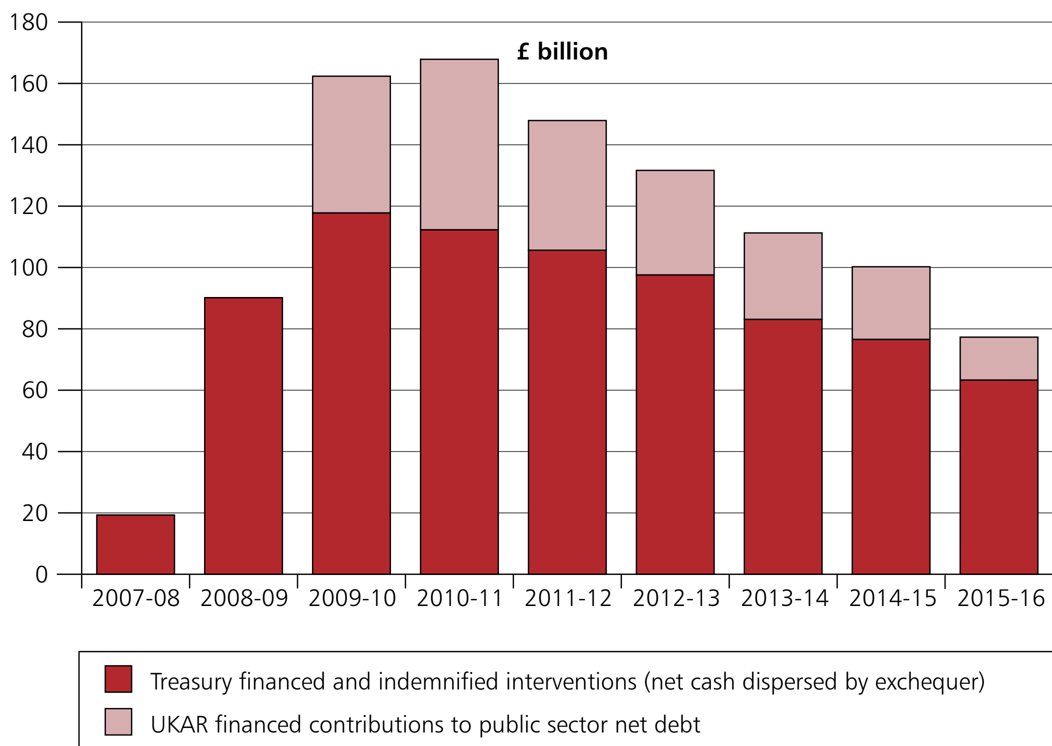
2.52 The government's long-term economic plan has underpinned positive market conditions. Together with Lloyds moving into profit and paying a dividend, this will enable the government to continue its sales programme for the taxpayers' remaining stake in the bank. As a result **this Budget announces the government's plan to sell £9 billion of Lloyds shares over the next year, continuing the progress of the last year**. The government will continue to consider options for allowing the British public to participate directly in future sales of bank shares.

2.53 The government is also taking action to continue to exit from the nationalised banks. **UK Asset Resolution (UKAR), which manages the government's ownership of NRAM plc and Bradford & Bingley plc, is announcing a major sale of assets held from the forced nationalisation of Northern Rock and Bradford & Bingley plc.** In parallel, UKAR will explore potential options for the sale or outsourcing of its mortgage servicing activities. Any sales will be contingent on ensuring value for money for the taxpayer. The government's central estimate, certified by the OBR, is that these sales of Lloyds shares and UKAR assets are expected to raise approximately £20 billion in 2015-16.[38]

[37] Published sales of corporate and financial assets (800MHz and 2.6 GHz spectrum, the Tote, Northern Rock, High Speed 1 (30 year concession), Lloyds Banking Group (multiple sales), Royal Mail, mortgage style student loan book, Plasma Resources UK, UK Asset Resolution Ltd mortgage portfolio, ConstructionLine, Greencoat UK Wind, Food and Environment Research Agency, Defence Support Group, Eurostar) total over £19.9 billion. In general proceeds from sales of corporate and financial assets will reduce public sector net debt. There may also be an impact on public sector net borrowing as future income (or costs) are foregone, such as dividend payments, loan repayments, or the need for future investment. The specific arrangements for some assets may vary.

[38] 'Economic and fiscal outlook', OBR, March 2015.

Chart 2.5: Calculated impact of financial sector interventions on net debt



Source: HMT calculations based on HMT accounts, Office for National Statistics and Office for Budget Responsibility.

Figures for 2015-16 include OBR-certified costings of the sale of financial sector assets in 2015-16, comprising Lloyds Banking Group and UKAR.

2.54 As set out in Budget 2014, RBS's new management committed to a new strategy for serving its UK customers, reducing assets in its 'bad bank', and supporting lending to British businesses. This has brought forward the point at which the bank can start being returned to private ownership. It is not good for taxpayer value or for the competitiveness of the UK's banking system to have such a large and complex bank in state hands for too long. As a result, the government intends to take a decision on the timing of any exit programme from RBS early in the next Parliament.

2.55 In March 2015, the Treasury signed a binding agreement to sell its entire holding in Eurostar International Limited for £757 million. Other asset sales include those of shares in Greencoat UK Wind for £52 million, ConstructionLine for £35 million, Food and Environment Research Agency for £20 million and Defence Support Group for £140 million. Progress also continues towards the sale of the government's stake in Urenco, the pre-2012 Income Contingent Repayment student loan book and public sector spectrum. A central estimate of approximately £12 billion is expected from the sale of the Income Contingent Repayment student loan book.[39]

2.56 Autumn Statement 2013 set a target to deliver £20 billion of corporate and financial asset sales between 2014 and 2020. More than £8.9 billion of sales have now completed, or will shortly.[40] With over £20 billion in sales expected to complete in 2015-16 the government is on track to meet this target early and significantly exceed it.

[39] 'Economic and fiscal outlook', OBR, March 2015.

[40] Published sales of corporate and financial assets since January 2014 (Lloyds Banking Group (multiple sales), UK Asset Resolution Ltd mortgage portfolio, ConstructionLine, Greencoat UK Wind, Food and Environment Research Agency, Defence Support Group, Eurostar) total over £8.9 billion, of which £2 billion since Autumn Statement 2014.

Fiscal forecast

2.57 As set out in Table 2.C, from its post-war peak of 10.2% of GDP in 2009-10, the OBR forecasts public sector net borrowing will fall in each year of the forecast period, to:[41]

- 5.0% of GDP in 2014-15
- 4.0% of GDP in 2015-16, the final year for which the government has set departmental spending plans
- a surplus of 0.2% of GDP in 2018-19, increasing to 0.3% of GDP in 2019-20

2.58 Public sector net debt is forecast to peak at 80.4% of GDP in 2014-15, the same level as at Autumn Statement 2014, before falling each year and reaching 71.6% of GDP in 2019-20. In 2015-16 public sector net debt is forecast to be 80.2% of GDP, 0.2 percentage points lower than 2014-15.

Table 2.C: Overview of the OBR's central fiscal forecast

	% GDP, unless otherwise stated						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Fiscal mandate							
Cyclically-adjusted current budget deficit	2.6	2.5	2.1	0.4	-0.8	-1.7	-1.7
Deficit							
Public sector net borrowing	5.6	5.0	4.0	2.0	0.6	-0.2	-0.3
Public sector net borrowing (£ billion)	97.3	90.2	75.3	39.4	12.8	-5.2	-7.0
Cyclically-adjusted net borrowing	4.1	4.2	3.7	1.9	0.6	-0.3	-0.3
Current budget deficit	4.1	3.3	2.4	0.5	-0.8	-1.7	-1.7
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
Treaty deficit[1]	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
Debt							
Public sector net debt[2]	79.1	80.4	80.2	79.8	77.8	74.8	71.6
Treaty debt[3]	87.9	88.4	88.8	88.7	87.1	84.4	81.4
Memo: Output gap	*-2.0*	*-0.8*	*-0.4*	*-0.2*	*0.0*	*0.0*	*0.0*
Memo: total policy decisions[4]		*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*

[1] General government net borrowing on a Maastricht basis.

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

[3] General government gross debt on a Maastricht basis. Taken from http://budgetresponsibility.org.uk/wordpress/docs/Correction-to-Treaty-debt-ratio-forecast-March-2015-Economic-and-fiscal-outlook.pdf

[4] Equivalent to the 'Total policy decisions' line in Table B.2.

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

2.59 The OBR's March 2015 'Economic and fiscal outlook' includes a comparison of key fiscal aggregates to Autumn Statement 2014. Public sector net borrowing is forecast to be £7.2 billion lower in 2014-15 than in 2013-14, and it continues to fall year on year throughout the forecast period. Public sector net debt has been revised down relative to Autumn Statement 2014 from 2015-16 onwards in both cash terms and as a share of GDP. By the end of the forecast period, public sector net debt is forecast to be 71.6% of GDP, 1.2 percentage points lower than forecast at Autumn Statement 2014.

[41] 'Public Sector Finances', ONS, January 2015.

Table 2.D: Comparison of key fiscal aggregates to Autumn Statement 2014

	% GDP, unless otherwise stated						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public sector net borrowing (£ billion)							
Budget 2015	97.3	90.2	75.3	39.4	12.8	-5.2	-7.0
Autumn Statement 2014	97.5	91.3	75.9	40.9	14.5	-4.0	-23.1
Change compared to Autumn Statement	-0.2	-1.1	-0.7	-1.5	-1.8	-1.2	16.1
Public sector net debt							
Budget 2015	79.1	80.4	80.2	79.8	77.8	74.8	71.6
Autumn Statement 2014	78.8	80.4	81.1	80.7	78.8	76.2	72.8
Change compared to Autumn Statement	0.3	0.0	-0.9	-0.9	-1.0	-1.4	-1.2
Cyclically-adjusted current budget deficit							
Budget 2015	2.6	2.5	2.1	0.4	-0.8	-1.7	-1.7
Autumn Statement 2014	2.6	2.7	2.2	0.5	-0.7	-1.5	-2.3
Change compared to Autumn Statement	0.0	-0.2	-0.1	-0.1	-0.2	-0.2	0.5

Source: Office for National Statistics and Office for Budget Responsibility.

Performance against the fiscal mandate

2.60 The government's fiscal strategy is underpinned by a forward-looking mandate, as updated in the Charter for Budget Responsibility approved by Parliament on 13 January 2015, to achieve a cyclically-adjusted current balance in the third year of a rolling 5-year forecast period.[42]

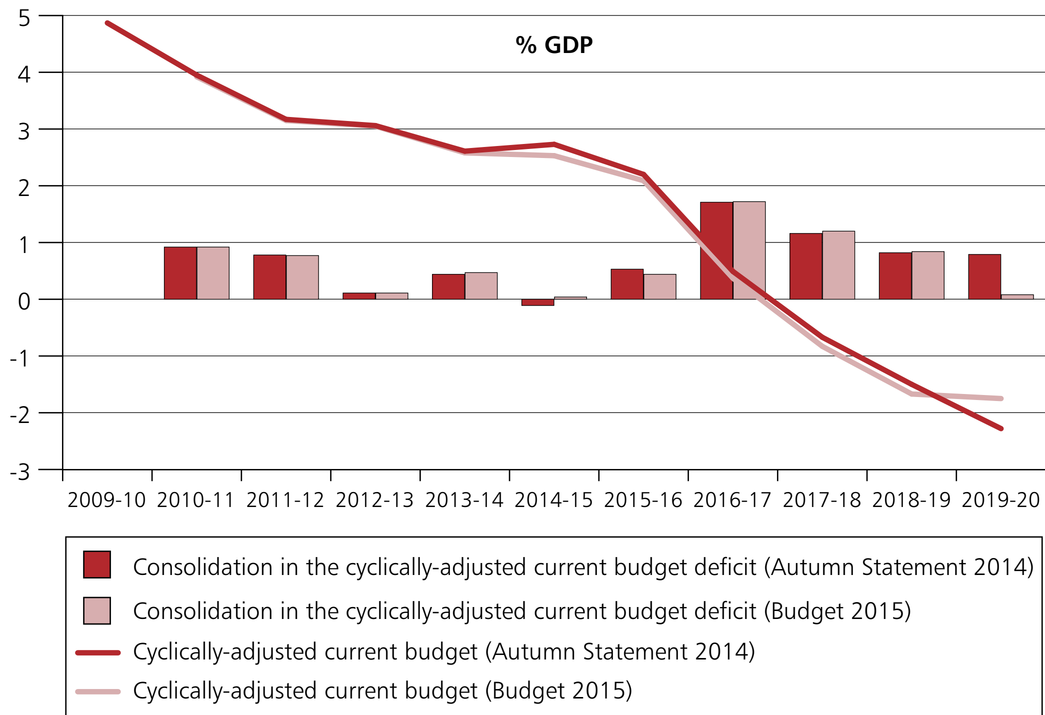
2.61 The OBR's March 2015 'Economic and fiscal outlook' confirms the government is on course to meet the fiscal mandate in the third year of the forecast period, 2017-18. The OBR's judgement is that the government's policies are consistent with roughly a 65% chance of achieving the fiscal mandate in 2017-18. Chart 2.6 shows the government's performance against its fiscal mandate.

2.62 The government's fiscal mandate is supplemented by an aim for public sector net debt as a percentage of GDP to be falling at a fixed date of 2016-17. As set out in Chart 2.7, the OBR forecasts that the supplementary debt aim will be met a year early, with debt falling by 0.2% of GDP between 2014-15 and 2015-16. Public sector net debt falls by 0.4% of GDP between 2015-16 and 2016-17.

2.63 Public sector net debt is forecast to peak in 2014-15 as a share of GDP, before falling from 2015-16 and thereafter across the forecast horizon. This is the first time debt has been forecast to fall as a share of GDP in the coming year since Budget 2002. The government is forecast to meet the target for debt to be falling as a share of GDP by the end of 2015-16, as set out in the June Budget 2010.

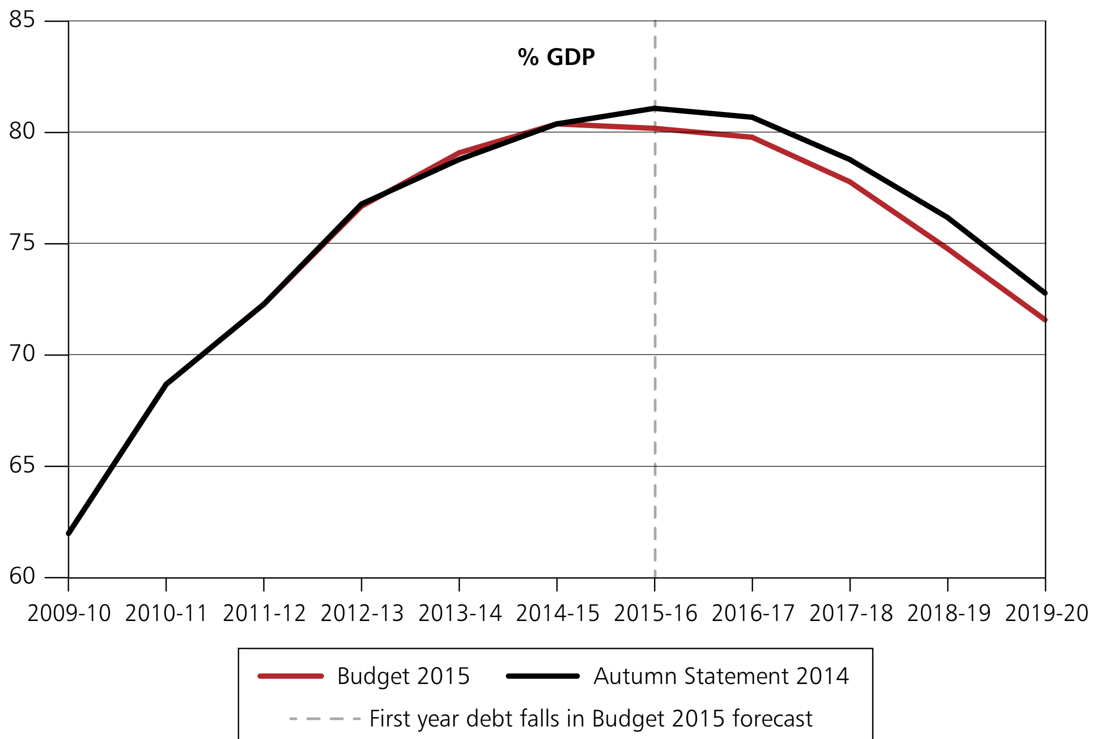
[42] 'Charter for Budget Responsibility: Autumn Statement 2014 update', HM Treasury, December 2014.

Chart 2.6: Consolidation in the cyclically-adjusted current budget deficit



Source: Office for Budget Responsibility and HM Treasury.

Chart 2.7: Public sector net debt



Source: Office for National Statistics and Office for Budget Responsibility.

Performance against EU targets

2.64 The government remains committed to bringing the UK's Treaty deficit in line with the 3% target set out in the Stability and Growth Pact (SGP). The government is forecast to meet the EU SGP target for the Treaty deficit in 2016-17.

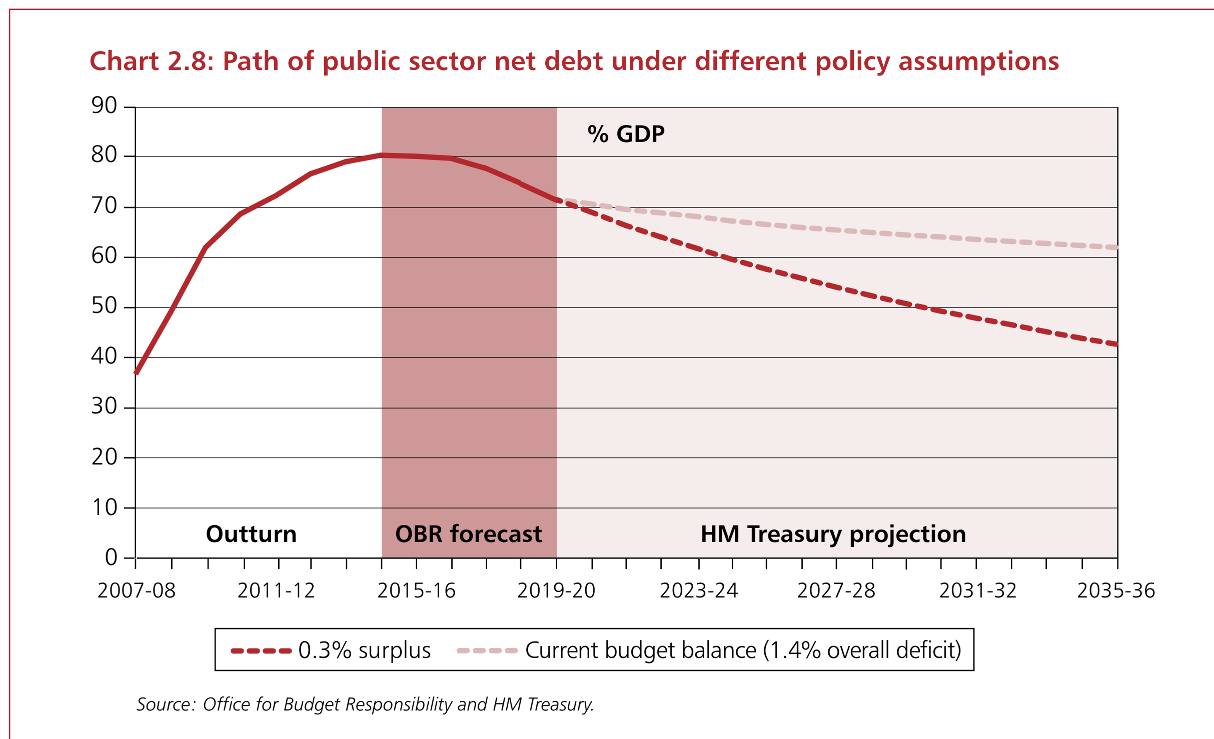
The long-term debt challenge

2.65 As a result of the Great Recession, public sector net debt is forecast to have risen by more than 40% of GDP since the financial crisis, to a peak of 80.4% of GDP in 2014-15.[43] The peak in debt will be the highest level of debt since the late 1960s.[44] By the time public sector net debt begins to fall, it will have been increasing as a percentage of GDP in every year since 2001-02. This is the longest period of year-on-year increases in debt as a percentage of GDP since at least 1700.[45] Debt would be even higher if the government had not pursued its plan to reduce the deficit.

2.66 Central government (gross) spending on debt interest is forecast to be £45.7 billion this year. Reducing debt in future will help control these costs and reduce the burden on future generations. Debt interest would be £3.6 billion a year lower for every reduction in debt of 10% of GDP, based on the market interest rates used by the OBR in its March 2015 'Economic and fiscal outlook.'

2.67 High public debt also increases the UK's vulnerability to future shocks. It is more likely a new shock would increase debt to potentially unsustainable levels if starting from a higher level, increasing uncertainty, pushing up interest rates and undermining economic stability. Chart 2.8 shows projections for the path of public sector net debt as a percentage of GDP, assuming two different scenarios for levels of borrowing from the end of the 5-year forecast horizon. This chart is based on a simple scenario in which there are no shocks to the economy.

Chart 2.8: Path of public sector net debt under different policy assumptions



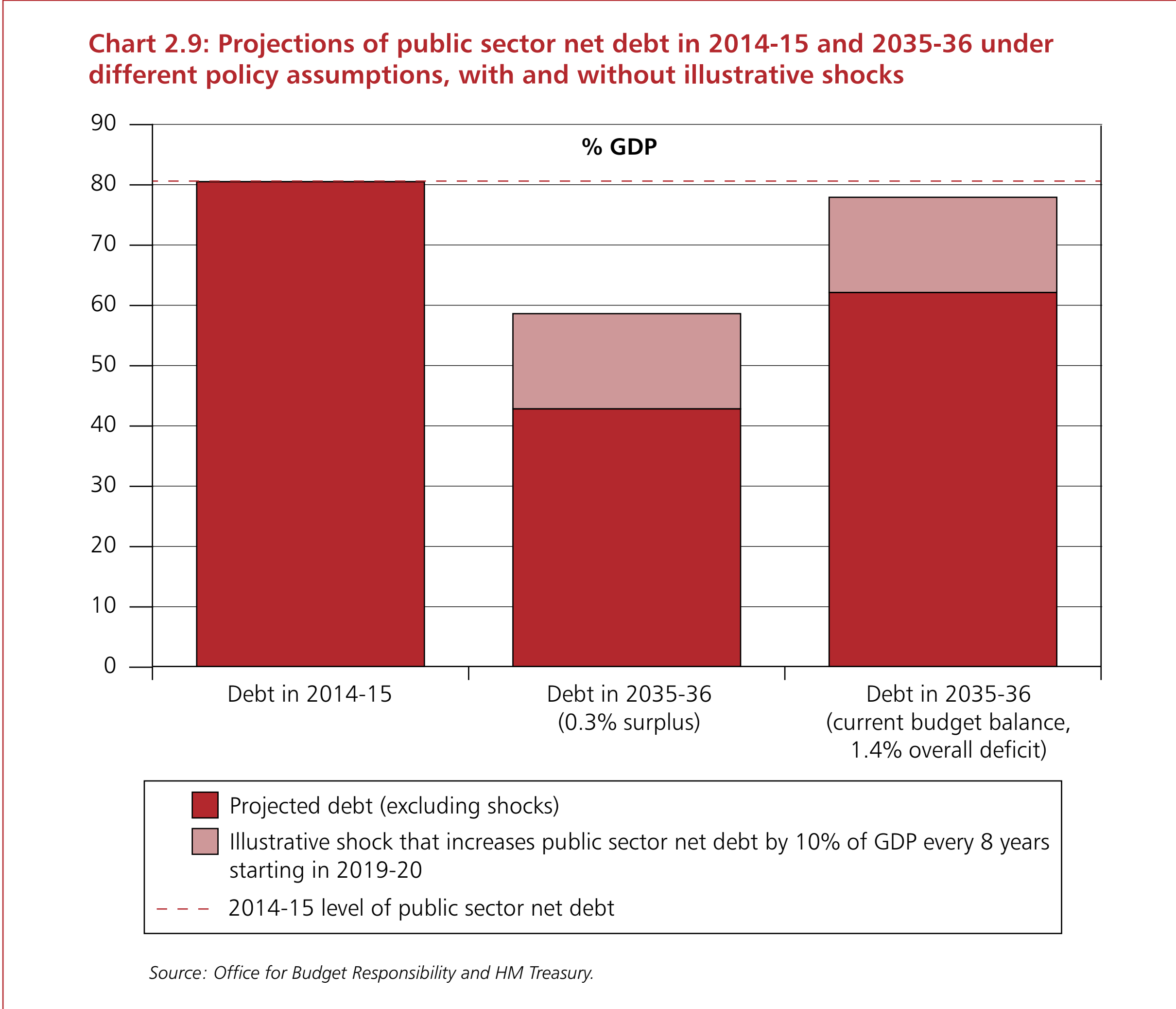
Source: Office for Budget Responsibility and HM Treasury.

2.68 As illustrated by Chart 2.8, sustained action will be needed to bring down debt even in the absence of future shocks. Prudent fiscal policy should, however, take account of future

[43] 'Public Sector Finances', ONS, January 2015.
[44] 'Three Centuries of Data on the UK Economy', Bank of England data.
[45] 'Three Centuries of Data on the UK Economy', Bank of England data.

shocks to the economy, even though the scale and timing are inherently unpredictable and any analysis of potential future shocks can only be illustrative. Chart 2.9 shows how the level of public sector net debt in 2035-36 would be affected by a simple scenario in which the economy is hit once every 8 years by a shock that increases public sector net debt by 10% of GDP (less than the peak increase following the recession in the 1990s). This should not be interpreted as a prediction, though increases in debt of this magnitude are consistent with the previous impacts of economic downturns on public borrowing.

Chart 2.9: Projections of public sector net debt in 2014-15 and 2035-36 under different policy assumptions, with and without illustrative shocks



Source: Office for Budget Responsibility and HM Treasury.

2.69 In this illustrative scenario, a permanent 1.4% deficit, equivalent to a balanced current budget with investment equal to its 2019-20 forecast level, results in debt falling by only around 3% of GDP by 2035-36 from its 2014-15 peak, still leaving debt at historically high levels. A permanent 0.3% surplus, as forecast by the OBR for 2019-20, under the same scenario results in debt falling from its peak by around 25% of GDP by 2035-36. Larger or more frequent shocks in the future would result in higher levels of public debt and vice versa.

Consolidation in the next Parliament

2.70 Budget 2015 confirms that, in line with previous policy, the government's planned consolidation in the next Parliament is reflected in the fiscal assumption that Total Managed Expenditure (TME) will fall in real terms in 2016-17 and 2017-18 at the same rate as over the period 2010-11 to 2014-15. Alongside the updated Charter for Budget Responsibility the government estimated that around £30 billion of discretionary consolidation is likely to be required over these years. From 2018-19 the government has set a neutral fiscal assumption,

holding TME flat in real terms in 2018-19 and in 2019-20 increasing TME in line with nominal GDP.

2.71 The government will continue to prioritise capital investment. At Spending Round 2013, the government set out a long-term pipeline of capital investment worth more than £100 billion over the next Parliament. Autumn Statement 2014 set out in detail how over £30 billion of this money will be invested in Britain's infrastructure and growth promoting sectors, including roads, flood and coastal defences, and science. The government will continue to hold public sector gross investment (PSGI) constant in real terms in 2016-17 and 2017-18, and it will increase in line with GDP from 2018-19.

2.72 The fiscal assumption for 2016-17, 2017-18, 2018-19 and 2019-20 is expressed in terms of TME. It would, of course, be possible to do more of this further consolidation through tax instead.

2.73 The government's fiscal assumption for the years 2016-17 to 2019-20 set out above, combined with the OBR's forecast for Annually Managed Expenditure (AME) (excluding AME policy decisions in this Budget) and the PSGI assumption give projections for implied Departmental Expenditure Limits (DEL) including depreciation. The projections for implied DEL including depreciation at this Budget are higher in each year over 2016-17 to 2019-20 compared with Autumn Statement 2014.

Delivering on future consolidation plans

2.74 Choices will need to be made on the composition of further consolidation in the next Parliament, including funding any new commitments. The Budget provides further detail on some of these choices.

2.75 To deliver the necessary reductions in spending, the government will continue to identify and deliver significant efficiency savings. At Autumn Statement 2014 the government set out an aspiration to find £10 billion in further efficiency savings by 2017-18. This included a commitment to be much more ambitious in the use of digital technology.

2.76 Budget 2015 announces that the digital ambition will extend beyond central government and arms-length bodies, to consider local services. HM Treasury, the Department for Communities and Local Government and the Government Digital Service will collaborate with partners in local government, as the sector develops a set of proposals that will enable more customer-focussed, digitally-enabled and efficient local services in time to inform future budget allocations.

2.77 In this Parliament the government has delivered significant savings from centralising the procurement of goods and services. **Budget 2015 announces that, following a successful trial, the government will implement 'GOV.UK Verify' – a new way for people to prove their identity online when using government services – across central government.** This means that departments will use the same tool for their digital services, reducing duplication. Further, to prevent individual departments paying different amounts to either build their own data centres or outsource this service, the government will create a joint venture to host departments' non-cloud based servers, which could save up to £100 million.[46]

2.78 In education, evidence shows that the best performing schools focus their spending on teachers over the 'back-office'.[47] However, spending on back-office costs varies from £202 to £1,432 per pupil, and between 2003 and 2013 back-office spending per pupil in maintained schools increased by around 60% in real terms.[48] To help schools further improve their efficiency

[46] Cabinet Office business case analysis, February 2015.
[47] 'Review of efficiency in the schools system', Department for Education, June 2013.
[48] 'Review of efficiency in the schools system', Department for Education, June 2013; HM Treasury calculations based on Local Authority and School Expenditure 2002-03 and 2012-13. The 2012-13 data is available at gov.uk.

and focus their budgets on providing excellent teachers for their students, the government is launching a number of initiatives:

- **re-launching the energy supply framework:** schools are already realising savings by purchasing goods and services through procurement frameworks provided by the Crown Commercial Service (CCS); the government expects the recent launch of the updated CCS school energy supply framework to deliver significant savings for schools in the next Parliament
- **publishing improved management information and benchmarks:** by the end of 2015, the Department for Education (DfE) will provide schools with a new indicator to compare their overall efficiency, and parents will be able to access school benchmarking tools, allowing them to compare their child's school's spending with that of other schools and see how effectively the school uses its budget to promote educational attainment
- **piloting a cost comparison tool in 2015 to help schools identify a target price for their most commonly purchased items**
- **introducing a range of initiatives to improve the effectiveness of education support staff**, through a series of projects being run by the Education Endowment Foundation

2.79 The government will have increased the health budget in real terms every year this Parliament.[49] At Autumn Statement 2014, the government announced £2 billion of additional funding for frontline NHS services in 2015-16 that will be added to the NHS's baseline funding in future years. This will help to meet growing demand, improve services and kick-start the transformation set out in the NHS's 'Five Year Forward View'. However, the 'Five Year Forward View' also made it clear that the NHS will need to find significant annual efficiency savings in order to meet demand and maintain good quality patient care.[50]

2.80 Lord Carter, as Chair of the NHS Procurement and Efficiency Board, is undertaking action to help the NHS to deliver its efficiency aspiration. Interim findings from Lord Carter's work show that action in a number of areas, including procurement, pharmacy and property, could deliver significant savings that the NHS could recycle back into frontline care. For example, local savings of up to £5 million a year have been found in one Trust alone by improving contract management and engaging with suppliers to find ways to resist cost increases.[51] Measures such as this will be key to delivering the efficiency savings set out in the 'Five Year Forward View'.

2.81 In the criminal justice system, Sir Brian Leveson's report on the efficiency of court proceedings has highlighted that there is still significant scope to reduce cost and delay.[52] For example, measures to encourage the retention of cases in the Magistrates' courts rather than sending them to the Crown Courts should improve efficiency and reduce costs in the court system. The government notes these recommendations and, as part of the ongoing programme to reform the courts, which is intended to save in excess of £100 million a year by 2019-20, will explore how these recommendations can be taken forward.

2.82 The government will also expand the use of benchmarking public service performance as a means to identify savings. It has already demonstrated the potential in this area; for example, the programme to benchmark public sector prisons is driving down unit costs and will deliver annual savings of £300 million by 2015-16.[53]

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[49] 'Public Expenditure Statistical Analyses', HM Treasury
[50] 'Five Year Forward View', NHS, October 2014.
[51] 'Better procurement better value better care: a procurement development programme for the NHS', Department for Health and NHS England, August 2013.
[52] 'Review of Efficiency in Criminal Proceedings: Final Report', Sir Brian Leveson, January 2015.
[53] 'National offender management service business plan 2014-15', National Offender Management Service, April 2014.

2.83 Police forces are already delivering efficiency savings, in a period where crime is down by more than a fifth according to the independent 'Crime survey for England and Wales'.[54] This summer, Her Majesty's Inspectorate of Constabulary will carry out an in-depth efficiency inspection of every police force in the country, to help all forces make best use of resources and highlight best practice to continue driving down crime. The government is also committed to supporting a collaborative programme to standardise what the police buy, and aggregate police procurement to drive additional savings above the £200 million already achieved this Parliament.[55]

More strategic management of government land, property and spectrum

2.84 Over the next Parliament the government will transform how it manages the significant land and property assets it owns. **Budget 2015 announces that the government will implement a new commercially-driven approach to land and property asset management across the central government estate**, based on departments paying market-level rents for the freehold assets they own. The government will create a new central body or bodies, which, working under a cross-government framework and direction provided by the Treasury and the Government Property Unit of the Cabinet Office, will own and manage relevant property and land assets, as well as leasehold assets where appropriate. This will help drive better strategic oversight and management of the estate, and provide greater incentives for departments to rationalise the space they occupy. It will also deliver efficiencies, and release land and property for productive use, including building new homes. Implementation of the reform will commence immediately, with the model becoming operational by March 2017, subject to legislation.

2.85 Given their very large property and land holdings, there is also the potential to generate significant efficiencies within the Ministry of Defence estate. However, the Ministry of Defence maintains a varied estate, including assets of strategic military importance. Therefore, the department will introduce a similar charging mechanism, to the same timescale, within its existing estate management organisation, to incentivise users of the Ministry of Defence estate to reduce their footprint and release value, including land for development. Given the specialised nature of the Foreign and Commonwealth Office's overseas estate, appropriate charging principles will also be developed with land and property managed in their existing departmental boundary.

2.86 In addition to implementing this model for land and property, **Budget 2015 announces that the government will take a more strategic approach to managing public sector spectrum**. The government will implement a central management system, which will enable it to better prioritise spectrum management, and maximise the economic value of public sector spectrum.

Integrating services to improve outcomes and reduce costs

2.87 Further savings will also be achieved by making local services work better for the people who need them. The £448 million invested in the Troubled Families programme has helped over 105,000 families to turn their lives around, the government has demonstrated its commitment to early intervention in a child's earliest years and the £5.3 billion Better Care Fund is helping people to benefit from joined up health and social care.[56] This is based on the principles that intervening early can prevent problems arising later on and locally joined up services can better meet the needs of vulnerable people. Building on the government's ambitious programme of reform, **the Budget announces that the government is exploring the cost-effectiveness**

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[54] 'Crime Survey for England and Wales – year ending September 2014', ONS, January 2015.
[55] Home Office analysis of data on Police Forces' non-IT procurement savings between 2010 and Q3 2014.
[56] 'Troubled Families programme: progress information at December 2014 and families turned around at February 2015', Department for Communities and Local Government, March 2015.

of options to integrate spending around some of the most vulnerable groups of people, including:

- taking the next steps on from the Better Care Fund to continue to join up services for people with health and social care needs, and learning from Greater Manchester's experience following their recent landmark agreement to bring together commissioning of around £6 billion of local health and social care budgets
- improving the links between health and employment support for people who are unable to work because of a health condition, learning from the roll out of Fit for Work and the mental health pilots agreed as part of the Growth Deals and at Autumn Statement 2014 – Budget 2015 takes a major step forward through a package of measures to improve employment outcomes for people with mental health conditions
- exploring whether improving housing can help people with care needs stay in their homes longer and reduce costs to the NHS
- assessing the scope to reduce the estimated £4.3 billion spent because of a failure to support troubled individuals struggling with homelessness, addiction and mental health problems including through social investment[57]
- designing a more integrated, multi-agency approach to divert from custody, where appropriate, female offenders who are convicted of petty, non-violent offences

Future welfare spending

2.88 Since 2010, the government has legislated for measures in the welfare system in order to reduce spending by £21 billion in 2015-16, through reform of benefit structures, and changes to eligibility and rates.[58] The reforms promote work and personal responsibility while protecting the most vulnerable members of society. The government is introducing Universal Credit, which will help more people off welfare and into work. However, as the OBR has noted in its 'Welfare trends report', over the next Parliament and beyond a number of factors will continue to put upward pressure on spending in some areas.[59] Outcomes could also be further improved for claimants. While 46% of disabled people of working age are in work, in each quarter only one economically-inactive disabled person in a hundred moves into work.[60] The government remains committed to helping people into work and improving outcomes.

Welfare cap

2.89 At Budget 2014, the government introduced the welfare cap to ensure that significant increases in welfare spending do not go uncorrected. The cap is a firm limit on total welfare spending, applying to all welfare spending in AME with the exception of the state pension and automatic stabilisers. The OBR's assessment at Autumn Statement 2014 was that the welfare cap was met. The OBR will next assess performance against the cap in autumn 2015, when the cap will cover from 2016-17 until the end of the rolling forecast period. At Budget 2015, the OBR's forecast for spending within scope of the cap is on average £2 billion per year lower than at Autumn Statement 2014 and in total £9.7 billion lower over the forecast period.

[57] 'Hard edges: mapping severe and multiple disadvantage in England', Lankelly Chase Foundation, January 2015.
[58] 'Policy measures database', OBR, February 2015.
[59] 'Welfare trends report', OBR, October 2014.
[60] 'Labour market status of disabled people (Equality Act core disabled)', ONS Statistical Bulletin: UK Labour Market, February 2015; 'The disability and health employment strategy: the discussion so far', Department for Work and Pensions, December 2013.

Table 2.E: Spending within the welfare cap

	£ billion				
	2015-16	2016-17	2017-18	2018-19	2019-20
Welfare cap	119.7	122.3	124.8	127.0	129.8
Forecast margin (2%)	2.4	2.4	2.5	2.5	2.6
Total spending: difference from welfare cap	0.8	-1.3	-3.0	-2.9	-3.2
of which: Budget policy decisions[1]	+0.0	-0.0	-0.0	-0.1	-0.1
Total spending: difference from Autumn Statement 2014	-0.1	-1.4	-2.2	-2.8	-3.2
Total spending within scope of the welfare cap	120.6	121.0	121.8	124.0	126.5

[1] *Welfare cap impact of policy decisions set out in Chapter 2.*

Source: Office for Budget Responsibility

Debt and reserves management

2.90 The government's financing plans for 2015-16 are set out in full in the 'Debt and reserves management report 2015-16', published alongside the Budget. It is anticipated that the net financing requirement of £140.4 billion will be met through gilt issuance of £133.4 billion and an increase of £7.0 billion in the stock of Treasury bills.

2.91 National Savings and Investments (NS&I) will have a net financing target of £10.0 billion in 2015-16, within a range of £8.0 to £12.0 billion. This target accommodates the extension of NS&I's market-leading bonds for people aged 65 and over (the '65+ bond'), as well as the increase in the Premium Bond limit from £40,000 to £50,000 from 1 June 2015, both of which are key elements of the government's plan to support savers. As a result of their popularity, the government announced that NS&I's 65+ bonds would remain on sale until 15 May 2015. This longer timeframe is expected to raise an additional £3.2 billion of financing, above the original £10 billion of inflows announced at Budget 2014.

2.92 The financing arithmetic provides for £6 billion of sterling financing for the Official Reserves in 2015-16. The government is planning on the basis of sterling financing for the Official Reserves at a similar level on average over the 4 years from 2016-17 up to, and including, 2019-20. This additional financing, announced at Autumn Statement 2014, is intended to meet potential calls on the reserves that may arise and ensure that the level of foreign currency reserves held is sufficient for the UK to remain resilient to possible future shocks.

2.93 Budget 2014 announced the government's plans to introduce a new and highly secure £1 coin. Since then, the Royal Mint has conducted a public design competition to determine the artwork to feature on the first reverse, or 'tails' side. **Budget 2015 announces the winning entry**, giving the British people a first chance to see what the new coin in their pocket will look like. The winning design, by 15 year-old David Pearce, pays tribute to the 4 nations of the United Kingdom.

2.94 HM Treasury carried out a consultation alongside this design competition, focusing on the physical and material characteristics of the new £1 coin. The government response to that consultation is published alongside the Budget, and **confirms the specification of the new coin and the key milestones ahead of an expected introduction in early 2017**.

Devolution

2.95 The government continues to deliver against its commitment for further devolution to Scotland, Wales and Northern Ireland. The Smith Commission was established on 19 September

2014, as a cross-party process to decide what new powers should be transferred to the Scottish Parliament. Following the Smith Commission report on 27 November 2014, the government published draft legislative clauses on 22 January 2015. The clauses published will make it possible to translate the Smith Commission Agreement into law quickly in the next Parliament. Work has started on Scotland's new fiscal framework and this will be agreed alongside the introduction of legislation.

2.96 The government announced new devolution arrangements for Wales on 27 February 2015. The measures include the introduction of a floor in the level of relative funding the UK government provides to the Welsh Government, in the expectation that it will call a referendum on Income Tax powers in the next Parliament. Work has already started on the funding floor and the details will be agreed in the next Parliament. Additionally, the government will consider the case and options for devolving powers to the Assembly over Air Passenger Duty (APD), informed by a review of potential options to mitigate the impacts of APD devolution on regional airports in England.

2.97 The Scottish and Welsh governments' sources of borrowing are also being extended to include bond issuance for capital investment. These powers will be within existing borrowing limits, and subject to a number of conditions, including that the Scottish and Welsh governments will be solely responsible for meeting their liabilities and that the UK government will provide no guarantee on any bonds issued.[61]

2.98 In December 2014, as part of the Stormont House Agreement, the government agreed a package of significant financial support for the Northern Ireland Executive. The agreement emphasised the need for the Executive to demonstrate that its finances are being put on a sustainable long-term footing. On that basis, legislation was introduced to Parliament on 8 January 2015 to devolve a Corporation Tax rate-setting power to the Northern Ireland Assembly. The Bill has now completed consideration by the House of Commons, and is expected to receive Royal Assent before the 2015 General Election.

2.99 The Agreement was also clear that the Corporation Tax powers would only be commenced in 2017 if the Executive demonstrates that its finances are on a sustainable footing, which will require successfully implementing a range of reform measures, including changes to the welfare system. It is critical that the parties continue to focus on meeting their commitments, so that the opportunities presented by the Stormont House Agreement are not lost.

Building a strong and stable financial system

2.100 Over this Parliament, the government has introduced a significant set of reforms that have built a much stronger and more stable financial system. The government has now completed the task of ensuring that banks separate their core high street banking services from investment banking. The government legislated to implement this ring-fence through the Banking Reform Act (2013). On 5 March 2015 the Banking Reform Pension Regulations were passed in Parliament, completing the fourth and final piece of legislation required to implement the ring-fence. The package of financial sector reforms completed in this Parliament will help make sure that taxpayers will never again need to bail out the banks.

2.101 Safeguarding financial stability requires constant vigilance. The Financial Policy Committee (FPC), created by this government, plays a central role in monitoring the financial system. The government has granted the FPC the powers it needs to make sure that the banks do not recreate the conditions that led to the last crisis. Alongside the Budget, **the Chancellor of the Exchequer has provided the FPC with its remit and recommendations for the**

[61] Further detail on the conditions for the Scottish and Welsh governments' bond issuance powers can be found in the 'Debt and reserves management report' published alongside the Budget.

year ahead, as required by the Bank of England Act 1998 (and amended by the Financial Services Act 2012). On 12 February 2015, the government laid legislation that will grant the FPC powers of direction on housing market tools and a leverage ratio framework to further safeguard the stability of Britain's financial system.

Financial sanctions

2.102 The government will review the structures within HM Treasury for the implementation of financial sanctions and its work with the law enforcement community to ensure these sanctions are fully enforced, with significant penalties for those who circumvent them. This review will take into account lessons from structures in other countries, including the US Treasury Office of Foreign Assets Control. It will consider how to maintain and improve the service that HM Treasury provides to the private sector, maintain the integrity of, and confidence in, the UK financial services sector, and strengthen the government's ability to implement and help enforce this vital tool in the UK's national security interests.

Growth

2.103 The UK economy had the fastest annual growth among G7 economies in 2014 – its strongest performance since 2007.[62] At the end of 2014 there were more people in work than ever before, unemployment was falling, and average weekly earnings were increasing in real terms.[63] In order to sustain the UK's growth and international competitiveness, further work is needed to support businesses and boost productivity. This Budget sets out a comprehensive package of measures that builds on existing reforms to create a dynamic, regionally balanced economy and to support future productivity growth, including:

- setting out a significant package of support through the tax system to back British business, including freezing fuel duty for another year and substantially reducing oil and gas taxes to improve competitiveness in the North Sea
- supporting long-term investment in the UK's digital communications infrastructure, including by setting out a new ambition that ultrafast broadband of at least 100 Megabits per second should be available to nearly all UK premises
- securing a truly national recovery by investing in infrastructure, housing, science and innovation across the whole of the UK, and building a Northern Powerhouse
- supporting manufacturers by bringing forward compensation for small-scale feed in tariffs for energy intensive industries to 2015-16, and supporting the retail and hospitality sectors by cutting alcohol duty on beer, cider and spirits
- developing a more highly-skilled UK labour market by strengthening support for postgraduate research and apprenticeships, and setting out plans for further investment in the UK's world-leading science and innovation base
- creating a dynamic economy that is the best place in the world to start, invest in, and grow a business, including through a package of measures to help unlock the potential of the sharing economy, improve access to finance and boost exports
- backing business by launching a comprehensive review of business rates, piloting schemes that reward additional business rates growth, and radically simplifying tax administration by abolishing the annual tax return

2.104 The government will continue to take the difficult decisions needed to implement its long-term economic plan of rebalancing the economy, supporting jobs and growth, and building a stronger economy and fairer society. Figure 1 sets out some of the key supply-side reforms that the government has implemented and the impact they have had so far.

[62] Quarterly National Accounts, OECD, March 2015. Further detail can be found in 'Budget 2015 Data Sources'
[63] Labour Market Statistics, ONS, February 2015, and Consumer Price Inflation, ONS, December 2014. Further detail can be found in 'Budget 2015 Data Sources'

Figure 1: Implementation of the government's growth commitments

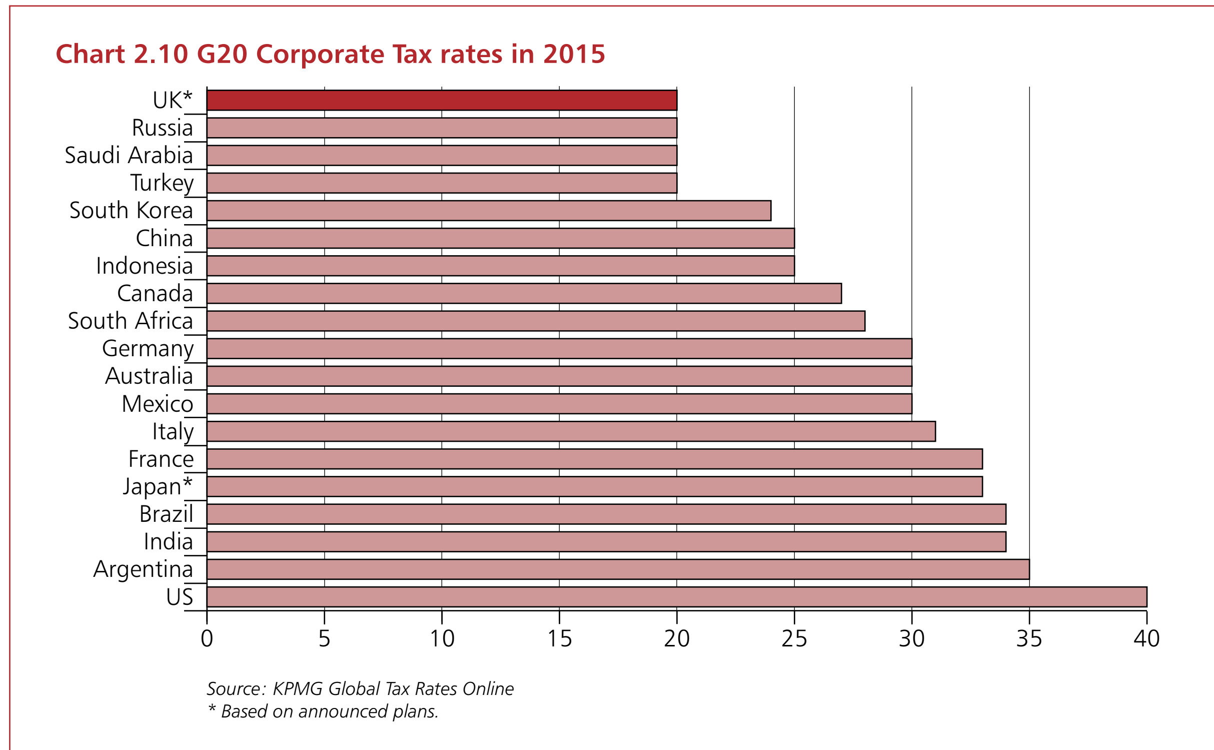
Tax and reliefs	Exports, inward investment and access to finance
• The main rate of **corporation tax** has been cut from 28% to 21%, and to 20% in April 2015, the joint lowest in the G20 • The **personal allowance** will increase to £10,600 from April 2015, this is worth £825 to a typical taxpayer and will take over 3m individuals out of income tax • Over 1m employers have now benefited from the **NICs Employment Allowance**. Around 500,000 employers will have been taken out of Employer NICs altogether in 2014-15 thanks to the Allowance • The abolition of **Employer NICs for under 21 year olds** from April 2015 will benefit employers of almost 1.5m young people, by £332 per employee on average • **Business rates** support of £2.7bn for 5 years from April 2014 will benefit 1.8m properties in England • Action on **fuel duty** since 2011 will save a typical motorist £675 by the end of 2015-16	• **UKTI** has more than doubled the number of businesses it helps from 24,550 in 2010-11 to over 50,000 in the year to June 2014 • **British Business Bank** programmes are supporting £3bn of finance for businesses, including over £140m for more than 27,000 **Start Up Loans** • UKTI has helped secure 5,100 **inward investment projects**, creating or safeguarding 333,000 jobs since 2010 • **UK Export Finance** is delivering its services to record numbers of British businesses and has provided over £16bn of support for exports since 2009-10 • **Enterprise Zones** have created over 12,500 jobs and attracted £2bn in private investment • The annual net burden of **regulation on business** has fallen by £2.2bn since January 2011 • The **Red Tape Challenge** has identified over 3,200 regulations to be scrapped or improved, bringing over £1bn in annual savings to business
Housing, planning and local growth	**Infrastructure**
• Almost 83,000 households have bought a home through the **Help to Buy scheme** • Levels of **planning approvals** and **housing starts** are at 7-year highs • More than 537,000 **new homes** have been built over this Parliament • £2.9bn has been committed to more than 470 **Regional Growth Fund** projects • Over 400 local projects agreed through **Growth Deals** are due to begin in 2015-16, including work on more than 150 roads, 150 housing developments and 20 stations • **Northstowe** public sector-led development to deliver up to 10,000 homes	• From 2010-11 to 2013-14 average **annual public and private infrastructure investment** was around £47bn. Over 2,650 **infrastructure projects** have been completed since 2010 • Over 2m more premises can access **superfast broadband** thanks to £1.7bn government investment • To improve the **Strategic Road Network,** 15 major schemes worth £3.4bn have been completed with a further 16 schemes worth £2.3bn underway • Over the Parliament, Network Rail has completed improvements to over **400 stations**
Education and skills	**Science and innovation**
• Government has established 4,580 **academies**, including 322 **free schools, studio schools** and **UTCs** • In 2015-16 over £2.5bn will be delivered to schools via the **Pupil Premium** • Around 260,000 two-year-olds are entitled to a funded **early education place** • Over 2.1m people have started **apprenticeships** this Parliament, with a six-fold increase in **higher apprenticeships** started since 2009-10 • The government will remove the arbitrary **cap on university student numbers** for 2015-16. Since the controls were lifted in 2014-15, an extra 10,000 students have taken up places	• Government has provided £4.6bn of **research funding** per year since 2010 • At SR13 the government provided a long term commitment to **science capital infrastructure** – £1.1bn a year rising with inflation from 2016-2021 • Over £1.4bn of public and private investment in 27 research infrastructure projects through the **Research Partnership Investment Fund** • 7 **Innovation Catapults** launched to support sectors such as High Value Manufacturing • Government has introduced a new 'above the line' **R&D expenditure credit** and increased the rate of **SME R&D tax credits**, benefiting over 15,000 innovative businesses

Source: HMT, KPMG, HMRC, DCMS, DCLG, BIS, Start Up Loans, UKTI, UKEF, British Business Bank, DfE, DfT, Regional growth funds, HEFCE

Supporting business through the tax system

2.105 The government aims to have a tax system that supports businesses, is simple to understand, and encourages growth. The main rate of corporation tax has been reduced from 28% in 2010 to 21% today, and it will be cut to 20% in April 2015 – the joint lowest in the G20. Chart 2.10 sets out the expected main rate of corporation tax in G20 economies from April 2015, while Table 2.F shows the benefits to 4 illustrative businesses as a result of selected tax cuts introduced by the government.

Chart 2.10 G20 Corporate Tax rates in 2015



Source: KPMG Global Tax Rates Online
** Based on announced plans.*

Table 2.F: Cumulative cash savings to selected illustrative small businesses between 2010-11 and 2015-16

	Employer National Insurance contributions (NICs)	Business rates	Fuel duty	Total savings
Small retailer	£4,443	£6,763	£675	**£11,881**
Computer repair shop	£8,234	£6,763	£338	**£15,335**
Food manufacturer	£32,790	£540	£4,150	**£37,480**
Hi-tech manufacturer	£15,008	£480	£1,400	**£16,888**

Source: HMT calculations based on illustrative businesses.
Notes: The modelled businesses have 3, 8, 44 and 13 staff respectively (including some apprentices), pay business rates on premises with rateable values ranging from £10,000 to £45,000, and run vehicles ranging from part-time use of a car to a combination of cars and vans.

Fuel Duty

2.106 Budget 2015 builds on the support provided by the government to motorists over this Parliament. **The Fuel Duty increase by RPI planned for 1 September 2015, due to be 0.54 pence per litre, will be cancelled.** In total, the government will have eased the burden on motorists by £22.4 billion by the end of 2015-16. This equates to a saving of £675 for a typical motorist, £1,400 for a small business with a van, and £21,000 for a haulier.[64] Due to government action on fuel duty since 2011, by the end of 2015-16 the typical motorist will save £9 each time they fill their tank.[65] By the end of 2015-16, fuel duty will have been frozen for 5 years, the longest freeze for more than 2 decades.

[64] HMRC/HMT calculations based on OBR 2015 RPI forecasts and compared to pre-2010 fuel duty plans
[65] HMRC/HMT calculations based on OBR 2015 RPI forecasts and compared to pre-2010 fuel duty plans

The long-term impact of the government's tax reforms

The government has focussed its policy interventions on areas that can most effectively increase growth, and support businesses to invest, export and create jobs. In order to better analyse the effectiveness of policy to achieve these goals, HM Revenue and Customs (HMRC) has developed a Computable General Equilibrium (CGE) model. This analyses the dynamic effects of policies, going beyond the immediate cost and impact to look at the behavioural impact on the wider economy.[66]

This model has shown that the effects of cuts to Corporation Tax and Fuel Duty have a large, dynamic impact on decisions made by firms and individuals. Lower Corporation Tax will increase investment and the demand for labour, which in turn raises wages and increases consumption. Fuel Duty reductions enable businesses to retain more profit, and increase wages and consumption.

Taken together, the modelling suggests that the cuts in Corporation Tax and Fuel Duty will increase GDP by between 0.9% and 1.3%, and investment by up to 6.5% in the long term. The modelling also shows that increased profits, wages and consumption all add to higher tax revenues. This reduces the costs of the cuts to Corporation Tax and Fuel Duty by up to 60% and 56% respectively.

Making tax easier

2.107 Over the course of this Parliament, the government has taken significant action to make tax easier, quicker and simpler. This includes investing £200 million in HMRC's digital services, reducing the burden on business by £250 million a year, and introducing cash accounting as recommended by the Office of Tax Simplification (OTS), which has been taken up by more than one million small businesses.[67]

2.108 Building on these foundations, **Budget 2015 announces that the government will transform the tax system over the next Parliament by introducing digital tax accounts, removing the need for annual tax returns.** By the end of the next Parliament over 50 million individuals and small businesses will be able to see and manage their tax affairs online.

2.109 'Making Tax Easier' sets out what this will mean for taxpayers.[68] As a first step, the government will:

- publish a roadmap later this year setting out the policy and administrative changes needed to implement this reform
- introduce digital tax accounts for all 5 million small businesses and the first 10 million individuals by early 2016
- abolish Class 2 NICs in the next Parliament and consult on reforming Class 4 NICs to include a contributory benefit test.

Business rates

2.110 The government wants to ensure that the tax system provides stable and sustainable revenues to fund public services in the least distortive way. **The government is therefore conducting a broad review of business rates** to ensure that they are fit for purpose for

[66] 'Analysis of the dynamic effects of Corporation Tax reductions', HM Treasury and HM Revenue and Customs, 5 December 2013, and 'Analysis of the dynamic effects of Fuel Duty Reductions', HM Treasury and HM Revenue and Customs, 14 April 2014, both show the results of applying the Computable General Equilibrium model to government policies
[67] 'Spending Round 2013', HM Treasury, June 2013, and other HMRC Internal Analysis
[68] 'Making Tax Easier', HMRC, March 2015

a 21st century economy. The terms of reference for this review were published on 16 March 2015.[69]

2.111 As part of the government's work to strengthen the financial incentives to encourage business growth, **Budget 2015 announces pilot schemes in Cambridgeshire and Peterborough and, subject to the formal approval of Greater Manchester Combined Authority, in Greater Manchester and Cheshire East, which will enable these areas to retain 100% of any additional business rate growth beyond expected forecasts.** These pilots will begin in April 2015 and will reward additional growth to the local business rate base whilst maintaining the nationwide business rate retention and redistribution system.

Support for the creative sector and the media

2.112 The creative industries deliver both cultural and economic benefits to the UK. The government has introduced new tax reliefs for high-end television, video games, animation and theatre, and has expanded the film tax relief. These reliefs have been highly successful in encouraging investment. To further encourage growth in the sector the government will:

- **increase the rate of film tax relief to 25% for all qualifying expenditure, and extend the high-end television tax relief** by reducing the minimum UK expenditure requirement from 25% to 10% and modernising the cultural test
- **introduce a new children's television tax relief from April 2015,** which will include children's programmes that are game shows or competitions
- **introduce a new orchestra tax relief from April 2016 at a rate of 25%**

2.113 To invest in skills and business development in the creative industries, the government will also:

- **extend the Skills Investment Fund,** providing £4 million to ensure that it can continue to match fund support for training and development in film, television, visual effects, video games and animation for a further two years
- **promote a vibrant business environment for new and growing video games companies across the UK by committing £4 million to a new Video Games Prototype Fund over the next 4 years;** this fund is designed to aid access to finance and business support, and to target games development talent

2.114 Local newspapers are an important source of information for local communities and a vital part of a healthy democracy. To support them as they adapt to new technology and changing circumstances, **the government will consult on whether to introduce a business rates relief for local newspapers in England.**

Alcohol Duty

2.115 The government is committed to helping pubs. Building on the steps the government has already taken, **Budget 2015 announces that, for the third year in a row, the tax on a typical pint of beer will be cut by one penny from 23 March 2015.** This means that an average pint of beer is 9 pence cheaper than under the previous government's duty plans.

2.116 To further support the great British success story, the Scotch whisky industry, **the duty on spirits will be cut by 2%.** Recognising the important contribution of cider makers to the rural economy, **the duty on lower strength cider will be cut by 2%.** To support the UK's growing wine industry, **the duty on wine will be frozen.** Beer and wine duties will continue to be broadly similar.

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[69] 'Business Rates Review: Terms of Reference and Discussion Paper', HM Treasury, March 2015

Energy intensive industries

2.117 Budget 2014 announced a package of reforms to radically reduce the energy costs faced by the most energy intensive manufacturers – around 80% of which are based in the North of England, Scotland and Wales – to ensure that they are as competitive as possible. This included compensation for the indirect costs of small-scale feed in tariffs (FITs) and the renewables obligation from 2016-17. **Budget 2015 announces that the government will bring forward the FITs component of the compensation to the earliest point at which State Aid approval is received in 2015-16.** This is expected to save energy intensive industries a further £25 million in 2015-16.

Agriculture

2.118 The government believes that it is important to have a productive and resilient agricultural sector. Uncontrollable factors such as the weather lead to volatile profits for farmers, making it difficult to plan for the future. **The government will provide further support to farmers by increasing the period over which they can average their profits for income tax from 2 to 5 years from April 2016.**

R&D

2.119 The government wants to ensure that R&D tax credits remain effective in helping small businesses grow. Following consultation, **the government will implement a package of measures to improve the accessibility of R&D tax credits for smaller businesses,** including producing new guidance aimed at smaller firms and setting out a roadmap for further improvements over the next 2 years.

Company car tax

2.120 Recent changes to the company car tax regime have supported the move to fuel efficient cars while ensuring that the benefit-in-kind is taxed fairly. **The Budget announces that in 2019-20 rates for Ultra Low Emission Vehicles will increase more slowly than previously announced, and that rates for other cars will increase by three percentage points.**

Delivering long-term infrastructure

Digital communications infrastructure

2.121 Better, faster fixed and mobile broadband drives economic growth, innovation and excellence, enhances national competitiveness, and underpins the government's long-term economic plan. The government has already provided access to superfast broadband to over 2 million homes and businesses across the UK, with 40,000 extra premises being connected each week.[70] The broadband connection voucher scheme has directly supported broadband upgrades for more than 12,600 small and medium-sized businesses in 22 cities so far.[71]

2.122 To further enhance the UK's digital communications infrastructure, **the government is announcing a new ambition that ultrafast broadband of at least 100 Megabits per second (Mbps) should be available to nearly all UK premises.**

2.123 The government will also take further action to support the delivery of broadband in rural areas, including looking to raise the Universal Service Obligation – the legal entitlement to a basic service – from dial-up speeds to 5 Mbps broadband, and subsidising the costs of installing superfast capable satellite services.

[70] 'Superfast broadband reaches 2 million more homes & businesses', Press release, DCMS, February 2015
[71] DCMS management information

2.124 The broadband connection voucher scheme, extended at Autumn Statement 2014 to March 2016, will be available in a total of 50 cities by 1 April 2015.

2.125 The government will provide up to £600 million to support the delivery of the change of use of 700MHz spectrum, which will further enhance the UK's mobile broadband connectivity. These funds will support the infrastructure costs of clearing the spectrum frequency, including support to consumers where appropriate, and retuning broadcast transmitters to enable broadcasters to move into a lower frequency. This will free up 700MHz spectrum for 4G mobile communications use through an auction next Parliament. **The government will also centralise the operational management of public sector spectrum, and will reset the release target.**

2.126 To affirm its commitment to the long-term digital future of the UK, the government is publishing its 'Digital Communications Infrastructure Strategy', proposing how best to support market delivery.[72]

Energy

2.127 A competitive, diverse, clean and secure energy sector is a vital component of sustainable economic growth. Budget 2015 outlines a package of measures to strengthen the UK's energy supply in both the short and longer term.

2.128 The UK Continental Shelf represents a huge opportunity for the UK: the oil and gas industry is the UK's largest industrial investor, supporting hundreds of thousands of jobs and supplying a large portion of the UK's primary energy needs.[73]

2.129 At Autumn Statement 2014, the government set out a plan for reform of the oil and gas fiscal regime.[74] This plan established a new set of principles to underpin taxation decisions, including recognising that the tax burden will need to fall as the basin matures and committing to consider the competitiveness of commercial opportunities – and the wider economic benefits of oil and gas production – when making decisions about fiscal policy. Delivering on this long-term plan, **the government will introduce a package of reforms to ensure that the North Sea continues to attract investment and to safeguard the future of this vital national asset.** Specifically, the government will:

- **introduce a new Investment Allowance to stimulate investment at all stages of the industry life cycle,** simplify the existing system of offshore field allowances, and provide investors with greater certainty which they can factor into their long-term investment decisions
- **reduce the Supplementary Charge from 30% to 20%,** building on the 2% cut announced at Autumn Statement, to send a strong signal that the UK is open for business and ensure the UK Continental Shelf remains competitive as the basin matures
- **reduce Petroleum Revenue Tax from 50% to 35%** to promote investment in incremental projects in older fields and extend the life of key infrastructure
- **provide £20 million of funding for a programme of seismic surveys** to boost offshore exploration in under-explored areas of the UK Continental Shelf
- **ensure that the Oil and Gas Authority has the powers it needs to scrutinise companies' plans for decommissioning programmes** to ensure they are cost effective

2.130 Together these measures are expected to lead to over £4 billion of additional investment and at least 120 million barrels of oil equivalent of additional production in the next 5 years,

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[72] 'Digital Communications Infrastructure Strategy', HM Treasury and DCMS, March 2015
[73] 'Digest of United Kingdom Energy Statistics 2014', Department of Energy and Climate Change, July 2014
[74] 'Driving investment: a plan to reform the oil and gas fiscal regime', HM Treasury, December 2014

boosting oil production in 2019 by 15%, equivalent to around 0.1% of GDP.[75] This will provide certainty for investors and create the right conditions for the basin to flourish and deliver maximum economic benefits for the UK.

2.131 The government will also bring forward proposals for legislation in the next Parliament for competitive tendering of onshore electricity transmission infrastructure. This could significantly reduce the cost of building this infrastructure. Competition in the offshore regime has worked well, having already saved consumers between £200 million and £400 million and helping to lower electricity bills.[76]

2.132 The government's first competitive auction for renewable electricity in February 2015 saw over 2GW of new capacity being supported across the UK: over 1GW of offshore wind and 748MW of onshore wind – enough to power more than 1.4 million homes. By introducing competition, the government has saved over £100 million per year, driving down costs for consumers.[77]

2.133 The government believes that there is significant potential for the deployment of tidal lagoons and tidal range technologies. Lagoon technology could theoretically contribute up to 25TWh/year, the equivalent of 8% of the UK's electricity consumption in 2013 of indigenous, predictable and low carbon electricity. Therefore, **the government has decided to enter in to the first phase of negotiations on a Contract for Difference for Swansea Bay Tidal Lagoon (without prejudice to the planning decision on the project)** to determine whether the project is affordable and value for money for consumers, and whether it will drive down costs for tidal lagoon energy in the UK.

Housing, planning and local growth

2.134 A streamlined, accessible planning system and a housing supply that is readily able to meet demand are essential components of a flexible, resilient and prosperous economy. Annual housing starts and planning approvals are at 7-year highs and over 537,000 new homes have been built during this Parliament.[78] In total, the government has committed investment of £24 billion up to 2020 into affordable housing, access to finance, and helping households into home ownership.[79]

2.135 The government is already delivering the most ambitious programme of affordable house building for a generation. It has delivered 217,000 affordable homes since April 2010, including over 63,000 for Affordable Home Ownership.[80] A further 275,000 homes will be provided in the five years from April 2015 to March 2020 – building more new affordable homes than during any equivalent period in the last 20 years.

2.136 The government has introduced a number of measures to support home ownership. Since Help to Buy was launched at Budget 2013, the equity loan scheme has boosted housing supply with almost 43,000 new-build completions, supporting first-time buyers across the

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[75] 'Economic and Fiscal Outlook', Office for Budget Responsibility, March 2015
[76] 'Conclusions of Consultation on the Evaluation of OFTO Tender Round 1 Benefits', Ofgem, September 2014
[77] 'World-leading auctions to provide major green electricity boost', Press Release, Department of Energy and Climate Change, February 2015
[78] 'Table 222: Permanent Dwellings started and completed, by tenure, England', Department for Communities and Local Government, February 2015, and 'New Housing Pipeline: Q3 2014 Report', Home Builders Federation, December 2014
[79] HM Treasury Internal Calculations
[80] 'Table 1000: additional affordable homes provided by type of scheme, England' and 'Table 1012: affordable housing starts and completions funded by the HCA and the GLA', Department for Communities and Local Government, February 2015. 'Help to Buy (equity loan) scheme monthly statistics', Department for Communities and Local Government, March 2015

country to get onto the property ladder.[81] In the year to the third quarter of 2014-15, the number of Right to Buy sales increased by 15%.[82]

2.137 Budget 2015 sets out further progress on the government's commitments to ambitious housing and regeneration projects. **The government is designating the first 20 Housing Zones outside London, and continuing to work with the other 8 shortlisted areas** – at least doubling the ambition announced by the Chancellor in his Mansion House speech to create 10 housing zones outside London.[83] Backed by government technical support and planning funding, brokerage and investment, these Zones could support up to 45,000 new homes.

2.138 The government is committing to enable the public sector to lead development on the next phases of Northstowe. Under the delivery model set out at Autumn Statement 2014, the government expects that three-quarters of the homes started on the public sector-owned site by 2020 will be built under direct contract with the public sector, with the rest in that period delivered through serviced plots in line with the public sector's overall master plan for the development. This model will help the development to build out at twice the rate of a conventional private sector route. The government has appointed the University of York to lead a study into the feasibility and economic impacts of direct commissioning of housing on a significantly wider scale, and to evaluate the development at Northstowe.

2.139 Budget 2015 also announces £97 million of funding and ring fencing of the local 50% share of business rate growth to support the London Borough of Barnet and the Greater London Authority's (GLA) plans for the regeneration of Brent Cross. This will unlock 7,500 new homes and create 4.9 million square feet of new commercial development with space for up to 27,000 jobs.

2.140 Following legislative authority from the Deregulation Bill later in March 2015, the government expects that the Urban Development Corporation (UDC) established to deliver a new garden city at Ebbsfleet will be operational from April 2015. **The Department for Communities and Local Government is announcing the Board members for the UDC for the garden city at Ebbsfleet,** who will lead the Corporation alongside the Chairman Designate, Michael Cassidy.

2.141 The government will consult shortly on a specification to deliver the master plan for the development at Ebbsfleet, which will provide the Development Corporation with a vision for the next stage of development. The Homes and Communities Agency (HCA) will shortly bring forward the Northfleet Embankment site for marketing, to deliver high-quality homes and employment opportunities. To further support development of the garden city, **the Chancellor has asked the UDC to work with the government to produce a prioritised, realistic and costed plan for infrastructure needs at Ebbsfleet.**

2.142 Budget 2015 launches a consultation into the compulsory purchase regime to make it clearer, faster and fairer for all parties. This will support the government's commitment to improving the consenting and planning processes for applicants and claimants, to support brownfield development.

2.143 Following the successful roll-out of City Deals across England, in 2014 the government signed an ambitious City Deal for Glasgow and the Clyde Valley, alongside the Scottish Government and the Glasgow and Clyde Valley local authorities. The government believes that there is merit in extending the City Deal model further in Scotland and Wales. Therefore, **Budget 2015 announces that the government is opening negotiations with local**

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[81] 'Help to Buy Equity Loan Scheme', Department for Communities and Local Government, March 2015
[82] 'Right to Buy sales: October to December 2014, England', Department for Communities and Local Government, February 2015
[83] 'Mansion House 2014: Speech by the Chancellor of the Exchequer', HM Treasury, June 2014, available on gov.uk

partners and the Scottish and Welsh Governments for City Deals for Cardiff, Aberdeen and Inverness. In Inverness, the government is making funding available in 2015-16 to help progress the deal.

Building a truly national recovery

2.144 The government is committed to building a truly national recovery, closing the long-term gaps between the north and south, London and the rest of the country, and strengthening the UK economy as a whole.

2.145 Outside London and the South East, the rest of England has grown more slowly than the national average since 1997.[84] The Chancellor has set out long-term economic plans for each region, with an ambition to raise the long-term growth rate of slower growing parts of England to at least the rate currently forecast for the UK as a whole. This could add an extra £90 billion to the UK economy by 2030.[85]

2.146 In contrast to strategies based on redistributing public sector activity, the long-term economic plans promote private sector growth, backing business and helping areas attract new investment by investing in better infrastructure, innovation and quality of life. They are tailored to the particular strengths of each part of the country: from tourism and farming to manufacturing and financial services – to build a stronger economy and fairer society.

2.147 Budget 2015 announces further steps to create a truly national recovery.

Northern Powerhouse

2.148 To build the Northern Powerhouse, the government is already:

- committing £13 billion of investment to transport in the north of England: connecting cities, electrifying the main rail routes, building the northern rail hub, and providing new trains through the new northern rail franchise[86]
- supporting a further £2.7 billion of investment for new trains on the east coast, and investing in major road upgrades including the A1, M62, M1, A556 and Mersey Gateway Bridge, in addition to the £50 billion commitment to develop High Speed 2 (HS2)[87]
- building on the north's existing strengths in science and technology with major new projects including the Sir Henry Royce Institute, Cognitive Computing Centre at Daresbury, Newcastle Institute for Ageing and National Graphene Institute, as well as ensuring that future revenue benefits of shale gas exploitation are reinvested through a long-term investment fund
- investing in the vibrant cultural life of the north, including £78 million for the Factory Manchester
- devolving power to Greater Manchester, including through the creation of a new directly elected metro Mayor, to give the north a powerful new voice
- devolving power to Sheffield, including over transport, skills and business support

2.149 Budget 2015 sets out further action to build a Northern Powerhouse.

2.150 Transport: In October 2014, the Chancellor announced the creation of Transport for the North (TfN), which will draw up a comprehensive Northern Transport Strategy. **TfN will shortly publish an interim report, committing to build on the concept of HS3 to develop a**

[84] Regional Gross Value Added (Income Approach), ONS, December 2014
[85] Long Term Economic Plan press releases, HM Treasury, January-February 2015
[86] 'Road Investment Strategy', Department for Transport , December 2014, 'National Infrastructure Pipeline', HM Treasury, December 2014, 'Local transport capital block funding', Department for Transport, March 2014 and Local Growth Fund figures provided by Local Enterprise Partnerships
[87] 'Investing in Britain's Future', HM Treasury, June 2013

network of high quality rail connections across the north – the TransNorth vision; bring the benefits of HS2 to the north sooner than planned; and work towards a single smart and integrated ticketing system across the region. **The government will now proceed with electrification of the Selby to Hull line,** subject to an acceptable contribution from Hull Trains and a business case, to complete the full electrification of the historic trade route between Liverpool and Hull.

2.151 Science and innovation: In January 2015, the Chancellor convened discussions with clinicians and biomedical scientists to discuss how to build on the north's strengths in health science. **The government is now committing £20 million to Health North,** to enable better care for patients, and to promote innovation through analysis of data on the effectiveness of different drugs, treatments and health pathways.

2.152 The government is also committing £14 million over two years to invest in an Advanced Wellbeing Research Centre (AWRC) in Sheffield, which will be a world-leading research centre to design, develop and implement physical activity interventions and products to improve wellbeing. The AWRC will form part of Sheffield's Olympic Legacy Park and is due to open in 2016.

2.153 Tech: In February 2015, the Chancellor convened tech entrepreneurs to launch the Tech Nation report, which revealed that over 170,000 people are now working in digital business in the North, many in rapidly expanding tech clusters.[88] To accelerate this growth, **the government will support the development of innovative businesses across the north through an £11 million investment in tech incubators in Manchester, Leeds and Sheffield.** These tech incubators will create thriving local ecosystems by nurturing start ups, fostering collaboration, and providing mentoring, learning and business support:

- **Sheffield 'Maker Hub' – £3.5 million government investment** to renovate a former Co-Op department store in the Castlegate area
- **Leeds 'Future Labs' – £3.7 million government investment** to renovate a derelict police headquarters in the heart of Leeds, creating a 6 floor incubator
- **Manchester 'Forward Plan' – £4 million government investment** towards an 8 floor incubator in Federation House, located in Manchester's Northern Quarter

2.154 The government will also provide funding to develop a financial technology incubator in Leeds.

2.155 Chemical innovation: The government will provide **£1 million to the Centre for Process Innovation** to support innovation and knowledge transfer in the North East's chemicals sector.

2.156 Supporting enterprise: The government will extend Enterprise Zones in Manchester and Mersey Waters, focusing respectively on logistics and healthcare, and on advanced manufacturing. **The Humber Enterprise Zone will be extended,** enabling it to capitalise on investment by Siemens, with their wind turbine supply chain facilities to be based on site. **The designation of the Leeds Enterprise Zone will be changed** to support energy and waste technology businesses. The government will also **extend the Enterprise Zone at Tees Valley, for oil and gas decommissioning.** After business case completion the government will also **create a new Enterprise Zone at Blackpool.**

2.157 Quality of life and tourism: Following previous significant cultural investments, including a £78 million investment in the Factory Manchester, **the government will now support the refurbishment of the Muni theatre in Pendle.** Building on previous measures

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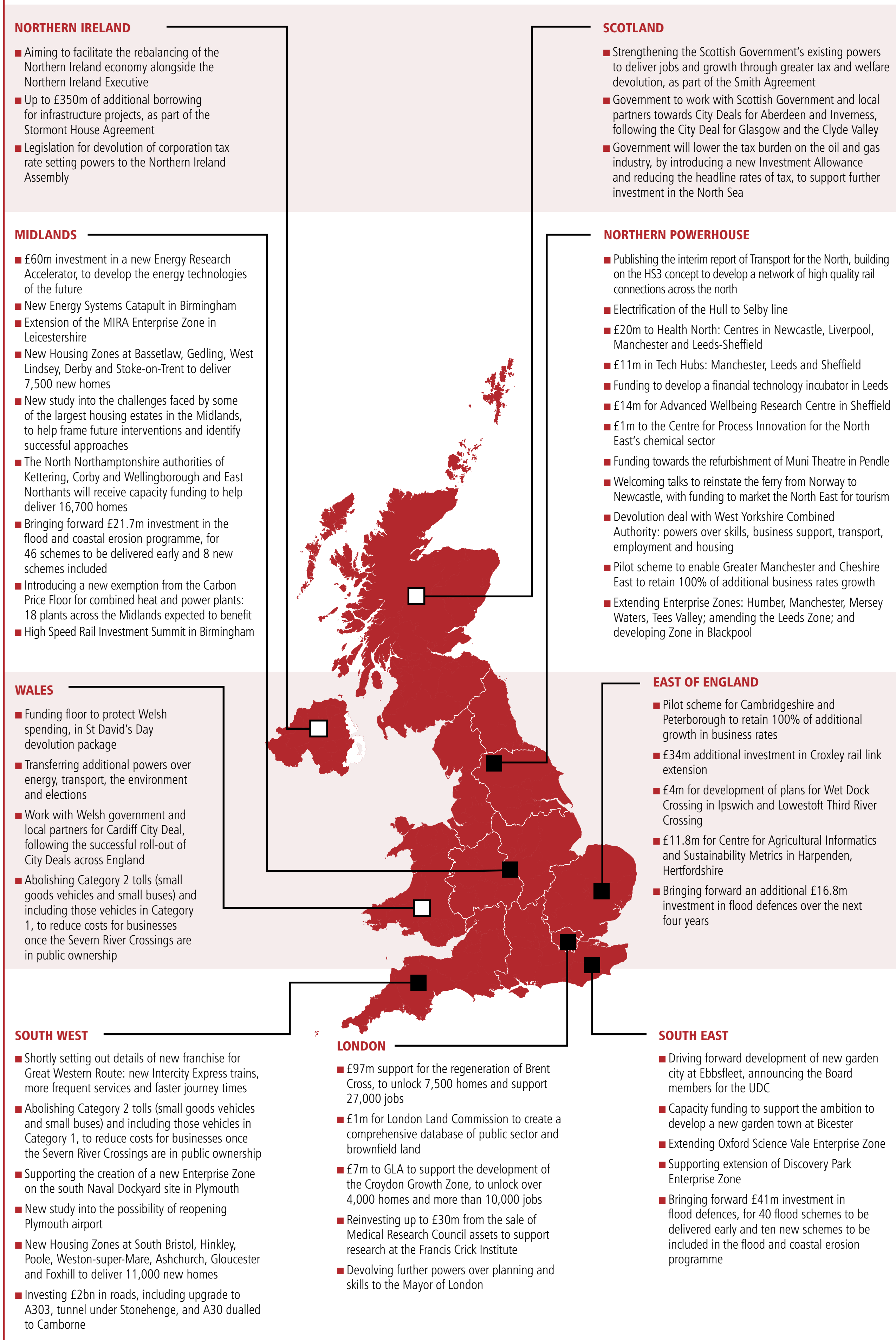
[88] Tech Nation: Powering the digital economy, Tech City, February 2015

Figure 2: Investment across the United Kingdom



to support tourism in the North East, **the government welcomes talks to reinstate the ferry from Norway to Newcastle and will provide funding to market the North East to help bring more visitors from Scandinavia.**

2.158 Devolution: A new devolution deal with the West Yorkshire Combined Authority will give West Yorkshire new powers over skills, business support and transport.

2.159 To build on Greater Manchester's ambitious devolution deal, **the government will, subject to the formal approval of Greater Manchester Combined Authority, pilot a scheme in Greater Manchester and Cheshire East to enable the retention of 100% of any additional business rate growth, starting in April 2015.** This will mean local areas will see the full benefits of policy decisions that increase the local growth rate and business rate revenues, sharpening incentives to boost jobs and growth.

Midlands

2.160 Transport: The government has already committed £5.2 billion to transport infrastructure across the Midlands. On top of this, the government is delivering HS2. To maximise the benefits for the Midlands, **the government will fund a High Speed Rail Investment Summit in Birmingham,** to attract overseas investment into regeneration projects in the region.

2.161 Science: The government will invest an initial £60 million in a proposal by six universities across the Midlands for a new Energy Research Accelerator, a major project to develop the energy technologies of the future. **As part of the government's creation of science catapult centres across the country, it is supporting a new Energy Systems Catapult in Birmingham,** which will bring together researchers and industry in order to develop new technologies and products.

East of England

2.162 Transport: The government has already committed £4.2 billion to transport infrastructure in the East of England. **Budget 2015 sets out plans to go further, including £34 million of additional government funding plus a further £16 million from Transport for London (TfL) for the development of the Croxley rail link to extend the Metropolitan Line on the London Underground to Watford Junction on the West Coast Main Line, and £4 million for further development of the Wet Dock Crossing in Ipswich, and Lowestoft Third River Crossing.**

2.163 Investment: Budget 2015 announces a pilot scheme in Cambridgeshire and Peterborough to enable the retention of 100% of any additional business rate growth, starting in April 2015. This will mean local areas will see the full benefits of policy decisions that increase the local growth rate and business rate revenues, sharpening incentives to boost jobs and growth.

2.164 Flood defences: The government has made significant investment in flood and coastal defences across the East during this Parliament, and in December 2014 set out a £240 million investment programme for the next 6 years. **The government is bringing forward an additional £16.8 million over the next 4 years.** Key schemes will start in Canvey Island in 2016, and new projects in Great Yarmouth and Canvey Island will be funded within the 6-year programme.

2.165 Innovation: Building on existing strengths in agri-tech, **the government will invest £11.8 million in a new Centre for Agricultural Informatics and Sustainability Metrics in Harpenden, Hertfordshire.** This world-leading big data centre will use data science and modelling to make food production more efficient and sustainable.

South West

2.166 Transport: The government has already committed £7.2 billion to transport infrastructure in the South West. This includes: £2 billion on upgrading key roads such as the A30, A303, A358 and the M5; a new tunnel at Stonehenge; and electrification of the Great Western Main Line. In January 2015, the Chancellor announced a new South West Peninsula Rail Task Force to bring forward proposals for strategic and local rail schemes.

2.167 The Secretary of State for Transport will shortly set out details of the **new franchise for the Great Western Route, which will introduce the new £3 billion Intercity Express trains, more frequent services and faster journey times.** To reduce costs for businesses, once the Severn River Crossings are in public ownership after 2018, **the government will abolish Category 2 tolls (small goods vehicles and small buses) and include those vehicles in Category 1 (motor cars and motor caravans)**.

2.168 Transport: The government has asked the South West Peninsula Task Force on rail to consider improvements to the Exeter to Salisbury line as part of its work. The government also encourages the relevant local authorities and Local Enterprise Partnership to develop a business case for investment in the North Devon Link road, to form the basis of a future application to the Local Growth Fund.

2.169 Plymouth Marine Enterprise Zone and airport: The government will seek to create a new Enterprise Zone on the south Naval Dockyard site, and **commission a new study into the possibility of reopening Plymouth airport.**

2.170 Housing: To meet the housing needs of the South West and regenerate brownfield sites the government will support the new housing zones at South Bristol, Hinkley, Poole, Weston-super-Mare, Ashchurch, Gloucester and Foxhill. These zones will see the government providing support and finance to enable the regeneration of brownfield sites into new homes. Together the zones across the South West will deliver over 11,000 new homes.

London

2.171 Housing: In February 2015, the Chancellor set out a plan to tackle housing in London, the biggest challenge facing the city. As well as announcing new housing zones, the government announced the creation of the London Land Commission (LLC), tasked with developing brownfield and public sector land. **Budget 2015 provides £1 million to allow the LLC to create a comprehensive database of public sector and brownfield land.** Alongside ongoing support for the regeneration of Barking Riverside and Brent Cross, **the government will also provide £7 million to the Greater London Authority to support the development of the Croydon Growth Zone.** This could unlock over 4,000 homes and 10,000 jobs.

2.172 Science: The government has already made major investments in science in London, including the Francis Crick Institute and Alan Turing Institute. **The government will now reinvest up to £30 million from the sale of Medical Research Council assets to support research at the Francis Crick Institute, with matched funding from Cancer Research UK and the Wellcome Trust.**

2.173 Devolution: The government is devolving further powers to the Mayor of London, including over planning and skills. This will allow the Mayor to accelerate the provision of new homes by reducing planning delays, and to tailor decisions over skills provision to London's needs.

South East

2.174 Housing: Housing remains a significant challenge across the South East. In 2014, the government created an Urban Development Corporation (UDC) to drive forward development of a new garden city at Ebbsfleet. **The government is announcing the Board members for the UDC, and expects it to be up and running from April 2015.** The UDC will now produce a business plan ahead of the next spending review. **The government will also provide capacity funding to support Bicester's ambition to become a garden town, including assessing the potential for recoverable government investment, subject to a business case.**

2.175 Innovation: Building on the science strengths in the South East is crucial to maintaining strong economic growth. **The government will extend the Oxford Science Vale Enterprise Zone for advanced energy, space and satellite science, and will extend Discovery Park Enterprise Zone,** subject to a business case, allowing it to expand its operations in life sciences and environmental technologies.

Strengthening the UK's skills and innovation base

Education and skills

2.176 The government has implemented a package of measures to improve access to training and higher education. Over 2 million people have started apprenticeships during this Parliament, and in the academic year 2014-15 the highest ever number of young students and students from disadvantaged backgrounds applied to, and were accepted into, university.[89] The youth Claimant Count more than halved between May 2010 and January 2015.[90] At Autumn Statement 2014 the government announced that it would increase the financial support for students on postgraduate taught courses with a new income-contingent loan offer.

PhD funding

2.177 The UK excels both in terms of volume and quality of research. The government has supported researchers by ring-fencing the science budget and strengthening partnerships with industry, for example through Doctoral Training Centres. However, demand for individuals with doctorates is outstripping supply, both in the UK and internationally. Despite increases in the proportion of the labour market with a PhD in the US and UK, wage differentials with those whose highest qualification is an undergraduate degree have risen substantially.[91]

2.178 In addition, the market for postgraduate skills is becoming more internationally competitive. Countries such as the US and China are competing more for top researchers and have increased PhD student numbers in recent years, whereas in the UK PhD enrolment has remained relatively flat.[92]

2.179 The government will introduce a package of measures to broaden and strengthen support for postgraduate researchers (including both masters and PhDs). This additional support will focus on seizing new opportunities in postgraduate research and build on partnerships with industry, charities, academies and individual members of society. It will include:

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[89] 'FE Data Library: Apprenticeships - Apprenticeships by quarter: starts and achievements 2002-02 to 2012-13, Skills Funding Agency and Department for Business, Innovation and Skills, February 2015; and FE Data Library: Apprenticeships - Breakdown by geography, equality, diversity and sector subject area: starts 2002/03 to 2014/15, Skills Funding Agency and Department for Business, Innovation and Skills, February 2015. 'End of Cycle Report 2014', UCAS, December 2014

[90] Labour Market Statistics, ONS, February 2015. Further detail can be found in 'Budget 2015 Data Sources'.

[91] 'Rising Wage Inequality and Postgraduate Education', Lindley, J., and Machin, S., Centre for Economic Performance Discussion Paper No1075, September 2011

[92] 'International Comparative Performance of the UK Research Base', prepared by Elsevier for the Department for Business, Innovation and Skills, 2013

- **launching a review into how the government can strengthen its funding for postgraduate research.** This review will examine the balance between number and level of research stipends to ensure that the UK's offer remains internationally competitive
- **assessing, as part of this review, options to strengthen partnerships and co-funding between government, industry and charities.** This will include increased support for crowd-funding for wider research to attract investment from individual members of society and business
- **introducing income-contingent loans of up to £25,000 to support PhDs and research-based masters degrees.** These loans will be in addition to existing funding, and designed to minimise public subsidy. The government will work with research councils, universities and industry to examine how best to design them so that they complement existing funding streams and continue to support the most excellent research

Apprenticeship funding

2.180 Apprenticeships equip people with the skills they need to compete in the labour market, and that employers need to grow their businesses. **The government, through the introduction of an Apprenticeship Voucher, will put employers in control of the government funding for the training apprentices need.** The new mechanism, which will be developed and tested with employers and providers immediately and fully implemented from 2017, will give employers the purchasing power to have an even greater say in the quality, value for money and relevance of the training that their apprentices receive. As confirmed at Autumn Statement 2013, the government and employers will make cash contributions towards the cost of training for apprentices.

Support for road hauliers

2.181 The government will review the speed with which Heavy Goods Vehicles (HGV) driving tests and driver medical assessments currently take place and will consider options to accelerate both in order to help address the shortage of qualified HGV drivers. The government will also work with road haulage firms on an industry-led solution to the driver shortage, including looking at the right level of access to, and funding support for, training.

Supporting science and innovation

2.182 Science and innovation are core drivers of economic growth, and the UK's ability to transform its world-leading science base into new products, services and markets is critical to increasing productivity, providing jobs, and improving societal wellbeing. That is why the government has prioritised overall science funding throughout this Parliament (£4.6 billion each year to 2015-16), and provided the longest commitment to capital investment in science facilities of any Parliament (£1.1 billion per year, rising with inflation, between 2016 and 2021).[93]

2.183 The government has also increased its direct support to innovation – having raised the annual budget of Innovate UK from £360 million in 2010-11 to over £500 million in 2015-16 – and committed £845 million over 7 years to develop a network of Catapult centres to help bring innovative ideas to market.[94]

2.184 This Budget goes further, announcing that **the government will commit £400 million to 2020-21 for the next round of funding for cutting-edge scientific infrastructure.** This will be a competitive fund, based on scientific excellence, which seeks to lever industrial and charitable funds. The government welcomes exciting proposals from across the UK that aim to push scientific boundaries and maximise scientific impact.

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[93] 'Spending Review 2010', HM Treasury, October 2010 and 'Spending Round 2013', HM Treasury, June 2013
[94] Annual Report and Accounts, 2010-11', Technology Strategy Board, May 2012

2.185 The government will also provide further strategic science and innovation investments to make the UK a global leader in emerging markets and technologies, drawing on and supporting the UK's existing world-class research base. The government will commit:

- **£138 million of funding towards the UK Collaboratorium for Research in Infrastructure and Cities (UKCRIC),** subject to a satisfactory business case and the provision of substantial co-funding. The UKCRIC will apply research to ensure that the UK's infrastructure is resilient and responsive to environmental and economic impacts. It will have hubs in London, and further centres initially in Birmingham, Newcastle, Sheffield and Southampton
- **£100 million for Research and Development into Intelligent Mobility,** which will focus on enhancing the development of driverless car technology and the systems required to implement and adopt the technology, such as telecommunications
- **£40 million for demonstrator programmes, business incubator space and a research hub to develop applications for Internet of Things technologies in healthcare and social care, and Smart Cities**

2.186 Smart City technology could prove transformative, as well as providing significant opportunities for supporting jobs and growth. To ensure that the UK can take advantage of this technology local areas will need to be empowered to make decisions, and collaborations will need to be built between cities, universities and business. **The government will support a competition to fund a Smart Cities demonstrator as part of the Internet of Things programme** to trial and showcase these new technologies.

2.187 Budget 2015 confirms that the government will invest a further £100 million in cutting-edge research projects through the current UK Research Partnership Investment Fund round. The Higher Education Funding Council for England received 22 proposals in the latest competition round from areas ranging from advanced steel research to compound semi-conductor technology and tissue repair. The successful projects will leverage over £350 million of private sector investment and are being led by universities from across the UK.

2.188 The government will also provide the UK's world-leading Research Institutes with greater freedoms to attract the brightest minds, re-invest commercial income, and develop cutting-edge technology.

2.189 The government would like to ensure that academics and researchers are appropriately rewarded when they contribute towards valuable intellectual property used in spin out companies. **The government will therefore review the availability of capital gains tax (CGT) entrepreneurs' relief on disposals by academics of shares in such companies.**

2.190 The government wants to ensure that regulations do not restrict the creation of valuable and innovative products, services and business models. **The government will therefore engage with business to determine where regulations inhibit innovation, including disruptive technologies, and develop a programme for addressing this in the next Parliament.**

2.191 The government announced in February 2015 the launch of a £10 million ultra-low emission vehicle (ULEV) battery prize, which will see a UK-based collaboration of manufacturers and researchers develop a new commercially viable battery pack for ULEVS. The winner will be announced in summer 2015.

Creating a dynamic economy

2.192 Creating the right conditions to start and grow a business, across all sectors and regions, is vital to ensuring a prosperous and balanced economy. This Budget announces a package of measures to unlock the potential of the sharing economy and to help UK businesses to succeed domestically and to expand into new markets overseas.

Support for the sharing economy

2.193 The government wants to ensure that Britain is the global centre for the sharing economy, enabling individuals and businesses to make the most of their assets, resources, time and skills through a range of online platforms. This Budget therefore announces a comprehensive package of measures that will break down barriers, create opportunities for sharing, and unlock the potential of this dynamic and growing area. Building on the recommendations of the independent review of the sharing economy, the government will:[95]

- **make it easier for individuals to sub-let a room through its intention to legislate to prevent the use of clauses in private fixed-term residential tenancy agreements that expressly rule out sub-letting or otherwise sharing space on a short-term basis, and consider extending this prohibition to statutory periodic tenancies**
- **enable government employees to use sharing economy solutions to book accommodation and transport when travelling on official business, where this represents value for money**
- **encourage Local Authorities to use their business rates discretionary relief powers to support the sharing economy,** including shared workspaces and makerspaces

2.194 The sharing economy also presents an opportunity to drive local growth and deliver local public services more innovatively and efficiently. To demonstrate the benefits of the sharing economy **the government will launch two pilots in Leeds City Region and Greater Manchester in 2015-16, to trial local sharing initiatives in the areas of shared transport, shared public space, and health and social care.**

2.195 These and other initiatives are set out in the government's response to the independent review of the sharing economy.[96]

Improving access to finance and markets

Exports

2.196 The government is committed to improving economic ties with major emerging markets. **Budget 2015 continues progress in this area and announces a near doubling of funding for UK Trade and Investment (UKTI) activities in China,** including a focus on the advanced manufacturing, transport, financial services, healthcare and life sciences sectors, to ensure that opportunities for British businesses to trade with China are maximised.

2.197 Budget 2015 also announces funding for an ambitious series of trade missions focused on regional strengths, and to ensure that the UK makes the most of the International Festival for Business in Liverpool.

Access to finance

2.198 On 12 March 2015, the Chancellor of the Exchequer announced the UK's intention to become the first major Western economy to be a prospective founding member of the Asian

[95] 'Unlocking the sharing economy: an independent review', www.gov.uk, November 2014
[96] 'Independent Review of the sharing economy: Government response', Department for Business, Innovation and Skills, March 2015

Infrastructure Investment Bank (AIIB). The AIIB will support access to finance for infrastructure projects across Asia to boost investment across a range of sectors including transportation, energy, telecommunication, agriculture and urban development. Subject to agreement by the existing prospective founder members, the government will join discussions to agree the AIIB's Articles of Agreement, governance and accountability arrangements.

2.199 The government is committed to helping the best businesses access the finance they need to grow. To improve access to finance for smaller firms, **the British Business Bank is launching a pilot 'Help to Grow' programme to increase the supply of growth loans to firms that need between £500,000 and £2 million to achieve their potential. Budget 2015 announces a request for proposals to deliver the pilot,** which will facilitate up to £100 million of finance for growing businesses.

2.200 The government will make amendments to the Seed Enterprise Investment Scheme (SEIS), Enterprise Investment Scheme (EIS), and Venture Capital Trusts (VCTs) to ensure that the UK continues to offer significant and well-targeted support for investment into small and growing companies, in line with new EU rules. The government will, subject to state aid approval:

- **require that companies must be less than 12 years old when receiving their first EIS or VCT investment, except where the investment will lead to a substantial change in the company's activity**
- **introduce a cap on total investment received under the tax-advantaged venture capital schemes of £15 million, increasing to £20 million for knowledge-intensive companies**
- **increase the employee limit for knowledge-intensive companies to 499 employees,** from the current limit of 249 employees

2.201 The government will also smooth the interactions between the schemes by removing the requirement that 70% of the funds raised under SEIS must have been spent before EIS or VCT funding can be raised.

Competition

2.202 Competition is a key driver of productivity and growth, and the government is committed to improving the functioning of markets. **The government will take forward Competition and Markets Authority (CMA) recommendations, and other actions agreed with the CMA, to improve the market for residential property management services (RPMS).** These changes will make tangible improvements in the RPMS market to the benefit of both leaseholders and landlords. **The government will also support customers to make informed choices in other key markets,** by developing improved guidance so that supermarkets can unit price most everyday items consistently, and by improving information for SMEs on access to legal services.

2.203 The government is determined to drive increased competition in the banking market, so that banks, alternative providers and financial technology (FinTech) firms compete vigorously, on a level playing field, to win and retain customers. **Budget 2015 announces a package of measures to further support competition in banking,** details of which have been published separately in 'Banking for the 21st Century: driving competition and choice'.[97] The lead measures in this package set out the government's approach to establishing a supportive framework for legitimate digital currency businesses and helping FinTech firms gain access to banking data.

[97] 'Banking for the 21st Century: driving competition and choice', HM Treasury, March 2015

2.204 The FinTech sector comprises a wide range of activities and companies with the potential to bring increased competition and innovation in financial services markets, to the benefit of UK customers. The government wants the UK to be the world's leading FinTech hub, and is now taking steps to supports innovation across the whole of the UK while safeguarding financial stability and consumer protection. In support of this, this Budget announces that:

- **the Financial Conduct Authority's (FCA) 'Project Innovate' will work with HMT and the Prudential Regulation Authority (PRA) to investigate the feasibility of developing a regulatory 'sandbox' for financial services innovators**
- **the FCA, working with the PRA, will also identify ways to support the adoption of new technologies to facilitate the delivery of regulatory requirements – so-called 'RegTech'**
- **Innovate Finance has agreed to deliver its FinTech regional strategy through a series of local partnerships;** the first partnership has already been established in Leeds, and further partnerships will be established in Manchester and Edinburgh by April, and in Newcastle, Bristol and other centres before the end of the year

Fairness

2.205 The government's long-term economic plan is underpinned by a firm commitment to support those who want to work hard and get on, while continuing to support and protect the most vulnerable in society. The government's ambition is to build a stronger economy and a fairer society. This Budget builds on the government's priorities over this Parliament of helping families and making work pay by raising the personal allowance and reducing the burden of Income Tax for the lowest paid; supporting and rewarding savers at every stage of their life; and taking firm action to tackle tax evasion and avoidance. The government's welfare reforms continue to promote work and personal responsibility, while putting expenditure on a sustainable footing.

2.206 As a result of the government's reforms to tax, welfare and public spending across the Parliament, the richest households will make the biggest contribution to reducing the deficit, both in cash terms and as a proportion of their income.

Supporting households

Personal allowance

2.207 The government's commitment to reduce taxes for low and middle-income earners has been a centre piece of this Parliament. The Coalition Agreement commitment to raise the Income Tax personal allowance to £10,000 over the course of this Parliament was achieved a year early in 2014-15. From April 2015, the personal allowance will be increased to £10,600, from £6,475 in April 2010.

2.208 Budget 2015 announces that the personal allowance will be increased to £10,800 in 2016-17 and to £11,000 in 2017-18. The Marriage Allowance will also rise in line with the personal allowance.

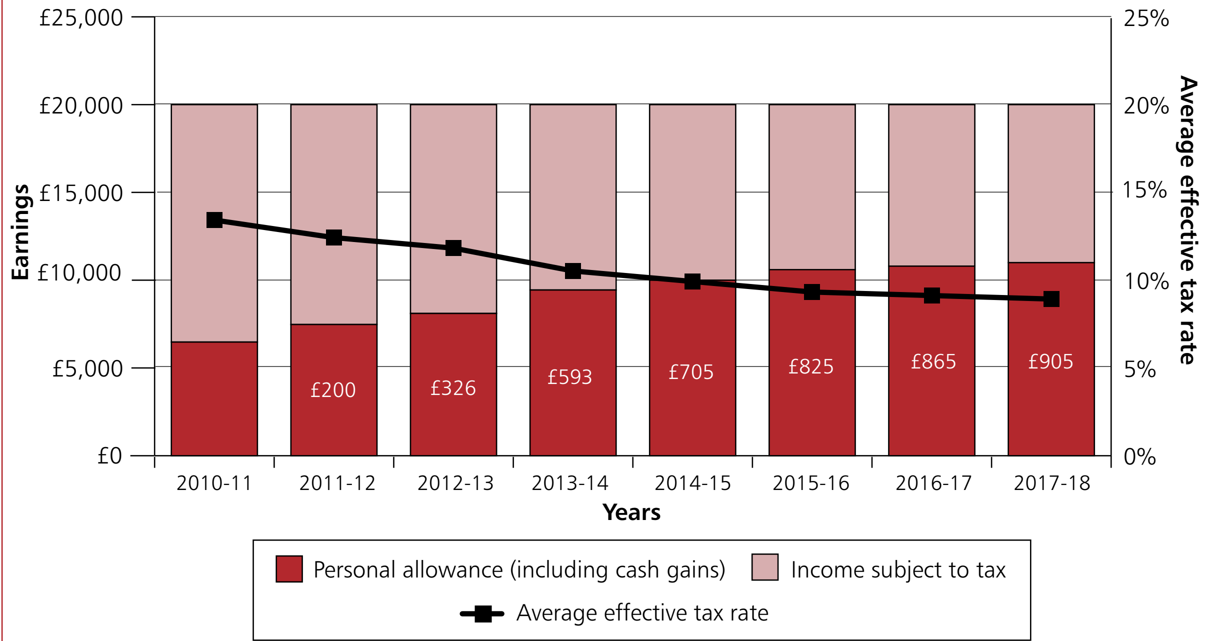
2.209 The successive increases in the personal allowance total £4,525 since 2010, representing a rise of 70% under this government. Taken together, these changes will benefit 27.2 million individuals and provide a cash gain of £905 to the typical basic rate taxpayer in 2017-18. By 2017-18, the government will have taken 3.7 million working-age individuals out of Income Tax altogether.

2.210 To ensure the full gain of the personal allowance increase is passed on to higher-rate taxpayers, the higher-rate threshold will rise in line with the personal allowance, taking it to £42,700 in 2016-17 and £43,000 in 2017-18. This is the first above-inflation increase in the higher-rate threshold for 7 years. A typical higher-rate taxpayer will have a cash gain of £848 by 2017-18.

2.211 The cumulative impact of these changes has significantly reduced the effective tax rate paid by individuals. In 2010, an individual earning £20,000 paid £2,705 in Income Tax. By 2017, an individual earning £20,000 will pay £1,800 in Income Tax, equivalent to a 33% reduction in the tax paid. The effective tax rate for an individual earning £20,000 in 2017-18 will be 9%.

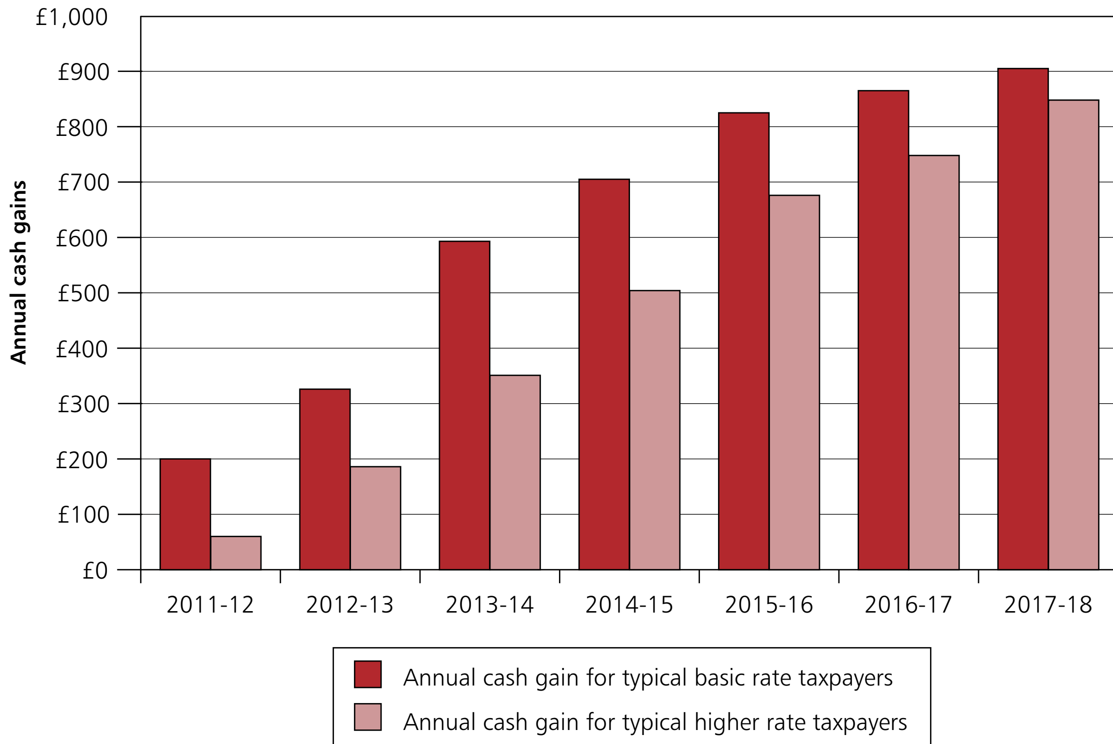
2.212 Someone working full time on the National Minimum Wage (NMW) in 2015-16 will earn around £12,000. In 2010, an individual earning £12,000 paid £1,105 in Income Tax. In 2017-18, an individual earning £12,000 will pay £200 in Income Tax, an 82% reduction in tax paid. The effective tax rate for an individual earning £12,000 in 2017-18 will be 1.7%.

Chart 2.11: Personal allowance: impact on an individual earning £20,000 per year



Notes:
1) This is based on an individual with earnings of £20,000 in each year
2) The average effective tax rate is for income tax only
3) The gains refer to the cash gains since 2010

Chart 2.12: Personal allowance: cash gains



National Minimum Wage

2.213 As announced by the Prime Minister and Deputy Prime Minister, the government has accepted the Low Pay Commission's recommendations for increases to the adult, 18-19 and 16-17 (NMW) rates. The adult NMW rate will increase by 3.1% to £6.70 from October 2015, representing the largest real-terms increase since 2006. This means that, from 1 October 2015, someone working full time on the adult NMW will see their annual salary rise by over £350.

2.214 The apprentice rate will increase by 57p an hour to £3.30, halving the gap to the 16-17 rate. This will result in an annual salary increase of over £1,000 for a full time worker on the current apprentice rate, and ensure those undertaking this important type of training are better rewarded.

Energy

2.215 The government is committed to improving competition in energy markets, to lower bills for consumers and drive efficiencies and innovation. In February 2015, the government launched the 'Power to Switch' campaign to help consumers reduce their energy bills by shopping around for the best possible deal. Over 300,000 households switched electricity supplier in February, up 30% on the same period in 2014.[98] Households switching energy supplier via a price comparison website are currently saving an average of around £300 on their annual energy bill as a result.[99]

2.216 The government commits to respond quickly to any recommendations from the Competition and Markets Authority's ongoing investigation into energy markets and to take forward appropriate implementation as quickly as possible. The government will also provide £1.3 million to fund the Big Energy Saving Network (BESN) in 2015-16. This will enable the BESN frontline workers to reach a predicted 100,000 vulnerable individuals, helping them to cut their energy bills.

2.217 The government will consult on reducing electricity distribution costs for consumers in the North of Scotland, to ensure that they pay no more for electricity distribution than consumers in the next most expensive region. The government estimates that this could save an average household in the North of Scotland around £30 per year on their electricity bill.

2.218 The government recognises that motorists in some rural areas face particularly high pump prices compared to the rest of the UK, and has now received full approval from the Council of the European Union to extend the rural fuel rebate scheme to 17 areas of the UK mainland, enabling retailers in eligible areas to register for a 5 pence per litre fuel duty discount. The government is also committed to ensuring that all consumers are able to take advantage of the best deal for their energy supply, including those consumers off the mains gas grid. The government will continue to work with the heating oil and liquefied petroleum gas (LPG) sectors to improve transparency and protections for vulnerable households who are off the gas grid.

Savings and pensions

2.219 Since the financial crisis, low interest rates have helped households and businesses through difficult economic times. These have kept mortgage payments down, but have also meant that returns on savings have been low. The government recognises that this has made it difficult for people's savings to grow, and that it has been harder for people to secure the income they expected in retirement.

2.220 At Budget 2014, the government announced a reduction in taxes for the lowest income savers, increased flexibility in saving and investment choices by reforming ISAs into a simpler product with a record increase in the ISA limit to £15,000, and introduced a market-leading National Savings & Investment bond to help retired savers. The government also announced the most fundamental change to the way people access their pension savings in almost a century, through removing the

[98] Electricity Switching, Energy UK, February 2015.
[99] Savings estimates based on industry data provided to DECC.

effective requirement to buy an annuity. The government is now going further to reduce taxes on savings, and to give people greater flexibility over how they hold those savings.

Reducing tax on savings

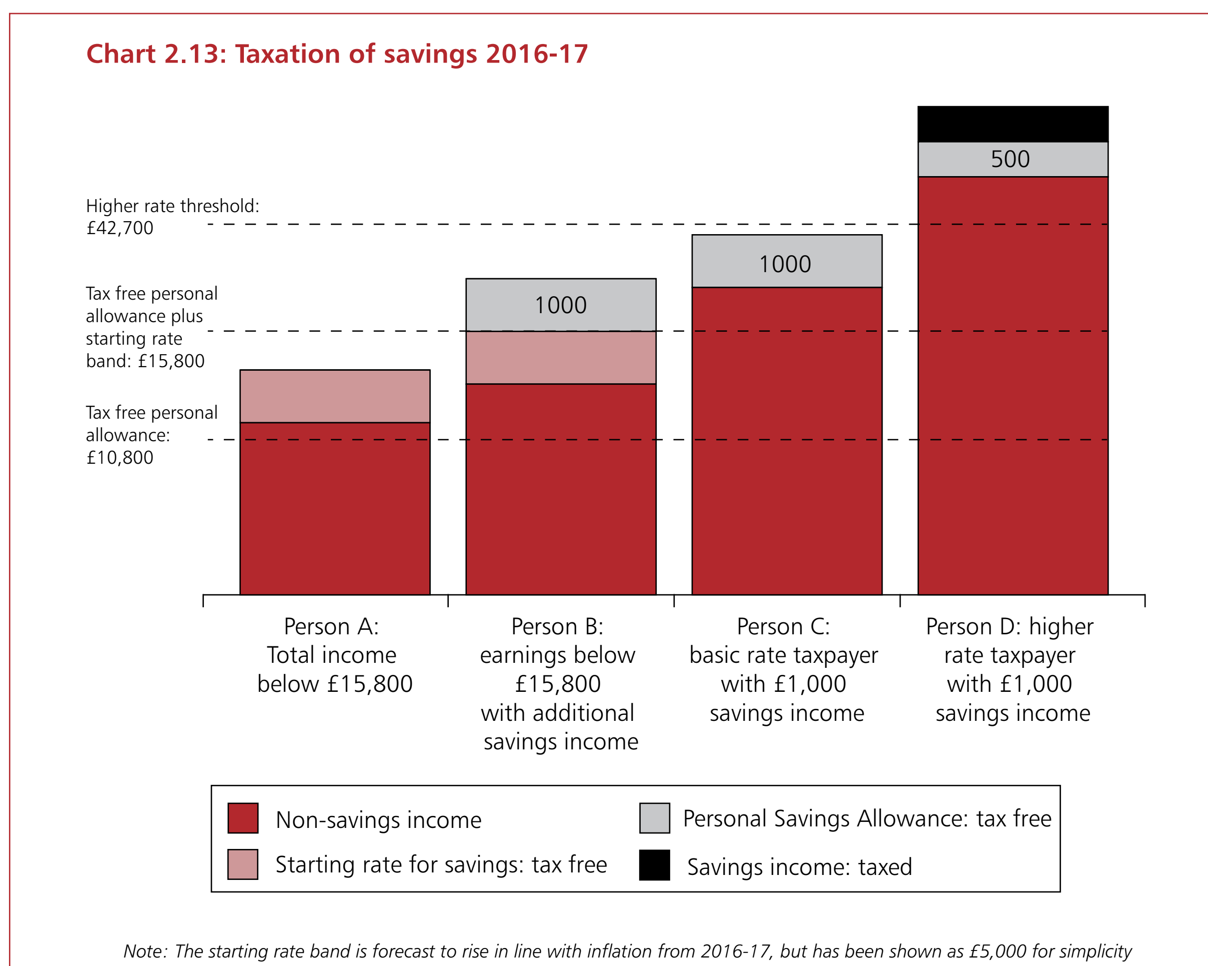
2.221 In their respective reviews of the UK tax system, the Nobel Prize-winning economists James Meade and Sir James Mirrlees considered that ordinary savings were over-taxed. Mirrlees concluded that ordinary savings "should just face a straightforward … system: saved out of taxed earnings and then no more tax applied," though noting that there is a case for some limits.[100]

2.222 In a radical reform to the savings tax system, **a new Personal Savings Allowance will be created from April 2016, exempting the first £1,000 of savings income from any tax for basic rate taxpayers and the first £500 for higher rate taxpayers, saving up to £200 off an annual tax bill**. This will not apply to additional rate taxpayers.

2.223 From April 2016, 95% of taxpayers can save completely tax free each year and choose from a range of savings products to meet their specific needs.

2.224 Because so many people will no longer pay tax on their savings, the automatic deduction of tax by banks and building societies will no longer be necessary. At present, 20% Income Tax is automatically deducted from most interest on savings outside ISAs. For those on low incomes, a 0% rate is applied, but only for those who have filled out a form to confirm they are eligible to receive gross interest. Higher rate taxpayers owe 40% tax and are therefore required to notify HMRC of their savings income so they can pay the additional 20%. Both the opt out and the requirement to notify HMRC are complex, burdensome and poorly understood. **Budget 2015 announces that the automatic deduction of 20% income tax by banks and building societies on non-ISA savings will cease from April 2016**. These changes represent a major tax simplification.

Chart 2.13: Taxation of savings 2016-17



Note: The starting rate band is forecast to rise in line with inflation from 2016-17, but has been shown as £5,000 for simplicity

[100] Tax by Design, Oxford University Press (2011), p344. See also p316.

2.225 The government will allow ISA savers to withdraw and replace money from their cash ISA without counting towards their annual ISA subscription limit for that year, as long as the repayment is made in the same tax year as the withdrawal. This will enable savers to access their ISA savings more flexibly without losing the benefits they have built up. These changes will be introduced in autumn 2015, following consultation with ISA providers.

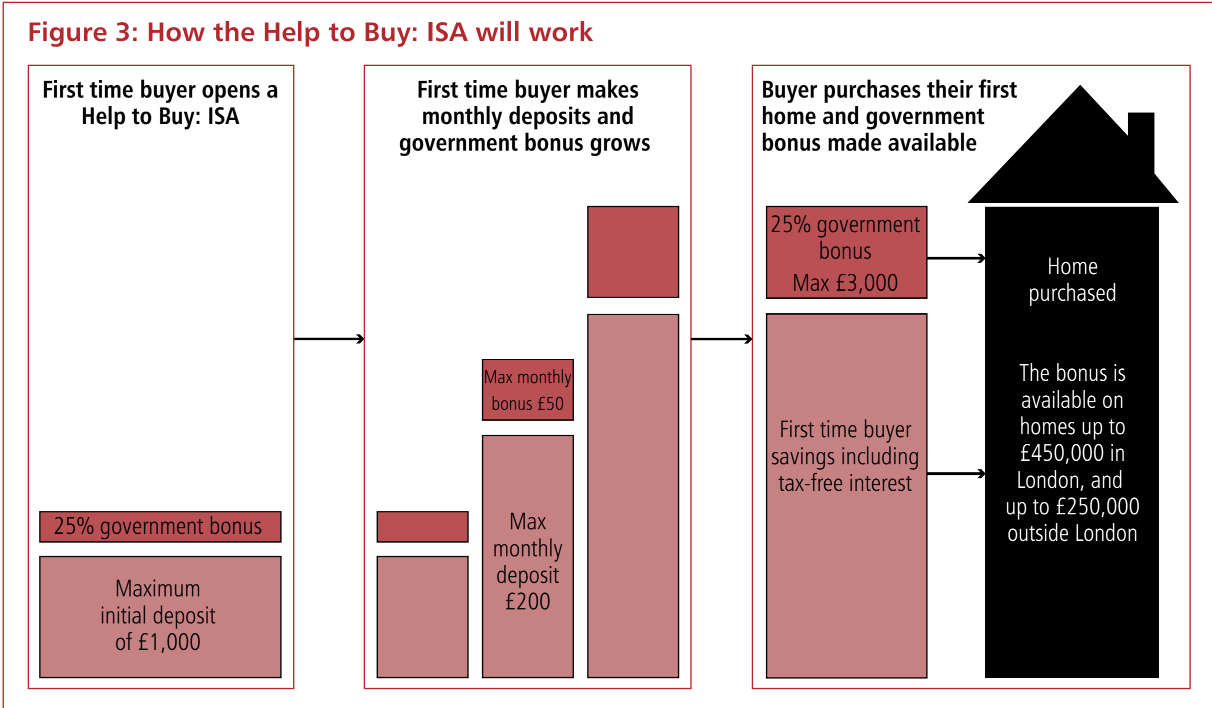
2.226 Following technical consultation with the financial services industry, **the government will extend the range of ISA eligible investments in 2015-16 to include listed bonds issued by a co-operative society and community benefit society and SME securities issued by companies trading on a recognised stock exchange. The government will also explore further extending the list to include debt and equity securities offered via crowd funding platforms,** and will consult in summer 2015 alongside a response to the consultation on how to include peer-to-peer loans.

2.227 As a result of their popularity, the government announced in February 2015 that National Savings and Investments 65+ bonds would remain on sale until 15 May 2015. These bonds have seen unprecedented demand – the biggest opening sale of any retail financial product in Britain's modern history – and the government has extended the issuance to ensure that eligible investors do not miss out on the market-leading rates on offer.

Help to Buy: ISA

2.228 In recognition of the impact the low interest rate environment has had on the ability of first time buyers to get on the housing ladder, Budget 2015 announces the Help to Buy: ISA. This will reward people that are making the difficult choices required to save regularly, and help them realise their aspirations of homeownership for the first time. The scheme will work by providing a government bonus to each person who has saved into a Help to Buy: ISA at the point they use their savings to purchase their first home. For every £200 a first time buyer saves, the government will provide a £50 bonus up to a maximum bonus of £3,000 on £12,000 of savings. Savers will have access to their own money and will be able to withdraw funds from their account if they need them for another purpose but the bonus will only be made available for home purchase. Further details are provided in the document 'Help to Buy: ISA'.[101]

Figure 3: How the Help to Buy: ISA will work



[101] Help to Buy: ISA, HM Treasury, March 2015.

Extending freedom and choice at retirement

2.229 This government has already introduced major reforms to allow people entering retirement much more flexibility over how they use their defined contribution pension pot, instead of being required to purchase an annuity. The government now wants to allow people who have already bought an annuity to also enjoy flexibility in how they access the value of their annuity, without interfering with binding contractual requirements.

2.230 From April 2016, the government will therefore change the tax rules to allow people who are already receiving income from an annuity to sell that income to a third party, subject to agreement from their annuity provider. The proceeds of the sale could then be taken directly or drawn down over a number of years, and would be taxed at their marginal rate, in the same way as those taking their pension after April 2015.

2.231 The government believes that for most people, continuing to hold their annuity will be the right decision. However, for others, this reform will allow them the flexibility to use the value of their annuity as they see fit. The government is therefore publishing a consultation on how best to remove the barriers to the creation of a secondary market in annuities, inviting views on how best to ensure that consumers are in a position to make an informed decision. The government will work with the Financial Conduct Authority (FCA) to consult on how best to support people's choices through consumer protection, and protect those who are most vulnerable.[102]

2.232 It is important that the UK's pensions tax system remains fair, affordable and sustainable for the future. In 2013-14, Income Tax relief for pension savings cost the government around £34.3 billion, up from £30.8 billion in 2009-10, with around two-thirds of this relief going to higher or additional rate taxpayers.[103] To protect the public finances from this growing cost, **the government will therefore reduce the lifetime allowance for pension contributions that benefit from tax relief from £1.25 million to £1 million.** This will be effective from 6 April 2016. **The lifetime allowance will be indexed to increase annually by CPI from 6 April 2018.** Over 96% of individuals currently approaching retirement have a pension pot worth less than £1 million, so this change will affect only the wealthiest pension savers.[104]

Mental health

2.233 The government is committed to parity of esteem between physical and mental health. The NHS Mandate includes a commitment to closing the health gap between people with mental health problems and the population as a whole and from April 2015 there will be new access and waiting times standards introduced for key mental health services. Autumn Statement 2014 committed £150 million over five years to caring for young people with eating disorders and funding to expand pilots testing new ways to support those with mental health problems to return to work. **To go further, Budget 2015 announces a £1.25 billion package of additional investment**.

2.234 Many children and young people experience problems with their mental health, and the government wants to ensure that they get the services that they need. **This is why Budget 2015 will be providing over £1 billion over the next 5 years to start new access standards which will see over 110,000 more children cared for over the next Parliament. Alongside this, the government will be providing £118 million by 2018-19 to complete the roll-out of the Children and Young People's Increasing Access to Psychological Therapies (CYP IAPT) programme**, ensuring that there are talking therapists in every part of the country providing the best quality treatment for children.

[102] Creating a secondary annuity market, HM Treasury and Department for Work and Pensions, March 2015.
[103] HMRC Statistics Table *PEN6* – Registered pension schemes: cost of tax relief.
[104] HMRC analysis of Office for National Statistics Wealth and Assets Survey, 2010-12 data.

2.235 Young people can develop mental health problems as a consequence of maternal mental illness. **Budget 2015 announces an additional £75 million over the next 5 years to give the right care to more women who experience mental ill health during the perinatal or antenatal period**. The Department for Education will also provide an additional £1.5 million towards piloting joint training for designated leads in Child and Adolescent Mental Health Services (CAMHS) and schools to improve access to mental health services for children and young people, including the most vulnerable.

2.236 Budget 2015 also announces a package of measures to improve employment outcomes for people with mental health conditions. Starting from early 2016, **the government will provide online Cognitive Behavioural Therapy (CBT) to 40,000 Employment and Support Allowance and Jobseeker's Allowance claimants and individuals being supported by Fit for Work. From summer 2015, the government will also begin to co-locate Improving Access to Psychological Therapies (IAPT) therapists in over 350 Jobcentres**, to provide integrated employment and mental health support to claimants with common mental health conditions.

2.237 The government is committed to ensuring that those who have given so much in the service of their country should receive the best possible care. **This is why Budget 2015 will provide an additional £8.4 million over the next 5 years to allow the NHS across England to significantly enhance current mental health and support services to the most vulnerable veterans in the community**.

Ensuring a fair contribution through the tax system

2.238 The government is committed to a fair tax system in which everyone contributes to reducing the deficit, and those with the most make the largest contribution. Budget 2015 announces further measures to tackle offshore evasion, close down tax avoidance, and ensure a fair contribution from businesses and individuals.

2.239 The vast majority of people and businesses in the UK pay the tax they owe and do not attempt to avoid their responsibilities. Nevertheless, where it exists, tax evasion and avoidance damages the ability of the tax system to raise revenue fairly and imposes additional costs on all taxpayers. This government has been relentless in its crackdown on tax evasion and avoidance, taking action to prevent such behaviour at the outset, and to detect and counter it effectively where it persists. During this Parliament, HMRC will have secured £100 billion in additional compliance revenue as a result of actions taken to tackle evasion, avoidance and non-compliance.[105]

Evasion

2.240 Tax evasion is a crime that deprives the country of much needed revenue for public services. Over the last two years, this government has led work in Europe, in the G20 and through the UK's G8 Presidency to transform international tax transparency. Agreement has now been reached among 92 countries to exchange information on bank accounts automatically every year. Regulations giving effect to these agreements will be laid shortly after Budget 2015.

2.241 Under these agreements, starting in 2016 for the Crown Dependencies and Overseas Territories, HMRC will receive a wide range of information on offshore accounts held by UK tax residents, including names, addresses, account numbers, interest and balances. This represents an unprecedented change in HMRC's ability to tackle offshore tax evasion.

2.242 Building on this, **the government will toughen sanctions for those who continue to evade tax by closing the existing disclosure facilities for tax evaders early. A tougher 'last chance' disclosure facility will be offered between 2016 and mid-2017, with penalties of at least 30% on top of tax owed and interest and with no immunity from criminal prosecutions in appropriate cases.**

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[105] HMRC 2010-11 Annual Report, HMRC 2013-14 Annual Report and HMRC's Mid-Year Report to Parliament – April to September 2014.

Avoidance

2.243 This government has introduced changes throughout this Parliament to tackle avoidance and to focus in on the diminishing minority who refuse to play by the rules. As proposed in the consultation document 'Strengthening Sanctions for Tax Avoidance,' **the government will introduce tougher measures for those who persistently enter into tax avoidance schemes that fail, and will develop further measures to publish the names of such avoiders and to tackle avoiders who repeatedly abuse reliefs.**[106] **The government will also widen the current scope of the Promoters of Tax Avoidance Schemes regime by bringing in promoters whose schemes are regularly defeated by HMRC.**

2.244 The government introduced a significant new regime for avoidance with the creation of the general anti-abuse rule (GAAR). **The government will increase the deterrent effect by introducing a penalty based on the amount of tax that is tackled by the GAAR.**

2.245 The government changed the economics of tax avoidance with the introduction of the Accelerated Payments regime, removing the cash-flow advantage that users of avoidance schemes have benefitted from. **HMRC has continued to review cases and more accelerated payment notices will now be issued than previously announced.**

2.246 Some companies enter into contrived arrangements, with little economic substance, to convert old losses into new ones and circumvent the loss relief rules. **The government will introduce a targeted anti-avoidance rule to level the playing field between the majority of companies, who follow the rules, and those others who side step them.**

Ensuring a fair contribution from business and individuals

Banking

2.247 This government has been clear that banks should make an additional contribution that reflects the risks they pose to the UK economy. This contribution has always needed to be balanced against financial stability considerations and banks' ability to lend to the real economy. However, with banks now strengthening their balance sheets and returning to profitability, the government believes that the sector should be expected to absorb a greater burden of remaining deficit reduction. **The government will therefore increase the Bank Levy from 0.156% to 0.210% from 1 April 2015.**

2.248 Companies are currently entitled to deduct the costs of compensation payments in calculating their profits liable to corporation tax. The government believes that it is unacceptable that banks' corporation tax receipts continue to be depressed by compensation associated with widespread misconduct in the sector. **The government therefore intends to make these compensation payments non-deductible for corporation tax purposes through legislation in a future Finance Bill.**

2.249 The government will no longer allow businesses to take account of foreign branches when calculating how much VAT on overhead costs they can reclaim in the United Kingdom. Under the current system businesses could manipulate their deductions. This measure prevents that and will ensure that all businesses in the United Kingdom pay their fair share of VAT.

Umbrella companies and employment intermediaries

2.250 Autumn Statement 2014 announced that the government would review the growing use of overarching contracts of employment that allow some temporary workers and their employers to benefit from tax relief for home-to-work travel expenses, relief not generally available to other workers. This is unfair. As a result of the review, **the government will change the rules to**

[106] Strengthening sanctions for tax avoidance, HMRC, January 2015.

restrict travel and subsistence relief for workers engaged through an employment intermediary, such as an umbrella company or a personal service company, and under the supervision, direction and control of the end-user. This will take effect from April 2016 following a consultation on the detail of the changes. It will level the playing field between employment businesses that seek to lower their costs by using these arrangements and those that do not.

2.251 Stakeholders have also raised concerns that individuals do not understand how their take-home pay is affected by these arrangements. The government wants employment intermediaries to provide workers with greater transparency on how they are employed, and what they are being paid. The Department of Business Innovation and Skills will consult on these proposals on transparency later this year.

Capital gains tax

2.252 The government is committed to supporting entrepreneurs and wants to ensure that capital gains tax entrepreneurs' relief is well targeted. The government will therefore address use of the entrepreneurs' relief rules for tax planning which is not in keeping with the policy intention. **The government will target structures set up so that people with only a small indirect stake in a trading company can benefit from the relief. The government will also ensure that entrepreneurs' relief on the disposal of personal assets used in a business is only available when someone is making a meaningful withdrawal from that business.**

Tobacco

2.253 Raw tobacco represents an increasing risk to excise duty revenues, but under current law, raw tobacco can only be seized when officers can prove an intention to fraudulently evade duty at the time of seizure. **To prevent raw tobacco being diverted into the illegal market, the government will introduce a registration scheme for users and dealers of raw tobacco before the end of 2016.**

2.254 Smoking imposes costs on society and it is fair to ask tobacco manufacturers and importers to make a greater contribution towards these costs. However it is essential that this is done in the most effective way. At Autumn Statement 2014, the government announced a consultation on a tobacco levy. The responses revealed issues that the government would like to explore further, and so the consultation will be continued informally with stakeholders in order to develop detailed policy proposals.

3 Excessive deficit procedure

3.1 The UK entered into the Excessive Deficit Procedure (EDP) under the EU's Stability and Growth Pact (SGP) following a decision by ECOFIN Council in July 2008. In November 2009, the Council made recommendations to the UK, including a target to correct its excessive deficit.

3.2 When the UK's current Parliament began in 2010, the budget deficit was over 10% of GDP – the largest deficit in post-war history as a result of the Great Recession and unsustainable pre-crisis increases in public spending. In 2010, the government set out medium-term fiscal consolidation plans to return the public finances to a sustainable path. Since then, the government's long-term economic plan has delivered the stability and security needed to build a resilient economy. The government's plan has restored fiscal credibility, allowing activist monetary policy to support the economy.

3.3 The government is making significant progress in delivering its fiscal consolidation. Public sector net borrowing as a percentage of GDP is forecast to have fallen by half by the end of 2014-15. The latest data from the IMF shows that, between 2010 and 2013, the government reduced the structural deficit by more than half. The structural deficit fell by 4.6% of GDP over this period, a larger absolute reduction than any other country in the G7.

3.4 The government is forecast to meet its new forward-looking fiscal mandate in the third year of the forecast period, which is currently 2017-18, having reduced the cyclically-adjusted current budget deficit from its peak of 4.7% of GDP in 2009-10 to 2.6% of GDP in 2013-14. The supplementary aim for public sector net debt to fall as a share of GDP in 2016-17 is forecast to be met a year early with debt falling as a share of GDP in 2015-16. This is the first time public sector net debt has been forecast to fall as a share of GDP in 2015-16 since Budget 2012.

3.5 The government remains committed to bringing the UK's Treaty deficit in line with the 3% target set out in the SGP. As Table 3.A shows, the UK is forecast to meet the EU SGP target for the Treaty deficit in 2016-17.

Table 3.A: OBR fiscal forecast on a Maastricht basis

	% of GDP						
	Outturn	Forecasts					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Deficit							
Treaty deficit[1]	5.8	5.2	4.3	2.2	0.8	0.0	-0.1
Debt							
Treaty debt[2]	87.9	88.4	88.8	88.7	87.1	84.4	81.4

[1] General government net borrowing
[2] General government gross debt on a Maastricht basis

Source: Office for Budget Responsibility

3.6 The government remains committed to restore the public finances to a sustainable position and get public sector net debt on a declining path as a share of GDP. The latest forecast from the OBR shows that the cyclically adjusted current budget will be in balance in 2017-18 and the government will run an overall surplus from 2018-19. Running a surplus will speed up the process of debt reduction, reducing the burden on taxpayers and strengthening the ability of future governments to respond to economic shocks.

3.7 Since Autumn Statement 2014, the fiscal position has improved across the forecast period. Higher receipts in 2014-15 and lower debt interest costs across the forecast period are reflected in an improved path of public sector net borrowing. Public sector net debt as a percentage of GDP is forecast to fall 1 year earlier than at Autumn Statement and therefore Total Managed Expenditure (TME) is able to grow in line with GDP in 2019-2020, when public sector net debt will fall by 3.2 percentage points of GDP.

3.8 However, external risks facing the UK have increased since Autumn Statement 2014, with continuing instability in the euro area and Ukraine.

3.9 Budget 2015 announced further detail on how the government will continue to reduce the deficit and debt beyond this Parliament. Reflecting its ongoing commitment to responsible fiscal policy and returning the public finances to a sustainable position, the government is:

- taking action to accelerate the state's exit from ownership of banks, by announcing plans to sell up to £10 billion of the taxpayer's remaining shareholding in Lloyds Banking Group over the next 12 months, continuing the progress of the last year, and launching a major sale of NRAM plc assets from what was known as Northern Rock's 'bad bank'.
- Setting out plans for continuing to reduce the deficit in the next Parliament , with £30 billion of consolidation in 2016-17 and 2017-18, and an assumption that Total Managed Expenditure will be held flat in real terms in 2018-19 and rise in line with GDP in 2019-20
- Setting out further detail on the government's aspiration to find £10 billion in further efficiency savings by 2017-18
- Transforming the management of government land and property assets, by implementing a new commercially-driven approach across the central government estate.

4 Quality of public finances

Public spending

Total Managed Expenditure

4.1 Spending in the next Parliament – In line with previous policy, the government has set a fiscal assumption that Total Managed Expenditure (TME) in 2016-17 and 2017-18 will continue to fall at the same rate as over the period 2010-11 to 2014-15. In 2018-19 TME will be held flat in real terms. In 2019-20 TME will rise in line with nominal GDP. It would, of course, be possible to do some consolidation through tax instead.

4.2 The government will continue to prioritise capital investment over the medium to longer term, so within the overall fiscal assumption, public sector gross investment (PSGI) will be constant in real terms in 2016-17 and 2017-18 and will grow in line with GDP from 2018-19.

Table 4.A: Total Managed Expenditure[1]

	£ billion					
	2014-15	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
CURRENT EXPENDITURE						
Resource AME	332.5	335.7	347.0	361.5	375.5	389.7
Resource DEL, excluding depreciation	315.6	316.3				
Ring-fenced depreciation	21.3	22.3				
Implied Resource DEL, including depreciation[2]			*323.8*	*312.0*	*310.1*	*330.4*
Public sector current expenditure	**669.3**	**674.3**	**670.9**	**673.4**	**685.6**	**720.1**
CAPITAL EXPENDITURE						
Capital AME	22.2	20.6	21.7	21.6	21.2	21.5
Capital DEL	45.6	47.7				
Implied Capital DEL[2]			*47.7*	*48.9*	*52.4*	*55.7*
Public sector gross investment[3]	**67.8**	**68.3**	**69.4**	**70.5**	**73.6**	**77.2**
TOTAL MANAGED EXPENDITURE[4]	**737.1**	**742.6**	**740.3**	**743.9**	**759.2**	**797.3**
Total Managed Expenditure (% GDP)	40.7%	*39.6%*	*38.1%*	*36.8%*	*36.0%*	*36.0%*

Memo: average annual real growth in Total Managed Expenditure (2010-11 to 2014-15): -1.1%

[1] Budgeting totals are shown including the OBR's forecast Allowance for Shortfall. Resource DEL excluding ring-fenced depreciation is the Treasury's primary control within resource budgets and is the basis on which Spending Review settlements are agreed. The OBR publishes public sector current expenditure in DEL and AME, and public sector gross investment in DEL and AME. A reconciliation is published by the OBR. All totals in this table take into account Budget 2015 spending policy decisions.

[2] Implied DELs beyond 2015-16 assume no future policy changes to AME. Departmental budgets will be set at the next Spending Review.

[3] The PSGI growth rule is applied to a 2015-16 baseline which includes the OBR's forecast Allowance for Shortfall and excludes the effect of all policy measures announced at Autumn Statement 2013, Budget 2014, Autumn Statement 2014 and Budget 2015. Following the application of the PSGI growth rule, PSGI has from 2016-17 onwards been adjusted to take account of the same measure as at Autumn Statement 2014.

[4] The 2010-11 baseline for calculating the TME growth rule excludes in-year spending reductions announced at June Budget 2010 and departmental underspends against 2010-11 plans, but includes an estimate for the outturn effect of classification changes pre-empted by the OBR at Budget 2015. The 2014-15 baseline for calculating the TME growth rule excludes the OBR's forecast Allowance for Shortfall. The TME growth rule is applied to a 2015-16 baseline which excludes the OBR's forecast Allowance for Shortfall and the effect of all policy measures announced at Autumn Statement 2013, Budget 2014, Autumn Statement 2014 and Budget 2015. Following the application of the TME growth rule, TME from 2016-17 onwards has been adjusted to take account of the same measures as at Budget 2014 and Autumn Statement 2014. The effects of the historic adjustments to the UK's GNI-based contributions to the EU, and further anticipated GNI adjustments, and associated rebates, are excluded from the calculation of the TME growth rule. The effects of the reclassification of Multilateral Development Bank loans, pre-empted by the OBR at Budget 2015, are also excluded from the calculation of the TME growth rule.

Implied Departmental Expenditure Limits

4.3 The government's fiscal assumption for the years 2016-17 to 2019-20, combined with the OBR's forecast for Annually Managed Expenditure (excluding AME policy decisions in this Budget) and the PSGI assumption gives a projection for implied DEL including depreciation. The reductions to the OBR's AME forecast since Autumn Statement 2014 result in an increase in the projection for implied DEL. Table 4.B sets out a comparison of the Budget projection for implied DEL including depreciation with the Autumn Statement projection and the cost of all spending policy decisions in this Budget.

Table 4.B: Implied DEL

	2016-17	2017-18	2018-19	2019-20
Autumn Statement 2014 implied DEL, including depreciation[1]	368.7	357.8	357.4	357.5
Budget 2015 implied DEL, including depreciation[1,2]	371.9	361.4	363.2	387.0
Increase in implied DEL, including depreciation[2]	*3.1*	*3.6*	*5.8*	*29.6*
Spending policy decisions:				
Mental Health	-0.3	-0.3	-0.3	-0.3
Help to Buy: ISA	-0.2	-0.4	-0.6	-0.8
Other spending policy decisions	-0.2	-0.3	-0.2	-0.2
Illustrative increase in implied DEL, including depreciation, after Budget 2015 spending policy decisions[3]	*2.4*	*2.6*	*4.7*	*28.2*

[1] Implied DEL is implied Resource DEL plus implied Capital DEL. Departmental budgets will be set at the next Spending Review. Implied DELs beyond 2015-16 assume no future policy changes to AME (including welfare spending) or tax (including measures to tackle avoidance and evasion) which all else equal would feed through to a change in implied DEL due to the government's fiscal assumption for the years beyond 2015-16.

[2] This does not take into account Budget 2015 AME policy decisions.

[3] This is the illustrative increase in implied DEL net of all DEL and AME policy decisions announced at Budget 2015.

Departmental Expenditure Limits

4.4 Table 4.C shows departmental expenditure limits (DEL) as announced at Spending Review 2010 and Spending Round 2013, and subsequently adjusted for measures at fiscal events including the policy decisions contained in this Budget.

4.5 Departments remain ahead of their consolidation targets and are forecast to underspend by £3.5 billion in 2014-15. Underspends are forecast to continue into 2015-16, the final year for which departmental budgets have been set.

Other information

4.6 Other information relevant to the quality of public finances is presented in Chapter 2:

- Paragraphs 2.42 - 2.89 deal with deficit reduction;
- Paragraphs 2.238 – 2.246 cover ensuring a fair contribution through the tax system; and
- Paragraphs 2.247 – 2.254 deal with ensuring a fair contribution from business and individuals.

Table 4.C: Departmental Expenditure Limits

	£ billion	
	Estimate 2014-15	Plans 2015-16
Departmental Programme and Administration Budgets (Resource DEL excluding depreciation[1])		
Education	52.6	53.5
NHS (Health)[2]	109.3	111.8
Transport	2.5	2.4
CLG Communities	2.2	2.7
CLG Local Government	13.7	10.5
Business, Innovation and Skills	13.7	13.4
Home Office	11.2	10.3
Justice	7.1	6.4
Law Officers' Departments	0.6	0.5
Defence[3]	26.7	28.4
Foreign and Commonwealth Office	1.7	1.1
International Development	7.3	8.4
Energy and Climate Change	1.4	1.4
Environment, Food and Rural Affairs	1.7	1.7
Culture, Media and Sport	1.2	1.2
Work and Pensions	6.9	6.4
Scotland[4]	25.7	25.5
Wales[5]	13.8	12.9
Northern Ireland	9.7	9.8
Chancellor's Departments	3.4	3.5
Cabinet Office	2.4	2.2
Small and Independent Bodies	1.7	1.5
Reserve	0.0	1.9
Special Reserve	0.0	0.2
Adjustment for Budget Exchange[6]	0.0	-0.5
Total Resource DEL excluding depreciation plans	**316.5**	**316.9**
OBR allowance for shortfall	*-0.9*	*-0.6*
OBR Resource DEL excluding depreciation forecast	***315.6***	***316.3***
Capital DEL		
Education	4.3	4.9
NHS (Health)[2]	4.0	4.8
Transport	9.4	9.7
CLG Communities	4.6	5.3
CLG Local Government	0.0	0.0
Business, Innovation and Skills	2.2	4.0
Home Office	0.4	0.4
Justice	0.3	0.3
Law Officers' Departments	0.0	0.0
Defence[3]	7.8	7.0
Foreign and Commonwealth Office	0.2	0.1
International Development	2.4	2.6
Energy and Climate Change	2.3	2.6
Environment, Food and Rural Affairs	0.6	0.5
Culture, Media and Sport	0.3	0.4
Work and Pensions	0.2	0.2
Scotland[7]	3.5	3.1
Wales[7]	1.5	1.5
Northern Ireland[7]	1.1	1.1
Chancellor's Departments	0.3	0.1
Cabinet Office	0.4	0.4
Small and Independent Bodies	0.1	0.1
Reserve	0.0	0.9
Special Reserve	0.0	0.1
Adjustment for Budget Exchange[6]	0.0	-1.9
Total Capital DEL plans	**45.9**	**48.2**
OBR allowance for shortfall	*-0.3*	*-0.5*
OBR Capital DEL forecast	***45.6***	***47.7***

[1] Resource DEL excluding ring-fenced depreciation is the Treasury's primary control total within resource budgets and the basis on which Spending Review settlements were made.

[2] The health budget remains projected to grow in real terms from 2014-15 to 2015-16.

[3] The defence budget for 2015-16 reflects the likely initial drawdown of funding from the Special Reserve for the net additional cost of military operations at Main Estimates.

[4] The Scottish block grant has been adjusted to reflect the devolution of SDLT and Landfill Tax with effect from 1st April 2015

[5] Welsh business rates score as AME rather than DEL from 2015-16

[6] Departmental budgets in 2015-16 include amounts carried forward from 2014-15 through Budget Exchange, which will be voted at Main Estimates. These increases will be offset at Supplementary Estimates in future years so are excluded from spending totals.

[7] Borrowing by Devolved Administrations scores as AME

5 Institutional features of public finances

The fiscal policy framework

5.1 June Budget 2010 set out comprehensive policies to bring the public finances back under control. This action involved substantial fiscal framework reform, including:

- the creation of the new Office for Budget Responsibility (OBR), introducing independence, greater transparency and credibility to the economic and fiscal forecasts on which the government's fiscal policy is based
- the announcement of a clear, forward-looking fiscal mandate and a supplementary target for debt to guide fiscal policy decisions over the medium term; these were revised in the update to the Charter for Budget Responsibility approved by Parliament on 13 January 2015[1]

Office for Budget Responsibility

5.2 The government's fiscal policy decisions are based on the independent forecasts of the economy and public finances, prepared by the OBR. Since the general election in May 2010, the OBR has produced all the official forecasts of the economy and public finances, independently of ministers.

5.3 The government established the OBR on an interim basis on 17 May 2010. Since then the OBR has been placed on a permanent, statutory footing through the Budget Responsibility and National Audit Act 2011 (the Act), which received Royal Assent on 22 March 2011.

5.4 The OBR is comprised of the Chair of the OBR and 2 other members of the Budget Responsibility Committee (BRC), and at least 2 non-executive members. It is supported by a civil service staff.

5.5 The 3 BRC members: Robert Chote (Chair of the OBR), Steve Nickell and Graham Parker were appointed by the Chancellor in October 2010, with the approval of the Treasury Select Committee. Steve Nickell was re-appointed for a second term of office in October 2013 and in October 2014 the Chancellor also re-appointed Graham Parker. The non-executive members: Lord Burns and Kate Barker were appointed by the Chancellor in June 2011. In June 2014 Kate Barker was re-appointed to serve a second term of office.

Remit of the OBR

5.6 The main duty of the OBR is to examine and report on the sustainability of the public finances. This duty feeds directly into the Treasury's fiscal objective to deliver sound and sustainable public finances.

5.7 As set out in the Act, the OBR's responsibilities include:

- the production of at least 2 fiscal and economic forecasts each financial year, including independent scrutiny of the impact of policy measures and any resultant impact on the forecasts

[1] 'Charter for Budget Responsibility: Autumn Statement 2014 update', HM Treasury, December 2014.

- an assessment of the extent to which the fiscal mandate has been, and is likely to be, achieved alongside these forecasts
- an assessment on the accuracy of the previous fiscal and economic forecasts at least once each financial year
- an analysis of the sustainability of the public finances at least once each financial year

5.8 This remit provides for the OBR to investigate the impact of trends and policies on the public finances from a multitude of angles including through forecasting, long-term projections and balance sheet analysis. The OBR must perform its duty objectively, transparently and impartially and on the basis of government policy. This protects the independence of the OBR and ensures a clear separation between analysis (which is the role of the OBR) and policy making (which is the responsibility of ministers). The OBR has complete discretion in the performance of its duty subject to its statutory obligations.

Transparent framework

5.9 To ensure credibility of the fiscal framework and protect the independence of the OBR it is vital for there to be transparency in the responsibilities of the OBR and the rest of government. To support and clarify the provisions in the Act, there are a number of documents that seek to achieve this.

5.10 The Charter for Budget Responsibility provides guidance to the OBR in line with, and in support of, the provisions in the Act. This guidance helps to explain the role of the OBR within the fiscal framework and provide greater clarity as to the OBR's duty to independently examine and report on the sustainability of the public finances.

5.11 For the OBR to perform its duties accurately and efficiently, close working with the rest of government is essential. A Memorandum of Understanding established a transparent framework for cooperation between the OBR and the Treasury, as well as other parts of government that the OBR needs to work closely with to perform its forecasting and analytical duties.

5.12 The OBR is accountable to Parliament and the Chancellor for the analysis it produces and the way it uses public funds. A framework document sets out the broad governance and management framework within which the OBR operates.

Fiscal objectives

5.13 To promote transparent fiscal policy-making, the new fiscal policy framework, established by the Act, introduced a requirement for the government to set out its fiscal policy objectives and fiscal mandate before Parliament in the Charter for Budget Responsibility.

5.14 The government's fiscal policy objectives, presented in the Charter, are to:

- ensure sustainable public finances that support confidence in the economy, promote intergenerational fairness, and ensure the effectiveness of wider government policy
- support and improve the effectiveness of monetary policy in stabilising economic fluctuations

The fiscal mandate and supplementary target for debt

5.15 The Budget Responsibility and National Audit Act 2011 also requires the government to set a means to achieving its fiscal objectives, its "fiscal mandate". In the June 2010 Budget, the

government set out a forward-looking fiscal mandate to achieve cyclically-adjusted current balance by the end of the rolling, 5-year forecast period. In the update to the Charter, approved by Parliament on 13 January 2015, the fiscal mandate was revised, shortening the period to achieve cyclically-adjusted current balance to the third year of the 5-year forecast period. At Budget 2015, the end of the forecast period was 2019-20.

5.16 The fiscal mandate is based on:

- the current balance, to protect the most productive investment expenditure
- a cyclically-adjusted aggregate, to allow some fiscal flexibility at times of economic uncertainty
- a target of 3 years ahead, rather than 5 years, reflecting the progress achieving in tackling the deficit, which means the mandate can be safely shortened to create a tighter constraint on future fiscal policy choices

5.17 The fiscal mandate is supported by a supplementary target for debt that requires public sector net debt as a percentage of GDP to be falling at a fixed date of 2016-17, ensuring that the public finances are restored to a sustainable path.

5.18 Complementing the fiscal framework, in Spending Review 2013, the government announced that a cap on welfare spending would be announced to improve spending control. The OBR assesses the government's performance against the welfare cap once a year alongside Autumn Statement. To support transparency and public scrutiny, the OBR also reports annually on trends in and drivers of welfare expenditure in the scope of the cap.

5.19 The welfare cap was included in an updated Charter for Budget Responsibility and a motion for approval before Parliament on 19 March 2014. This motion was approved by the House of Commons on 26 March 2014.

Accounting and statistics

5.20 The independent Office for National Statistics and HM Treasury compile monthly statistics for the public sector and sub-sectors, on both a cash and accrued basis. Reconciliation tables between these are produced. The production is guided by the UK's code of practice which is consistent with the United Nations Fundamental Principles of Official Statistics and the European Statistics Code of Practice.

5.21 Information on the UK's contingent liabilities is published for all central government departments. The publication of the first audited 'Whole of Government Accounts' (WGA), based on International Financial Reporting Standards, extends the coverage across government for the year ending 31 March 2010. A summary of publicly available information on contingent liabilities is also published in the OBR's annual 'Fiscal sustainability report'.

5.22 WGA is a full accruals based set of accounts covering the whole public sector and audited by the National Audit Office. WGA is a consolidation of the accounts of around 1,500 organisation across the public sector, including central government departments, local authorities, devolved administrations, the health service, and public corporations.

A OBR analysis

A.1 This annex contains analysis prepared by the Office for Budget Responsibility (OBR). The first 3 pieces of analysis included are Chapters 3, 4 and 5 of the OBR's March 2015 'Economic and fiscal outlook'. They cover, in turn, the economic outlook, the fiscal outlook, and the performance against the government's fiscal targets. The final part of this annex is the executive summary of the OBR's 2014 'Fiscal sustainability report'.

3 Economic outlook

Introduction

3.1 This chapter:

- sets out our estimates of the amount of spare capacity in the economy and the likely growth in its productive potential (from paragraph 3.2);
- describes the key conditioning assumptions for the forecast, including monetary policy, fiscal policy, credit conditions and the world economy (from paragraph 3.21);
- sets out our short- and medium-term real GDP growth forecasts, as spare capacity is brought back into productive use (from paragraph 3.41) and the associated outlooks for inflation (from paragraph 3.54) and nominal GDP (from paragraph 3.69);
- discusses recent developments and prospects for the household, corporate, government and external sectors of the economy (from paragraph 3.74); and
- outlines risks and uncertainties (from paragraph 3.111) and compares our central forecast to those of selected external organisations (from paragraph 3.113).

Potential output and the output gap

3.2 Judgements about the amount of spare capacity in the economy (the 'output gap') and the growth rate of potential output provide the foundations for our forecast. Together they determine the scope for growth in GDP as activity returns to a level consistent with maintaining stable inflation in the long term.

3.3 Estimating the size of the output gap allows us to judge how much of the budget deficit at any given time is cyclical and how much is structural.[1] In other words, how much will disappear automatically, as the recovery boosts revenues and reduces spending, and how much will be left when economic activity has returned to its full potential. The narrower the output gap, the larger the proportion of the deficit that is structural, and the less margin the Government will have against its fiscal mandate, which is set in structural terms.

3.4 In this section, we first assess how far below potential the economy is currently operating before considering the pace at which potential output will grow in the future.

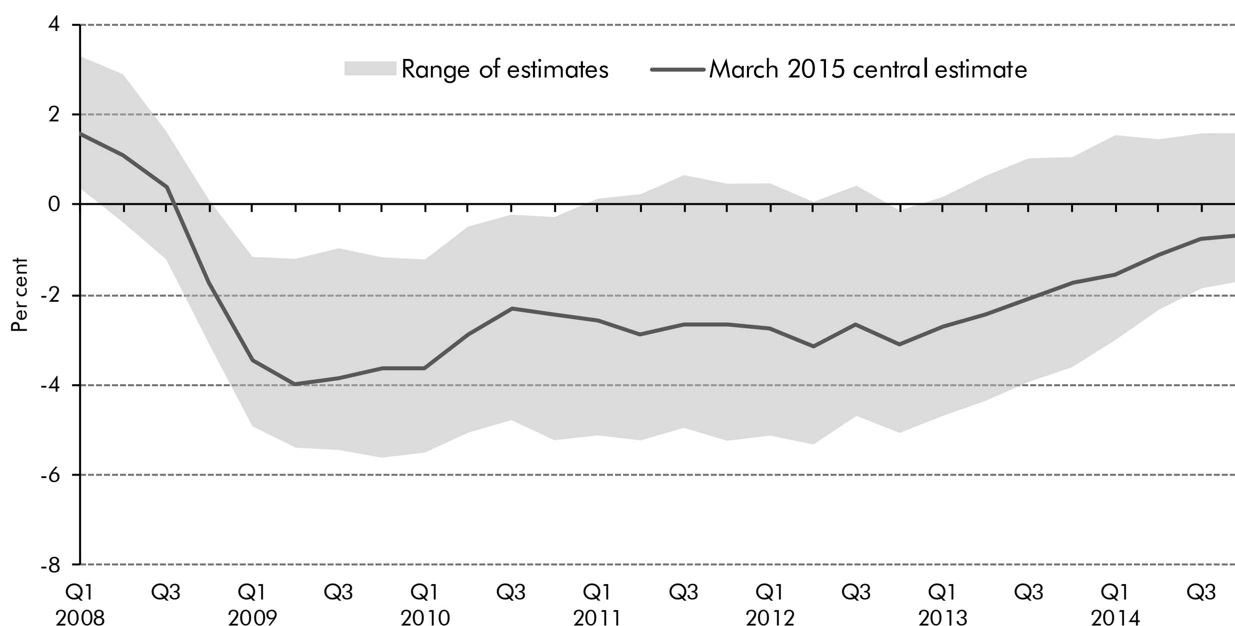
[1] The methodology we use to do so is described in Helgadottir *et al* (2012): *Working Paper No.3: Cyclically adjusting the public finances*.

The latest estimates of the output gap

3.5 The first step in our forecast process is to assess how the current level of activity in the economy compares with the potential level consistent with stable inflation in the long term. We cannot measure the supply potential of the economy directly, but various techniques can be used to estimate it indirectly, including cyclical indicators, statistical filters and production functions. In practice, every method has its limitations and no approach entirely avoids the application of judgement. We therefore consider a broad set of evidence when reaching a judgement on spare capacity.

3.6 Chart 3.1 shows a range of estimates of the output gap implied by nine different techniques, as well as our own latest central estimates.[2] All of these estimates showed spare capacity increasing during the course of the late 2000s recession, and the range between them increased. The swathe remained relatively stable until early 2013 when actual growth picked up. Most estimates have since narrowed, but the range remains wide. In the fourth quarter of 2014, the estimates vary from -1.7 to +1.6 per cent. But even this range may understate the degree of uncertainty, as such estimates are likely to change as new data become available and past data are revised.

Chart 3.1: Range of output gap model estimates



Source: OBR

3.7 The cyclical indicators approaches that we previously placed greatest emphasis upon implied that the output gap began to narrow in 2012, even though growth remained relatively weak. 'Aggregate composite' (AC) estimates imply that spare capacity continued to be used up at pace, and that output moved above its sustainable level towards the end of

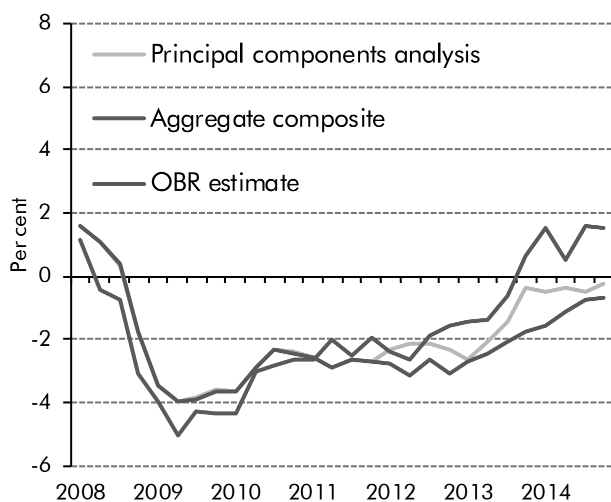
[2] The individual output gap estimates are included in the supplementary economy tables available on our website. The approaches – and the uncertainties associated with them – are discussed in Murray (2014): *Working Paper No.5: Output gap measurement: judgement and uncertainty*.

2013. 'Principal components analysis' (PCA) estimates also suggest a significant narrowing of the gap through 2013, but with the gap remaining stable, and slightly negative, through 2014.[3]

3.8 Chart 3.3 shows the disaggregated PCA series underlying the headline indicator. The PCA model varies the weights on the various indicators such that more weight is placed on those that move together and less on those that appear to be outliers. The AC weights are imposed using sector and income shares. It appears that:

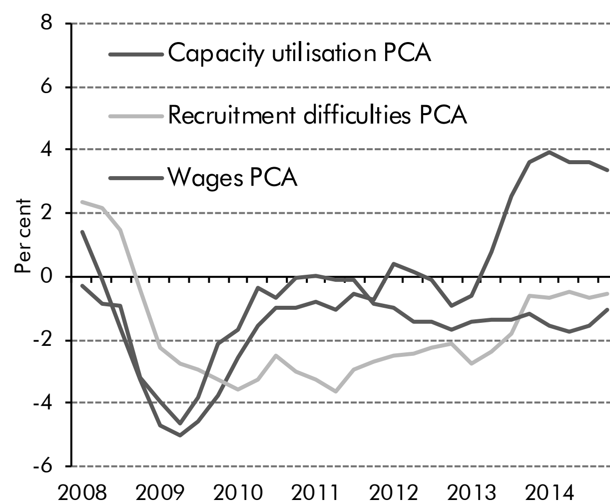
- PCA estimates are increasingly downplaying capacity utilisation indicators that suggest firms are operating at levels associated with significant overheating. These retain a higher weight in our AC estimates, based on the profit share of GDP;
- firms experienced greater recruitment difficulties through 2013, but the aggregate position has remained reasonably stable since – although there are signs of emerging skill shortages in some areas. Our PCA estimates currently place a high weight on recruitment difficulties indicators and so follow a similar path; and
- growth in the real product wage remains low, mainly reflecting the ongoing weakness of productivity growth. We judge that this has been a largely structural phenomenon, rather than indicating scope for further catch-up growth.

Chart 3.2: Cyclical-indicator-based estimates of the output gap



Source: OBR

Chart 3.3: Principal component subsets



3.9 CPI inflation was lower than expected in December, which could in principle suggest more slack in the economy. But we do not consider that likely, since the decline in recent months largely reflects lower food and petrol prices, and the effects of sterling appreciation. The unemployment rate has continued to drop at a steady pace, falling to 5.7 per cent in the

[3] More details are set out in our *Briefing Paper No.2: Estimating the output gap* and in Pybus (2011): *Working Paper No.1: Estimating the UK's historical output gap*.

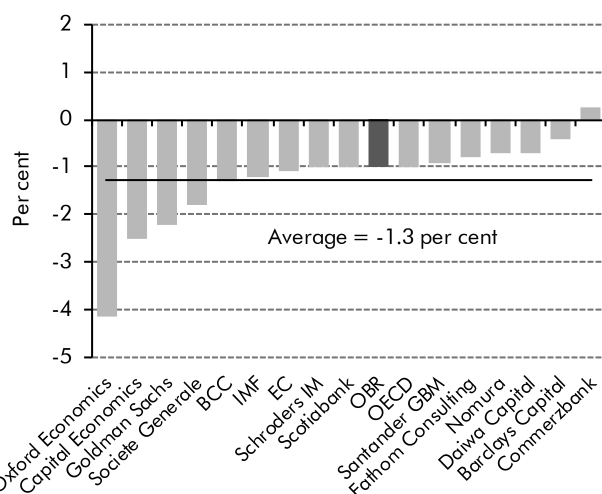
final quarter of 2014, in line with our December forecast. But, contrary to our expectations, the participation rate has also fallen, as has hourly productivity.

3.10 Considering the balance of evidence, we now judge that the output gap was 0.1 percentage point wider in the fourth quarter of 2014 than we forecast in December, at -0.7 per cent of potential output. This is in line with GDP growth also being 0.1 percentage point lower than forecast in the fourth quarter.

3.11 Of that -0.7 per cent output gap, we attribute -0.3 percentage points to the unemployment rate lying above its sustainable rate and a further -0.2 percentage points to the activity rate lying below its potential. Average hours worked exhibit a declining trend over the long term, but have risen since mid-2011. This may reflect unexpectedly weak income growth and negative wealth shocks for many households, leading them to increase their labour market input. Much of the shock to incomes is expected to be permanent, in which case it is unlikely that average hours will resume their long-term decline quickly. We therefore assume that trend average hours have been flat since the start of the recession, which still implies a positive average hours gap of 1.5 percentage points. This is offset by output-per-hour currently lying 1.6 percentage points below our estimate of its potential (i.e. cyclical weakness in actual productivity on top of the large structural shortfall that built up during and since the late 2000s financial crisis).

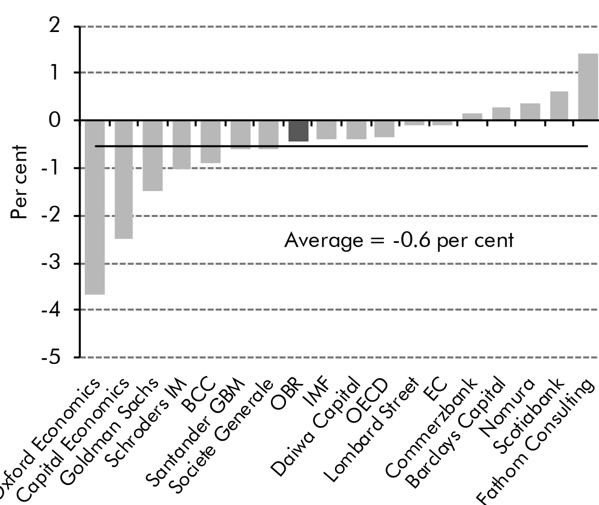
3.12 Charts 3.4 and 3.5 compare our central output gap estimates for 2014 and 2015 to those produced by other forecasters, as set out in the Treasury's February and March *Comparison of independent forecasts*. The average estimate is -1.3 per cent in 2014 and -0.6 per cent in 2015, only slightly wider than our central estimates of -1.0 per cent for 2014 and -0.5 per cent for 2015. However, due to the skew of the distribution, the median estimates are closer still, at -1.1 per cent and -0.4 per cent for 2014 and 2015 respectively.

Chart 3.4: Estimates of the output gap in 2014



Source: HM Treasury, plus updates where known

Chart 3.5: Estimates of the output gap in 2015



The growth of potential output

3.13 In our December *EFO*, we forecast a gradual strengthening of potential output growth over the forecast period and that remains our central judgement. But that outcome depends on the most important uncertainty in our (and most people's) economic forecast: the timing and strength of the long-awaited return to sustained productivity growth. The effects of significantly lower oil prices on potential output add a new source of uncertainty in this forecast, as do the relatively large shifts in net migration seen in recent quarters.

3.14 The growth of potential productivity per hour remains below its historical average throughout the forecast. That reflects our view that the slow pace of financial system normalisation and the related pace at which resources are reallocated to more productive uses will continue to weigh on the sustainable rate of growth – by diminishing amounts – for some years. But since it is difficult to explain the abrupt fall and persistent weakness of productivity in recent years, it is also hard to judge when or if productivity growth will return to its historical average.[4]

3.15 Actual hourly productivity growth has again been weaker than expected, with a fall in the final quarter of 2014 and a rise of only 0.2 per cent on the year. This suggests productivity growth might remain subdued for longer. But, looking ahead, lower oil prices should encourage additional non-oil business investment and hence the accumulation of capital, which would provide a small boost to productivity growth of around ¼ per cent (Box 3.1). We consider the downside news over the recent past and the potential upside from lower oil prices to be broadly offsetting, leading to an unchanged forecast for potential productivity growth.

3.16 We continue to expect population growth to slow and the potential employment rate to drift down over the medium term as the population ages. (This downward drift is due to the proportion of older people with lower-than-average employment rates increasing, which outweighs the effect of age-specific employment rates at older ages rising.) But we have made some changes to the population and employment rate assumptions underpinning our potential output growth forecast.

3.17 Net migration in the year to September 2014 rose to 298,000, up from 210,000 in the year to September 2013. Our previous forecasts have been underpinned by the assumption in the ONS low migration population projections that net migration will move towards 105,000 a year by mid-2019. A reduction over time seems consistent with the international environment and with the Government's declared efforts to reduce it. But in light of recent evidence, it no longer seems central to assume it will decline so steeply. So we now assume that net migration flows will tend towards 165,000 in the long term, consistent with the ONS principal population projections. Relative to our December forecast, this raises potential output growth by 0.5 per cent over the forecast period via 16+ population growth.

[4] In Chapter 5 of our December 2014 *Economic and fiscal outlook* we presented two scenarios that considered the implications of productivity growth remaining stuck at the low levels of recent years and of growth rebounding in line with the strongest UK performance of recent decades.

3.18 The age structure of inward migrants is skewed towards those of working age (see Chart 4.1 in Chapter 4), which implies that the effects on employment will be slightly bigger than on population growth. We have assumed that, conditional on age and gender, migrants are as likely as the broader population to be employed. Relative to our December forecast, this raises potential output by a further 0.1 per cent, which means that potential output growth has been revised up 0.6 per cent in total by the end of the forecast period. Output per worker is not affected by these changes, although GDP per capita is raised fractionally due to the higher employment rate.

Table 3.1: Potential output growth forecast

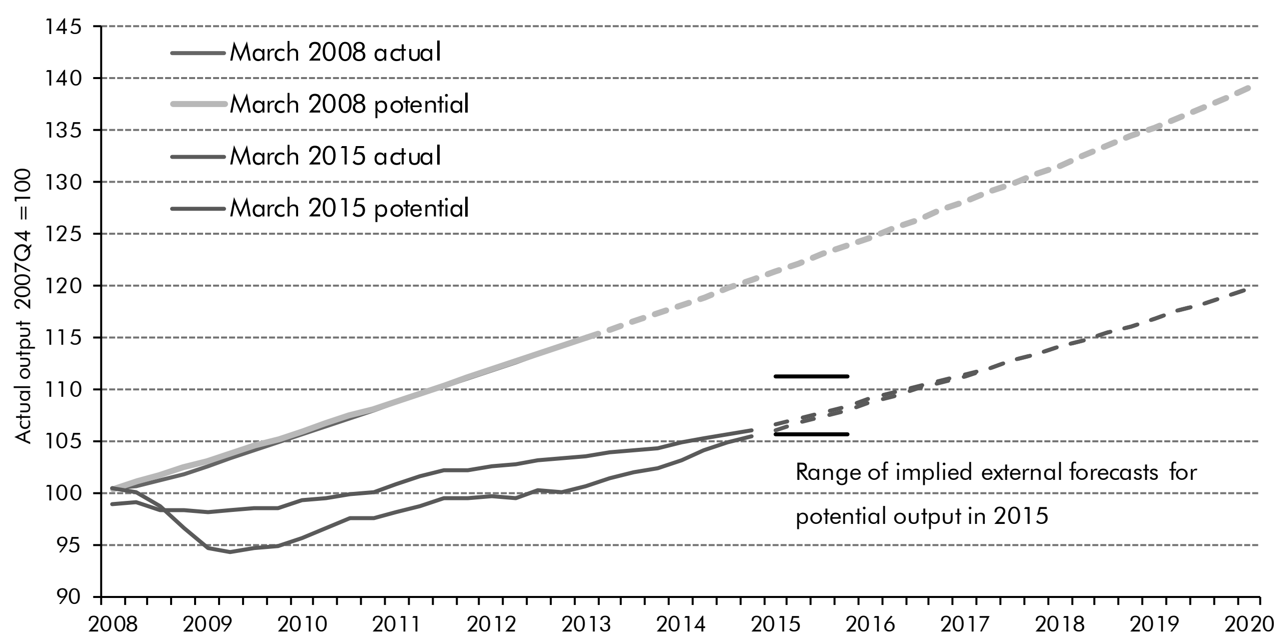
	Annual growth rate (per cent)				
	Potential productivity[1]	Potential average hours	Potential employment rate[2]	Potential population[2]	**Potential output[3]**
2015	1.4	0.0	0.0	0.6	2.0
2016	1.7	-0.1	0.0	0.6	2.2
2017	1.9	-0.2	0.0	0.6	2.3
2018	2.0	-0.2	0.0	0.5	2.4
2019	2.1	-0.2	0.0	0.6	2.5
2015-2019 average					
December forecast	1.8	-0.1	-0.1	0.5	2.2
March forecast	1.8	-0.1	0.0	0.6	2.3
Change	0.0	0.0	0.0	0.1	0.1

[1] Output per hour.
[2] Corresponding to those aged 16 and over.
[3] Components may not sum to total due to rounding.

3.19 Our latest forecast assumes that potential output was almost 11 per cent lower than an extrapolation of the Budget 2008 forecast by 2013-14 and that it will be almost 14 per cent below that extrapolation by 2019-20. This is little changed since December. Outturn estimates of actual output growth have been revised down for 2014, which implies an equal downward revision to potential output given that we assume that the output gap is essentially unchanged over that period. But this downward revision is offset over the forecast period by our assumption of higher net migration.

3.20 Even the most optimistic external assessments of potential output continue to lie well below the pre-crisis trend implied by Budget 2008. The range presented in the chart illustrates some of the uncertainty surrounding this crucial judgement – we test the sensitivity of the Government's fiscal mandate to it in Chapter 5.

Chart 3.6: Potential output forecasts



Source: HM Treasury, ONS, OBR

Box 3.1: Oil prices and the economy

Since our December forecast, sterling oil prices have fallen significantly. We now expect the sterling oil price to average £36 a barrel in the first quarter of this year – around 30 per cent lower than the level implied by our December forecast. By the end of the forecast period, sterling oil prices are 17 per cent lower in this forecast than was the case in December. There are a number of channels by which this decline is likely to affect prospects for GDP growth in the UK:

- the fall in consumer prices will increase households' real income, which is likely to feed through to higher real consumption;
- lower energy-related production costs and stronger domestic demand may support business investment and capital accumulation;
- UK trade tends to be more heavily weighted to oil importers than to oil exporters, so a boost to real consumption in those economies may support demand for UK exports; and
- lower oil prices make the North Sea less profitable, which is likely to reduce production, exports and investment by oil and gas extraction companies.

As a net oil importer, a fall in the oil price would be expected to have a positive net effect on UK GDP. A number of factors will affect the size of this boost. For example, a temporary oil price change would be expected to have a smaller effect than a permanent change because its effects would also be expected to be temporary. The response of the economy will also depend on the extent to which the oil price change reflects the influence of supply or demand: if lower oil prices primarily reflect weaker world demand, then an associated reduction in UK export growth may partially offset any improvement in real incomes. Disentangling the role of supply and demand in the recent decline in the oil price is difficult, although most analysis points to a role for both

factors. See Box 2.1 for further discussion.

Empirical studies point to a wide range of possible effects of oil price changes on UK GDP:

- using data since 1984, Blanchard and Gali (2007)[a] find that an increase in oil prices of 10 per cent reduces UK output by around 0.5 per cent;
- simulations produced by the National Institute for Economic and Social Research (NIESR) suggest that a permanent reduction in the oil price of $20 a barrel – a reduction of around 20 per cent relative to NIESR's baseline – could lead to a permanent increase in the level of UK GDP of around 0.5 per cent.[b] A temporary shock would have a much more modest effect, increasing GDP growth by 0.1 percentage points in the near term, but reducing GDP growth after two years as interest rates are assumed to rise in response to the increase in the oil price to previous levels;
- recent simulations by the Bank of England[c] using COMPASS (the Bank's central forecasting model), indicate that a 10 per cent fall in oil prices could raise the level of GDP by around 0.1 per cent after two years, with the increase in demand mainly resulting from higher real wages;
- Millard and Shakir (2013)[d] find that the effect of an oil price shock on UK GDP depends both on the source of the shock and the time period over which the effect is estimated. Based on the period from 1976 to 2011, a 10 per cent increase in the oil price that is entirely driven by weaker supply would be expected to reduce GDP by 0.12 per cent, while a world-demand driven increase in the oil price of the same magnitude would be expected to increase UK GDP by around 0.03 per cent. The size of the GDP effect is even smaller when estimated over a more recent sample period; and
- in 2010, the interim OBR set out an assessment of the effect of oil price fluctuations on the economy and public finances.[e] A permanent 20 per cent increase in the real oil price was assumed to reduce GDP by around ½ per cent, although this estimate did not incorporate any offsetting effect on North Sea output, and was based on the assumption that any effect of oil prices on potential output would occur relatively quickly. We expect the fall in the oil price to provide a small boost to productivity growth of around ¼ per cent. This is smaller than was assumed in the interim OBR study, and reflects an assumption that any effect on potential output from stronger capital accumulation will build relatively slowly. For this forecast we have also incorporated the effect of lower oil prices on North Sea production, which is expected to reduce GDP by 0.3 per cent by the end of the forecast period, part of which we expect to be offset by measures announced in the Budget (see Box 3.2).

[a] Blanchard, O and Gali, J, *The Macroeconomic Effects of Oil Price Shocks: Why are the 2000s so different from the 1970s?*, NBER Working Paper No. 13368, NBER, September 2007.
[b] Kirby, S and Meaning, J, *Oil Prices and Economic Activity*, National Institute Economic Review, February 2015.
[c] Bank of England, *Inflation Report*, February 2015.
[d] Millard, S and Shakir, T, *Oil shocks and the UK economy: the changing nature of shocks and impact over time*, Bank of England Working Paper No. 476, August 2013.
[e] Office for Budget Responsibility, *An Assessment of the Effect of Oil Price Fluctuations on the Public Finances*, September 2010.

Key economy forecast assumptions

Monetary and macro-prudential policy

3.21 Our forecast assumes that the Bank of England will try to bring inflation back to target over its forecast horizon, consistent with the Monetary Policy Committee (MPC) remit set by the Chancellor. In its February 2015 *Inflation Report*, the MPC forecast – on the basis of market interest rate expectations at the time – that CPI inflation would reach 1.96 per cent by the beginning of 2017 and 2.15 per cent by early 2018. In terms of forward guidance on policy, the MPC's expectation was that "*conditional on interest rates following the path currently implied by market yields, it was likely that slack in the economy would be absorbed and inflation would return to the 2 per cent target within two years*".

3.22 Since our December forecast, there have been no new announcements on macro-prudential policy, but the Bank of England has published its December *Financial Stability Report (FSR)*. That contained an update on progress towards previously announced recommendations and the results of recent commercial bank stress tests. The Bank argued that there had been sufficient progress on the four recommendations made in their June *FSR* (see paragraph 3.22 of our December 2014 *EFO*). The stress tests concluded that "*no system-wide, macro-prudential actions on bank capital are needed given the results of those tests, the capital plans agreed by banks with the PRA Board, and given that the banking system is on the transition path to meet higher standards of loss absorbing capacity.*"

Fiscal policy and Budget measures

3.23 Applying the multipliers we have used in previous forecasts to the latest estimates of the size and composition of the fiscal consolidation produced by the Institute for Fiscal Studies would suggest that it had reduced the level of GDP by around 1.5 per cent in 2013-14. They implied a positive impact on GDP growth of 0.3 per cent in 2014-15, as the effects of previous tightening fade a little faster than new tightening bears down on GDP. Needless to say, there is huge uncertainty around the size of fiscal multipliers and their speed of decay.

3.24 As set out in Box 3.2, the net effect on GDP of measures announced in Budget 2015 is expected to be small.

Box 3.2: The economic effects of policy measures

This box considers the possible effects on the economy of the policy measures announced in Budget 2015. More details of each measure are set out in the Treasury's Budget document. Our assessment of their fiscal implications can be found in Chapter 4 and Annex A.

The Government has announced a number of **policy measures** taking effect between 2015-16 and 2019-20 that are expected to have a broadly neutral fiscal impact overall, with 'giveaways' offsetting 'takeaways' over this period. Using the same multipliers that the interim OBR used in June 2010, these measures are expected to have a negligible effect on annual GDP growth and have no effect on our GDP forecast. Given the relatively small size of these measures, using

larger multipliers would not change this conclusion.

The Government has revised its assumption for the **growth of total managed expenditure** (TME) between 2016-17 and 2019-20, which has a material effect in 2019-20. TME is now assumed to grow in line with nominal GDP in that year, rather than being held flat in real terms. Within total spending, the change in the assumption implies a significant upward revision to the path of nominal government consumption in 2019, which is now forecast to grow by 5.0 per cent in that year, rather than falling 0.7 per cent in our December forecast. As a result, government consumption is now expected to remain broadly flat as a share of GDP between 2018 and 2019, rather than continuing to decline. At that time horizon, we have assumed this change affects the composition of real GDP rather than the level, as monetary policy is assumed to determine the overall amount of spending in the economy. But we have assumed that this adds around 0.6 percentage points to growth in the GDP deflator and nominal GDP in that year via its effect on the government consumption deflator.

The Government has announced a number of **measures that will directly affect inflation**. This includes a 2 per cent reduction in duty on most beer, cider and spirits and freezing duty on wine, relative to previously assumed increases in line with RPI in April, and the cancellation of the planned increase in fuel duty in September 2015 (in line with RPI inflation). These changes are expected to reduce CPI inflation by less than 0.1 percentage points in 2015 and 2016.

The Government has announced a package of policies affecting the **North Sea oil and gas sector**, including the introduction of a new investment allowance, a reduction in the supplementary charge on profits from 30 per cent to 20 per cent, and a 15 per cent reduction in petroleum revenue tax. All else equal, these measures would be expected to reduce the cost of capital associated with investment in the sector and therefore have a positive effect on capital expenditure and production, partially offsetting the negative effect of lower oil prices on the profitability of oil and gas extraction. We have assumed that these measures increase the level of oil production by 2019 by around 15 per cent, equivalent to around 0.1 per cent of GDP. This partly offsets the effect of the significant decline in the oil price since December, which in the absence of these policy changes we assume would have reduced the level of North Sea production by around 30 per cent. In Chapter 4 we provide greater detail on these pre- and post-measures assumptions that underpin our North Sea revenues forecast.

The Government has also introduced a scheme aimed at **first-time house buyers**. The scheme offers a bonus for first-time buyers saving for a deposit, equivalent to 25 per cent of the balance in the account, with a limit on the monthly deposit of £200 and a maximum Government bonus of £3,000. To the extent that this supports prospective first-time owner-occupiers relative to those looking to buy-to-let, then it is possible that the measure will lead to a change in the composition of transactions towards first-time buyers, although the effect on aggregate property transactions is unclear. In supporting overall demand for housing, it is also possible that the policy will add to house price growth, although given the scale of the scheme we would expect any effect to be negligible. We have therefore not adjusted our forecasts for housing transactions and house prices for this measure.

The Government has announced a number of measures relating to **household saving**. These include a tax-free allowance for savings income from April 2016 of £1,000 for basic-rate

taxpayers and £500 for higher-rate taxpayers; a change to ISA rules that allows savers to withdraw and replenish funds in cash ISAs up to the annual limit; an extension to the 'pensioner' bonds offered by National Savings and Investments; and measures that increase the flexibility with which annuity holders can sell their annuities for a cash lump sum. The net effect of these measures on aggregate spending and saving is highly uncertain. It is possible, for example, that the tax-free allowance will encourage households to change the composition of their saving assets. While a tax-free allowance will also provide an income boost to savers, the amount for most households will be small, suggesting a limited effect on aggregate consumption.

By increasing the flexibility with which individuals can sell an annuity, it is assumed that this will encourage a secondary market in annuities. If the creation of such a market is successful, it is possible that households' funds will be redirected from the assets backing annuities into other assets. As with the pensions flexibility measures introduced in Budget 2014, it is possible that some people may temporarily increase pension saving. Alternatively, lump sums could be used to finance consumption, although such effects are likely to be small. As we consider the principal effect of these measures will be on the composition of household assets, rather than aggregate flow of saving or spending, we have not adjusted our forecast for these measures. The uncertainties associated with them are particularly large.

The Government has introduced measures specific to the **financial sector**, most significantly an increase in the bank levy from 0.156 per cent to 0.21 percent. These measures will have a negative effect on retained earnings, which may affect banks' ability to meet capital requirements. To the extent that banks are capital constrained, the measures could affect the supply of credit and thereby GDP growth. However, we do not judge that such effects would be significant, given the scale of the changes and that the banking sector as a whole appears to be relatively well capitalised,[a] suggesting that material deleveraging would be unlikely. The changes are likely to have a small effect on the share prices of affected financial institutions by reducing the expected future flow of post-tax income.

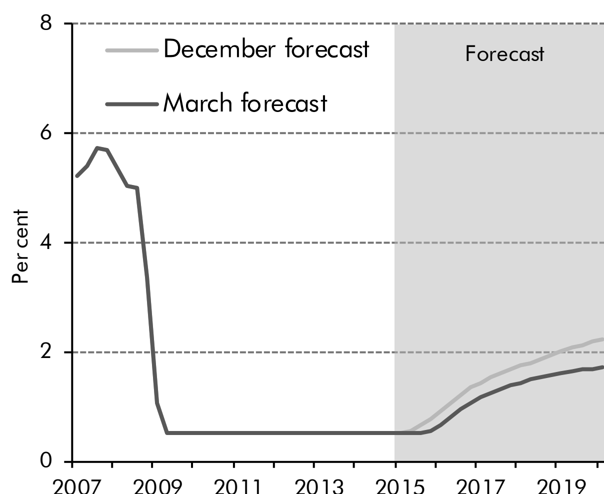
[a] In response to the Bank of England's 2014 stress-test exercise for the UK banking system, the Financial Policy Committee agreed that "the system should be sufficiently capitalised to ensure that banks were able to maintain the supply of lending in the face of adverse shocks". See Bank of England, *Record of the Financial Policy Committee meetings, 8 and 15 December 2014*, December 2014.

Credit conditions

3.25 Domestic financial and credit market conditions continue to ease, with the price of credit generally continuing to fall and volumes picking up. Bank funding spreads have continued to fall back towards pre-crisis levels and we assume that this relatively benign environment for bank funding will be sustained across the forecast period. We base our interest rate forecasts on market expectations for Bank Rate, gilt rates and commercial bank liability rates as published by the Bank of England. Since our December forecast, interest rate expectations have fallen significantly (Chart 3.7). The first increase in Bank Rate is now expected in mid-2016 rather than late 2015. Bank Rate expectations are 0.5 percentage points lower than in December for the first quarter of 2020, only reaching 1.7 per cent by the end of our forecast period. Gilt rate expectations have fallen in line with lower Bank Rate

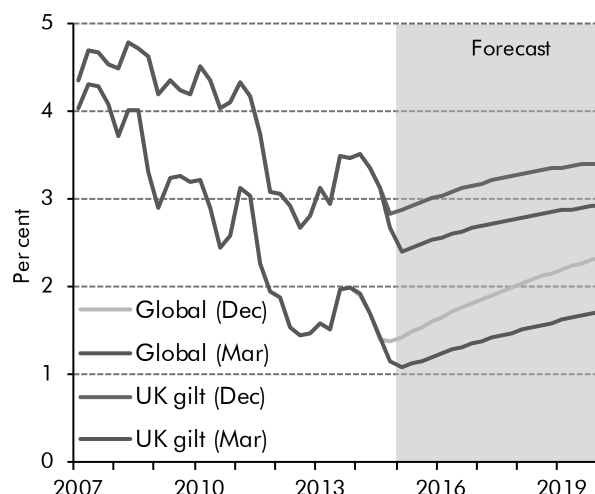
expectations. Movements in UK bond yields have largely matched those in other global bond markets (Chart 3.8).

Chart 3.7: Bank Rate expectations



Source: Bank of England, Thomson Reuters Datastream, OBR

Chart 3.8: Global bond rates

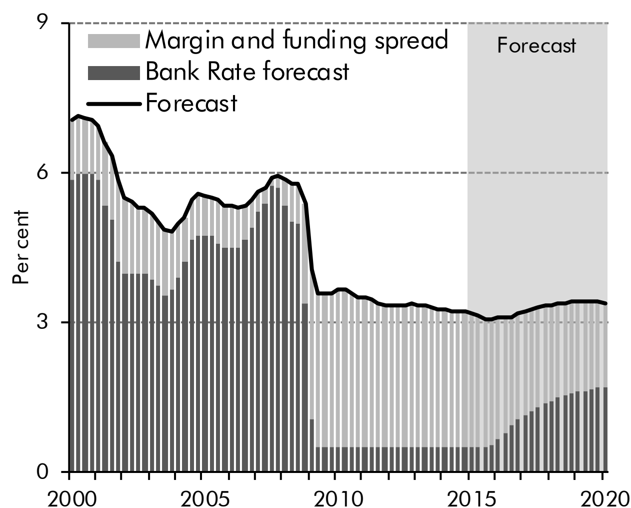


Note: 20-year gilts for UK, trade weighted bond rates for global

3.26 New mortgage rates have fallen significantly since mid-2012, but the effective interest rate paid on the stock of all UK mortgages has fallen by less. This is because the amount of new lending is much smaller than the stock, and terms on existing mortgages are revised only when contracts expire (typically every two to three years). For the same reason, the combination of gradually maturing mortgage contracts, competitive pressure on margins and the lagged effect of previous falls in new mortgage rates means that we expect effective mortgage rates to fall further in the near term and then to rise only slightly over the forecast period as increases in Bank Rate are offset by narrowing margins (Chart 3.9).

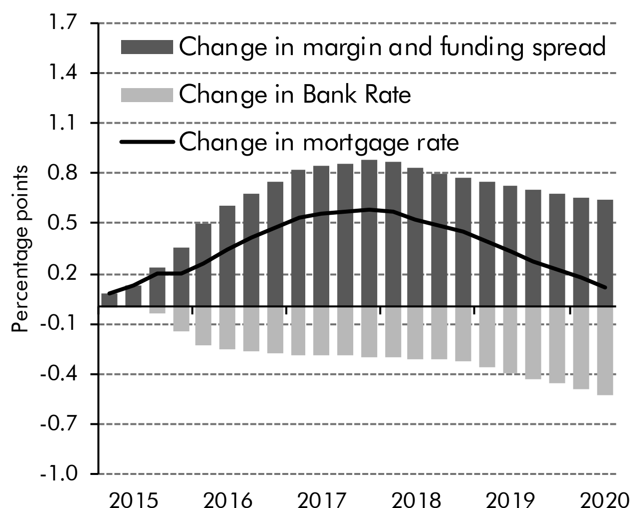
3.27 We have not changed our assumption for the evolution of bank funding spreads since December, so our forecast for bank funding costs is lower than December due to lower Bank Rate expectations. Offsetting these lower funding costs, we have assumed that lenders' margins will be higher over the forecast period than we assumed in December, leaving mortgage rates little changed by the end of the forecast period (Chart 3.10). Previously, we had assumed that margins, which have been elevated in recent years, would return towards their pre-crisis average as Bank Rate rises, normalising around the end of 2017. With market expectations implying later and more gradual Bank Rate rises, we have assumed that margins will normalise at a later date.

Chart 3.9: Mortgage rate forecast



Source: Bank of England, OBR

Chart 3.10: Change in mortgage rate forecast since December



3.28 Lending to households continues to pick up, mainly as rising house prices lead to more secured mortgage lending, which makes up the majority of household debt. However, secured debt has not risen as much as house price and transaction growth would imply, as the share of cash transactions has increased. We expect growth in mortgage debt to continue rising over the forecast period, as the share of cash transactions falls back, house prices continue to rise and transactions increase back towards their pre-crisis turnover rate. Strong growth in car purchases has contributed to the growth of unsecured lending, which in the fourth quarter of 2014 increased at the fastest rate since 2006.[5]

3.29 Bank lending to non-financial companies continues to fall. Large companies continue to choose non-bank sources of funds as favourable wholesale market conditions have encouraged strong net issuance of bonds. Lending to SMEs continues to fall year-on-year, although the rate of decline has eased slightly in the past few months.

World economy

3.30 World GDP is estimated to have increased by 3.3 per cent in 2014, in line with our December forecast. We now expect world GDP to grow by 3.5 per cent in 2015, down from 3.8 per cent in December. The revision is in spite of an overall boost to global GDP from lower oil prices and reflects weaker outturn data in emerging and oil-exporting countries.

3.31 The euro area economy has remained weak. In the fourth quarter of 2014, GDP was 0.9 per cent up on a year earlier. GDP was up 1.5 per cent on a year earlier in Germany and 0.2 per cent in France, but down 0.5 per cent in Italy. Spain saw stronger growth of 2.0 per cent in the year to the fourth quarter. Euro area GDP is estimated to have increased 0.9 per cent in 2014 as a whole and we forecast 1.2 per cent growth in 2015, slightly below our

[5] Car leasing arrangements, which are becoming a more popular way of purchasing cars, are classified as unsecured lending.

December forecast. We have made further small downward revisions across the rest of the forecast.

3.32 Deflation in the euro area remains a risk to the global and UK outlook. Euro area CPI inflation was -0.3 per cent in February, its third consecutive negative reading. Euro area core inflation in February was 0.6 per cent, the same as in January. Since January 2013, inflation has fallen well below the European Central Bank's inflation target of below but close to 2 per cent and a number of euro area countries are experiencing deflation. In response to this and declining medium-term inflation expectations, the European Central Bank announced that it would undertake a programme of quantitative easing. Unemployment in the euro area was 11.2 per cent in January, having fallen slightly in each month since October. Weaker growth, lower inflation and monetary policy easing have helped to push the euro to a seven-year low in relation to sterling and a 12-year low against the dollar. Our latest conditioning assumption for the first quarter of 2015 shows the euro down 8.4 per cent against the US dollar and 6.5 per cent against sterling in the period since our December forecast.

3.33 In our December *EFO*, we identified euro area rebalancing as a risk to the UK economic outlook. Since then, elections in Greece and subsequent negotiations over the country's debt obligations have brought these issues into focus once again. Our central forecast assumes that these issues are resolved without causing undue instability. Greece accounts for only 0.6 per cent of UK exports, so the direct channel of risk is limited, but any spillover to the wider euro area could be damaging, as witnessed between 2010 and 2012.

3.34 Data available at the time of our December forecast showed that US GDP increased by 1.0 per cent in the third quarter of 2014. That estimate has since been revised up to 1.2 per cent. Outturn data for the fourth quarter of 2014 showed growth of 0.5 per cent, leaving US GDP up 2.4 per cent in 2014 as a whole. The IMF's latest forecast suggests the rate of US GDP growth will pick up further in 2015 to 3.6 per cent.

World trade

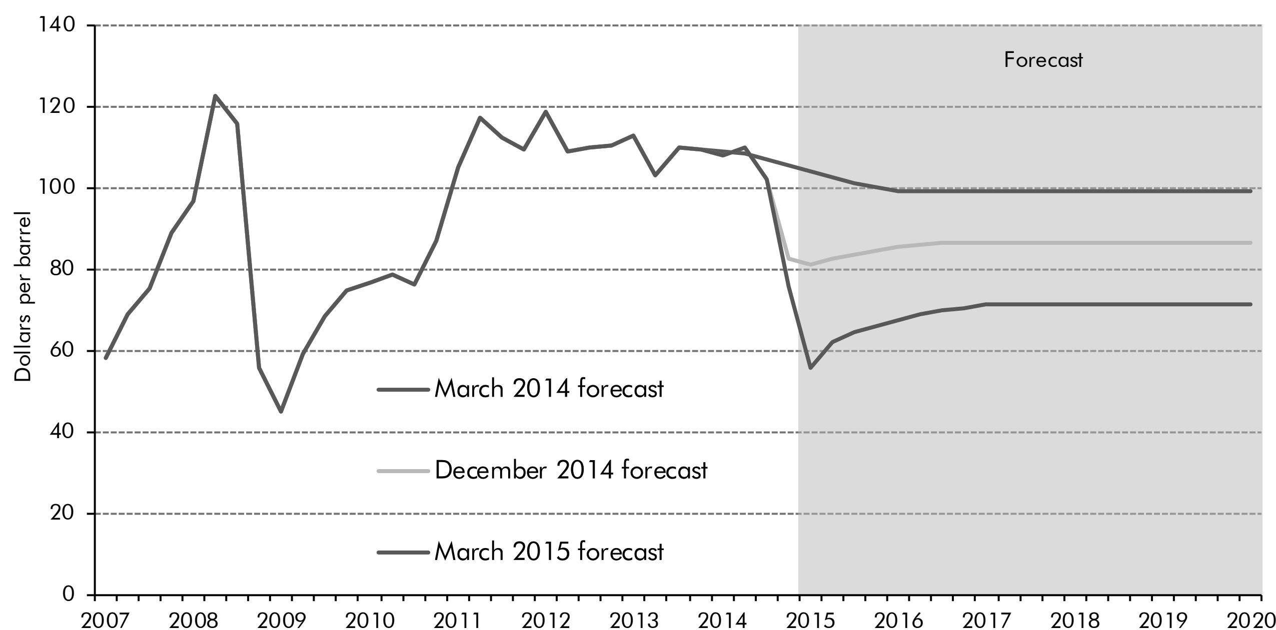
3.35 We expect world trade to grow by 4.0 per cent in 2015. This is slower than we forecast in December, partly reflecting weaker outturn data for the second half of 2014. World trade has also been revised down in each year of the forecast period and by a greater amount than world GDP. That is consistent with the IMF's downward revisions to world GDP and world trade growth in its January 2015 *World economic outlook update*, in particular reflecting lower expected growth in emerging markets.

3.36 UK export markets are expected to grow by 3.7 per cent in 2015. This is below our December forecast, but the change is smaller than the downward revision to overall world trade, which was driven by weaker growth in emerging markets that account for a smaller share of UK exports.

Oil prices

3.37 The most significant change since December to the market-derived assumptions we use in our forecasts relates to oil prices. In the 10 days to 26 February (the period we take for our conditioning assumptions), oil prices averaged $58, which was 27 per cent lower than in our December forecast (Chart 3.11). The fall since our March 2014 forecast has been 47 per cent. By the end of the forecast period, the differences are slightly smaller at 17 per cent lower than the December forecast and 28 per cent lower than the March 2014 forecast. This reflects the change from a downward sloping futures curve in March 2014 to a modestly upward sloping curve in December and a more steeply upward sloping curve now. (We only use the first two years of the futures curve in our forecast, holding prices flat thereafter.)[6] The drivers of the fall in oil prices are discussed in Box 2.1, while Box 3.1 summarises the channels along which lower prices might affect the economy.

Chart 3.11: Oil price assumption



Source: IMF, Thomson Reuters Datastream, OBR

Other conditioning assumptions

3.38 We use market-derived conditioning assumptions for our exchange rate and equity price forecasts. We assume that the exchange rate follows the path implied by the uncovered interest parity condition. In February 2015, the sterling effective exchange rate rose to its highest level since 2008. By the first quarter of 2015 we expect it to have moved 3.5 per cent higher than our December conditioning assumption due to the appreciation of sterling against the euro (Chart 3.12). The exchange rate is expected to depreciate over the forecast period as the forward UK interest rate curve is above the average of the UK's major trading partners. We assume equity prices rise in line with nominal GDP from their current level.

[6] See paragraph 3.49 of our December 2013 *Economic and fiscal outlook* for an explanation of this methodology.

The FTSE all-share index has risen above the December conditioning assumption, reaching an all-time high in February 2015 (Chart 3.13).

Chart 3.12: Sterling effective exchange rate assumption

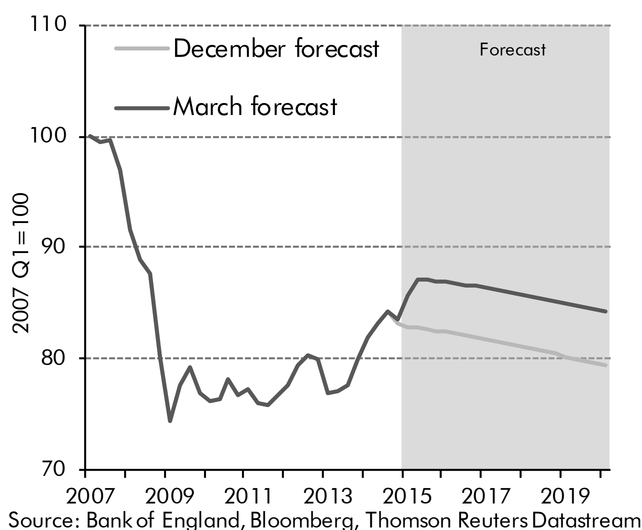
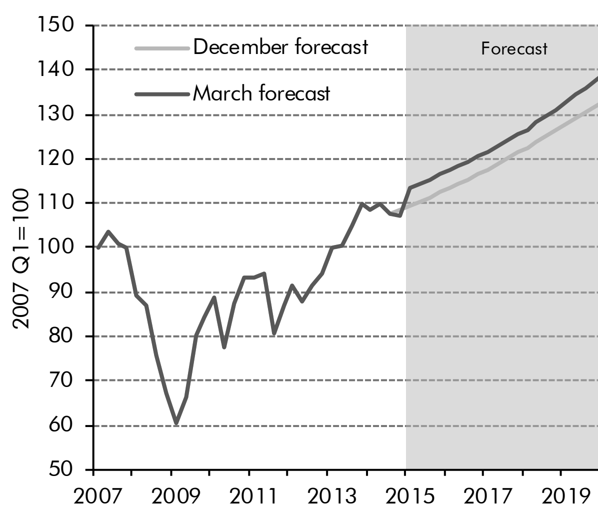


Chart 3.13: Equity prices assumption



Source: Bank of England, Bloomberg, Thomson Reuters Datastream, OBR

Summary

3.39 To summarise, the key assumptions underpinning our central forecast are that:

- monetary policy remains very loose and does not begin to tighten until mid-2016;
- fiscal consolidation continues to depress the level of GDP, while acting as less of a drag on growth than over the past four years;
- the measures announced in the Budget have a negligible overall impact on demand and a very small effect on CPI inflation;
- credit conditions and the financial system continue to normalise gradually;
- global activity and demand for UK exports pick up steadily, albeit slightly more slowly in the near term than expected in December; and
- financial markets are stable and oil prices rise slightly after recent falls.

3.40 Risks and uncertainties associated with these assumptions and other facets of the forecast are discussed later in the chapter.

Prospects for real GDP growth

3.41 In this section, we set out the expected path of GDP growth over the forecast period. We first consider the short-term outlook, based on recent economic data and forward-looking surveys. We then consider the rate at which GDP will grow over the medium term as spare capacity is put to productive use and the relatively small negative output gap closes.

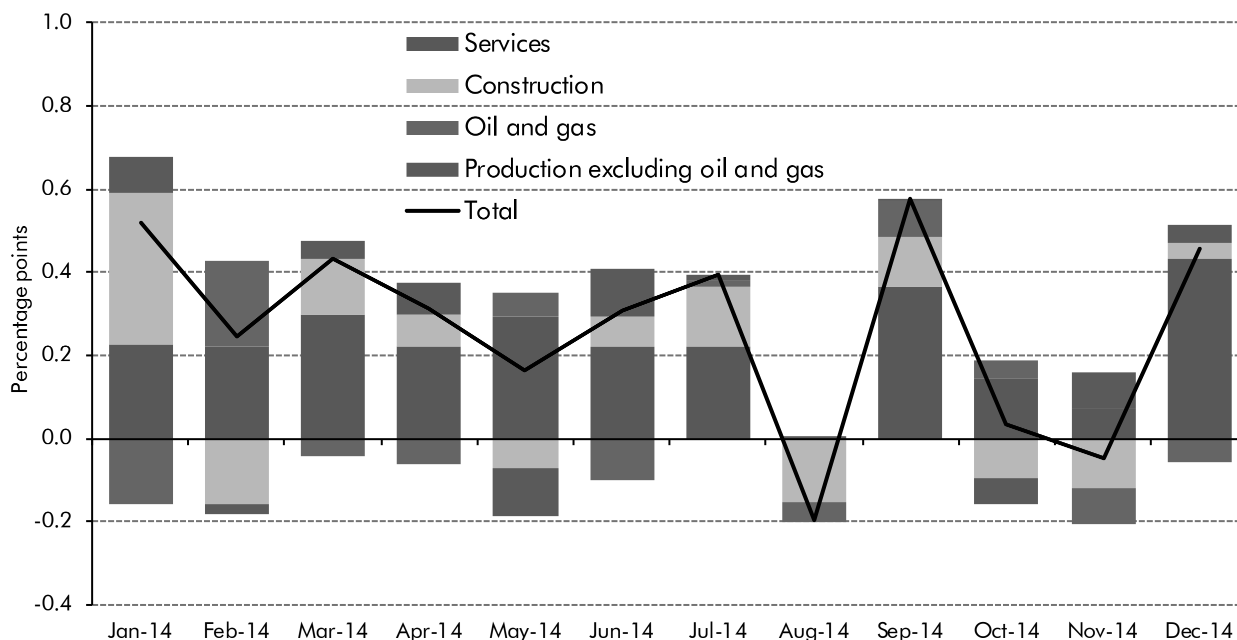
The short-term outlook for GDP

3.42 The economy grew by 0.5 per cent in the fourth quarter of 2014, slightly below the 0.6 per cent we forecast in December. *Quarterly National Accounts* data released after our December forecast contained downward revisions to GDP back to the start of 2013. As a result of this and the second estimate of fourth quarter GDP, the ONS now estimates that GDP increased by 2.6 per cent in 2014, below the 3.0 per cent we expected in December.

3.43 On a monthly basis, Chart 3.14 shows steady contributions to growth from the services sector in the second half of 2014. Contributions from the construction and production sectors were more volatile. The Markit/CIPS *Purchasing Managers' Index* (PMI) for February showed strong growth in the manufacturing and construction sectors. The services sector eased slightly in February, following a strong reading in January.

3.44 The latest survey indicators point to continued momentum into 2015, and we expect GDP growth to pick up to 0.7 per cent in the first quarter. We then forecast growth of 0.6 per cent in each of the remaining quarters of 2015, up slightly from our December forecast of 0.5 per cent a quarter over this period. This reflects a similar judgement to December that momentum would ease over the year, but incorporates an upward revision to growth due to lower oil prices boosting real household consumption. These changes leave GDP growth in 2015 as a whole at 2.5 per cent, slightly above our December forecast.

Chart 3.14: Contributions to monthly output growth in 2014



Source: ONS

Table 3.2: The quarterly GDP profile

	Percentage change on previous quarter											
	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
March forecast[1]	0.7	0.8	0.7	0.5	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
December forecast[2]	0.7	0.9	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.6	0.6	0.6
Change[3]	**-0.1**	**-0.2**	**0.0**	**-0.1**	**0.1**	**0.0**	**0.1**	**0.1**	**0.1**	**0.0**	**0.0**	**0.0**

[1] Forecast from first quarter of 2015.
[2] Forecast from fourth quarter of 2014.
[3] Changes may not sum due to rounding.

The medium-term outlook

3.45 Our forecasts for growth in the medium term are determined by the amount of spare capacity in the economy, and the speed with which we expect it to return to productive use. The prospects for monetary policy, fiscal policy, credit conditions, external demand and financial markets discussed in the previous section all inform that judgement.

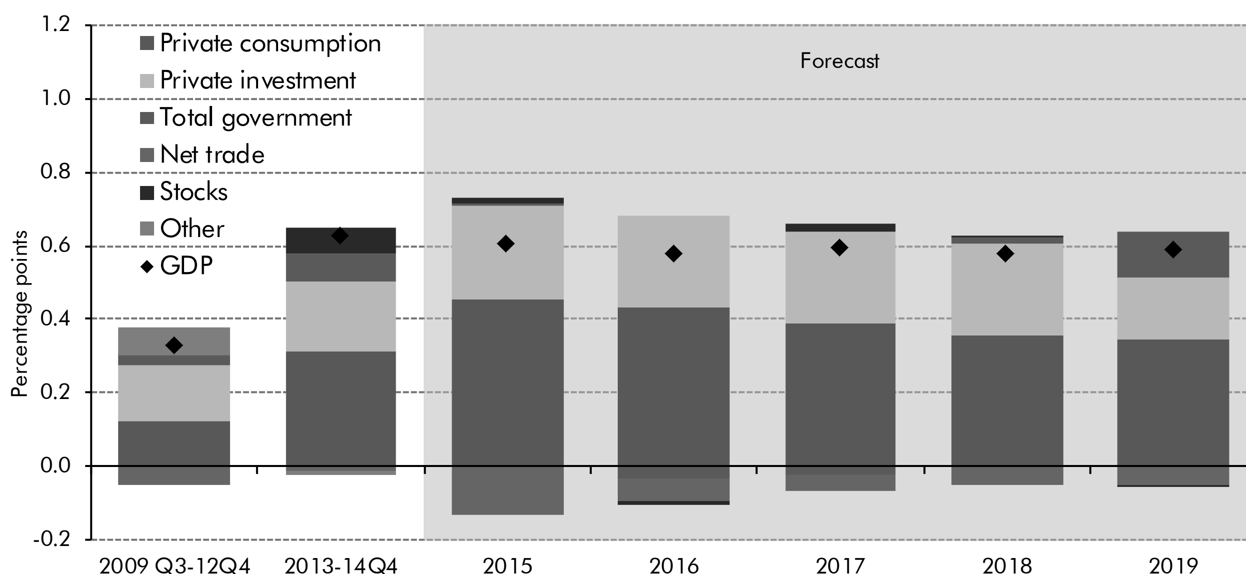
3.46 Recent ONS data revisions mean that the pick-up in GDP growth through 2014 now appears somewhat weaker than previously thought. Nevertheless the general picture of a significant pick-up in activity in 2013 and 2014 remains intact. GDP growth has averaged 0.6 per cent a quarter since the start of 2013, compared to just 0.3 per cent between the end of the recession and the end of 2012. Much of the increase in growth is attributable to a pick-up in consumer spending, as well as stronger investment growth, although investment is estimated to have fallen in the second half of 2014.

3.47 As set out in Box 3.1, the significant decline in the oil price since December is likely to affect economic activity in a number of ways: boosting real household incomes and thereby consumer spending and, to a lesser extent, encouraging business investment, but weighing on North Sea production and investment. Taken together we expect the fall in the oil price since December to increase GDP growth by around 0.4 percentage points across 2015 and 2016, with the largest effect likely to be observed over the second half of 2015 and first half of 2016. This more than offsets the effect on net trade of a further deterioration in the outlook for the UK's export markets. We have revised up our forecast for GDP growth in 2015 and 2016 by 0.1 and 0.2 percentage points respectively.

3.48 After 2016, the effect of lower oil prices on real income growth dissipates as the oil price is assumed to stabilise. Growth is instead supported by our assumption that productivity growth picks up towards its historical average rate. We therefore forecast the quarterly growth rate to remain at around 0.6 per cent from mid-2016. Lower oil prices are assumed to have a persistent effect on North Sea production in the medium term, implying a cumulative reduction in GDP of around 0.2 per cent by 2019 due to a 20 per cent downward revision to oil and gas production relative to our December forecast.

3.49 Overall, our forecast for cumulative real GDP growth between the third quarter of 2014 and the start of 2020 is slightly stronger than our December forecast (13.7 per cent versus 13.3 per cent). This reflects slightly stronger average growth of potential output, in turn reflecting the upward revision to assumed net inward migration (see paragraphs 3.17 to 3.18).

Chart 3.15: Contributions to average quarterly GDP growth

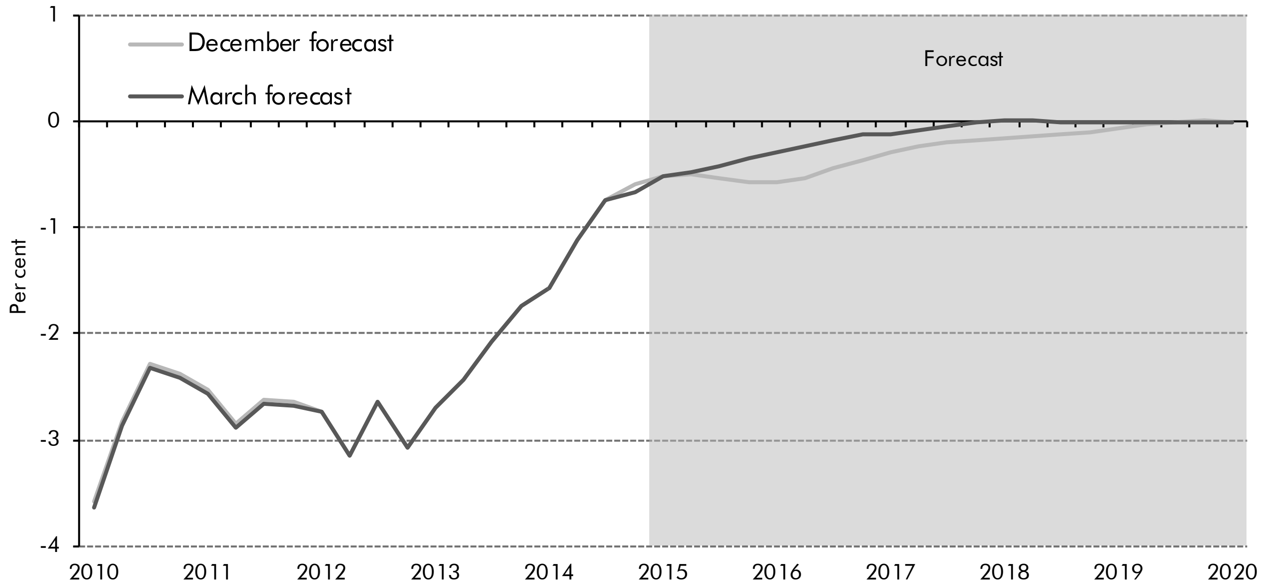


Note: 'Other' category includes the statistical discrepancy and the residual between GDP and the expenditure components prior to the base year (2011).
Source: ONS, OBR

3.50 Our estimate of the output gap at the end of 2014 is little changed from our December forecast. The boost to GDP growth from the lower oil price means that we now expect the output gap to be somewhat narrower from 2015, with output returning to its potential level

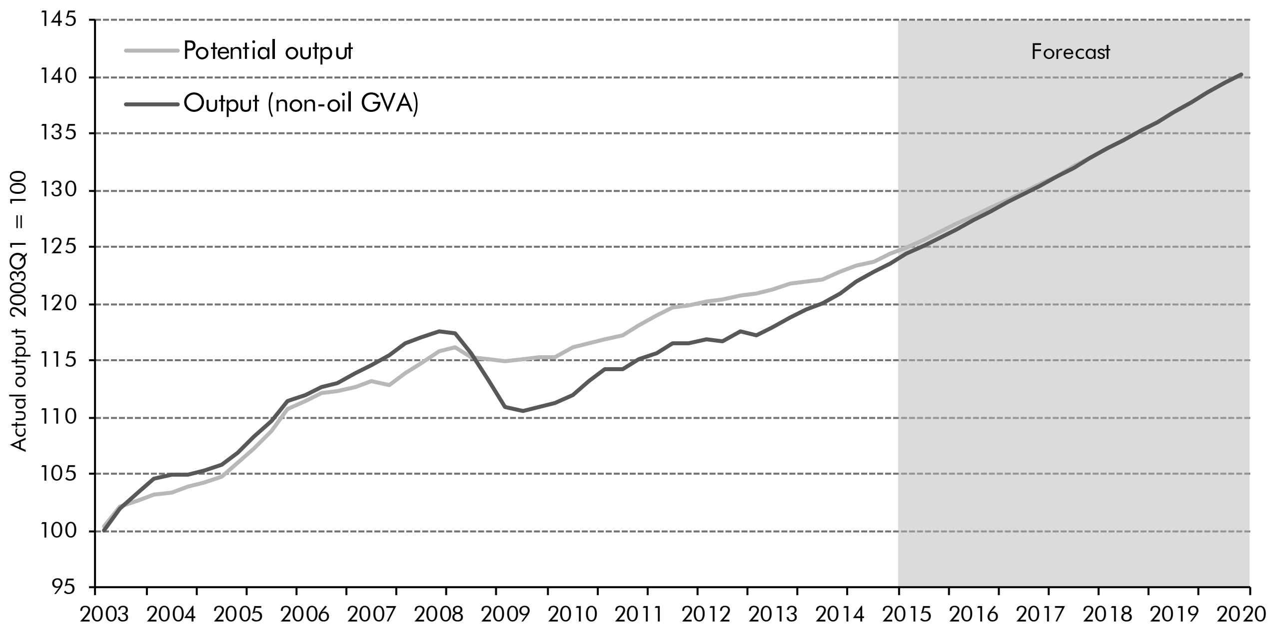
by the final quarter of 2017, around a year and a half earlier than we expected in December. That it does not close more quickly reflects a number of headwinds to growth over the medium term, including a pick-up in the pace of fiscal tightening, the slow return to health of the financial system, ongoing weakness in UK export markets and limits to what monetary policy can do to stimulate demand in these circumstances.

Chart 3.16: The output gap



Note: Output gap estimates on a quarterly basis, based on the latest National Accounts data and expressed as actual output less trend output as a percentage of trend output (non-oil basis).
Source: OBR

Chart 3.17: Projections of actual and potential output



Source: ONS, OBR

3.51 Table 3.3 summarises the expenditure composition of our real GDP forecast. Relative to December, we expect stronger consumption growth in the near term, as the fall in the oil price boosts real incomes. We also expect somewhat stronger government consumption. Our forecast for cumulative investment growth is somewhat weaker, reflecting a downward revision to the outlook for both business (particularly North Sea) and residential investment. Later sections of this chapter discuss the expenditure components of GDP in more detail.

Table 3.3: Expenditure contributions to growth

	Percentage points, unless otherwise stated						
	Outturn	Forecast					
	2013	2014	2015	2016	2017	2018	2019
GDP growth (per cent)	**1.7**	**2.6**	**2.5**	**2.3**	**2.3**	**2.3**	**2.4**
Main contributions							
Private consumption	1.1	1.3	1.6	1.8	1.6	1.5	1.4
Business investment	0.5	0.7	0.5	0.8	0.7	0.8	0.5
Dwellings investment[1]	0.2	0.3	0.1	0.2	0.2	0.3	0.2
Government[2]	-0.3	0.5	0.2	-0.1	-0.1	0.0	0.3
Change in inventories	0.3	0.2	0.1	0.0	0.0	0.0	0.0
Net trade	0.0	-0.5	-0.1	-0.4	-0.2	-0.2	-0.2

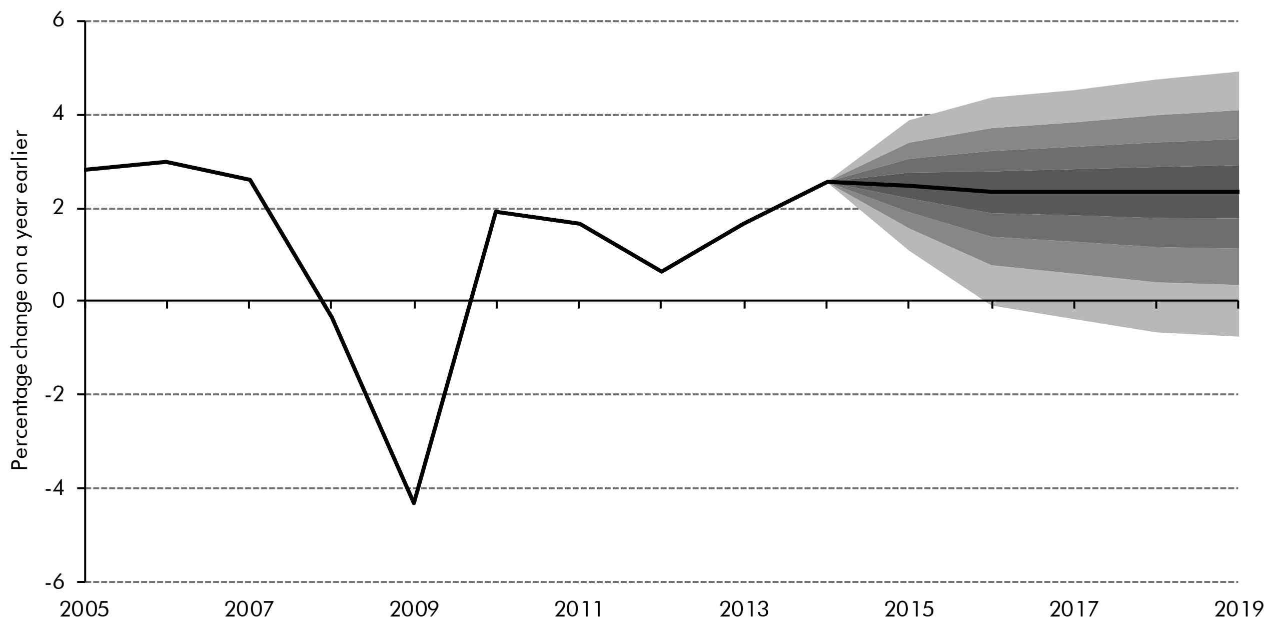
[1] The sum of public corporations and private sector investment in new dwellings, improvements to dwellings and transfer costs.

[2] The sum of government consumption and general government investment.

Note: Components may not sum to total due to rounding and the statistical discrepancy.

3.52 Our central GDP growth forecast is shown in Chart 3.18. The distribution surrounding it shows the probability of different outcomes based on past forecast accuracy. The solid black line shows our median forecast, with successive pairs of lighter shaded areas around it representing 20 per cent probability bands. These are based on the distribution of official forecast errors since 1987. They do not represent a subjective measure of the distribution of risks around the central forecast. Such risks are discussed at the end of the chapter.

Chart 3.18: Real GDP growth fan chart

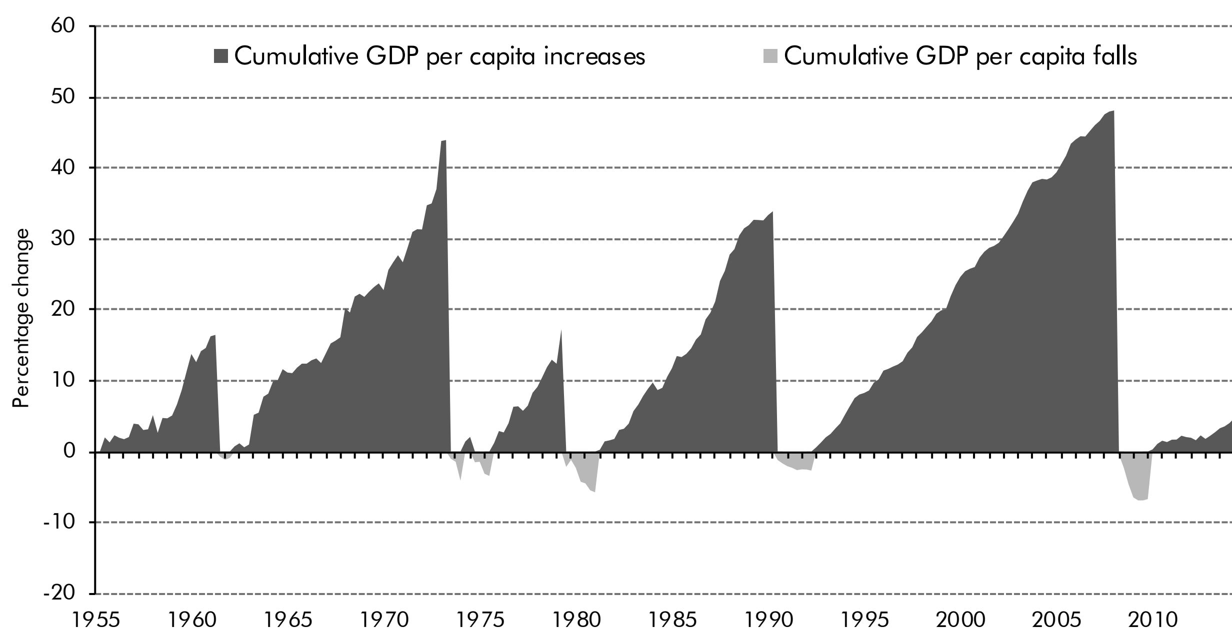


Source: ONS, OBR

3.53 The latest data imply that by the end of 2014, GDP per capita will have risen by 5.6 per cent since its trough in mid-2009, having grown at an average rate of just 1.0 per cent a year over that period. As Chart 3.19 shows, significant falls in GDP per capita like that experienced in the late 2000s recession are historically rare and typically short-lived compared with periods of expansion. The pace of expansion since the 2009 trough is notably subdued relative to the other post-war expansions shown in the chart.[7]

[7] Expansion periods are defined as continuing until GDP per capita falls cumulatively by more than 1 per cent over two consecutive quarters, triggering the start of a contraction period. Conversely, contraction periods are defined as continuing until cumulative GDP per capita growth is higher than 1 per cent over two consecutive quarters, triggering the start of an expansion period.

Chart 3.19: Cumulative growth in real GDP per capita



Source: ONS, OBR

Prospects for inflation

3.54 In assessing the outlook for the economy and the public finances, we are interested in a number of measures of inflation, including the Consumer Prices Index (CPI) and the Retail Prices Index (RPI). The basic measurement approach is the same in both indices, although there are a number of differences in coverage and the methods used to construct them (see Box 3.3 for more details). We also forecast the GDP deflator and its components, which are used in generating our nominal GDP forecast.

3.55 The CPI and RPI measures of inflation are important because they each affect our fiscal forecast. The Government uses the CPI for the indexation of many tax rates, allowances and thresholds, and for the uprating of benefits and public sector pensions. The RPI is used to calculate interest payments on index-linked gilts, student loan payments and the revalorisation of excise duties. The GDP deflator, among other items, feeds into the Government's policy assumption for total public spending growth. The ONS publishes other inflation measures, but these do not currently affect the public finances, so we do not forecast them.

CPI inflation

3.56 CPI inflation was 0.9 per cent in the fourth quarter of 2014, below our December forecast of 1.1 per cent. The lower-than-expected outturn is explained by food and fuel prices.

3.57 The most important development since December has been the further sharp fall in oil prices. The assumption for sterling oil prices underpinning our current forecast is 30 per cent lower in the first quarter of 2015 and 17 per cent lower in the medium term than in

December. This reduction has its greatest impact on inflation directly through fuel prices, with the transmission almost immediate. Fuel prices make up 3.4 per cent of the CPI, although a significant proportion of this reflects fuel duty, which is fixed in pence per litre so does not vary with oil prices. Part of the fuel price also represents other costs and margins for fuel retailers. Taking all this into account, the fall in oil prices is expected to subtract 0.3 percentage points from CPI inflation in 2015 through its direct impact on fuel prices. Some of this impact will be unwound later, as the oil futures curve is upward sloping.

3.58 Oil prices can also have indirect impacts on inflation through their role as a cost of production for firms – e.g. fuel costs affecting airfares, transport costs affecting the whole supply chain and lower production costs affecting global food commodity prices and subsequently retail food prices. We expect these indirect impacts to take longer to flow through to the CPI and eventually take a further 0.1 percentage points off inflation.

3.59 Wholesale gas prices have also fallen, with the average futures curve over the next two years 11 per cent lower than assumed in December. In response to these falls, the 'big six' energy firms have announced cuts to retail gas prices ranging from 1.3 to 5.1 per cent. Wholesale costs are thought to make up slightly less than half of utility prices, but energy companies buy wholesale energy up to two years in advance which means that changes in wholesale prices can take time to feed through to retail prices.[8] The announcements from energy firms take a further 0.1 percentage points off inflation in our forecast. We assume that utility prices will rise more slowly than assumed in December, as the lagged effects of lower wholesale prices partly offset increases in other costs of production.

3.60 Other inflation developments have included:

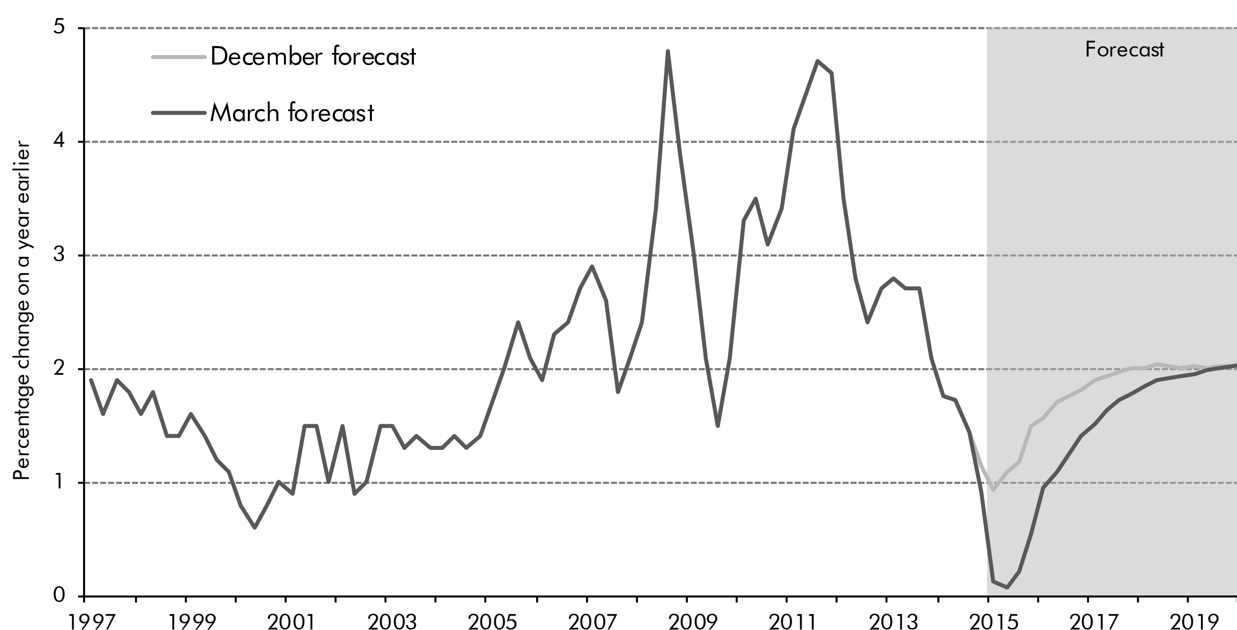
- more downward pressure on food prices, resulting from further falls in global commodity prices and intensification of competition in the food retail sector; and
- sterling appreciating further, which lowers the cost of import-intensive goods.

3.61 The sum of these developments means that we have significantly lowered our forecast for CPI inflation in the near term (Chart 3.20). Inflation is expected to trough at 0.1 per cent in the first half of 2015 (although it may well be negative in some months). It is expected to rise in the second half of 2015, as oil prices are assumed to rise and as spare capacity is used up. The CPI inflation profile jumps up at the start of 2016 as the peak impact of the recent fall in energy prices drops out of the year-on-year calculation.

3.62 Inflation is then forecast to return to the 2 per cent target slowly as the effects of the recent sterling appreciation and the indirect effects of the recent falls in commodity prices feed through with lags. The Bank of England is expected to look through the effects of these external influences and inflation is forecast to return to its 2 per cent target during 2019, when these effects have worked their way through.

[8] OFGEM, *Charts: Outlook for costs that make up energy bills*, February 2015.

Chart 3.20: CPI inflation



Source: ONS, OBR

RPI inflation

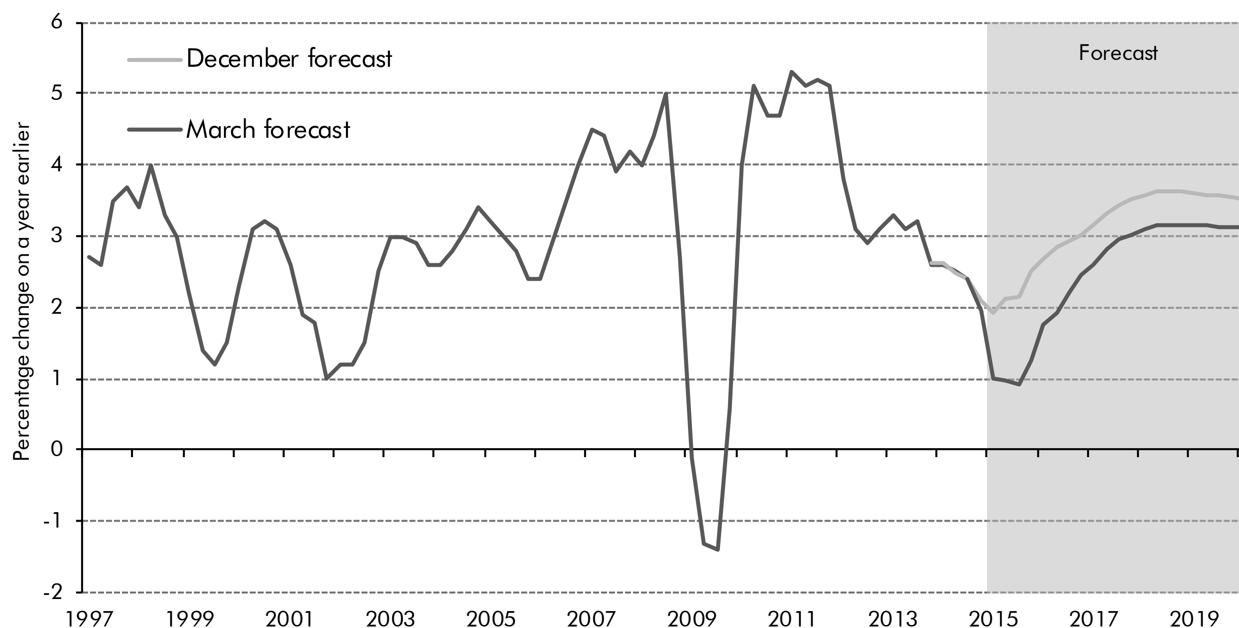
3.63 The calculation of RPI inflation in the UK does not meet international statistical standards,[9] but we continue to forecast RPI as it remains an input in our fiscal forecasts.

3.64 RPI inflation was 2.0 per cent in the fourth quarter of 2014, close to our December forecast of 2.1 per cent. The items contributing to the negative CPI surprise were partly offset by higher-than-expected mortgage interest payments (MIPs) inflation, which are not included in the CPI.

3.65 In the near term, we expect RPI inflation to fall back for the same reasons as CPI inflation. It is forecast to average 1.0 per cent in the first half of 2015, 1.0 percentage points lower than expected in December. Over 2015, RPI inflation rises in line with CPI inflation before an increase in MIPs pushes RPI inflation slightly above 3 per cent. The rise in MIPs is driven by an increase in mortgage debt as housing market turnover increases back towards its pre-crisis average. Compared to our December forecast, RPI inflation is lower over the whole forecast period, partly because we have lowered our assumption for the long-run wedge between RPI and CPI inflation (Box 3.3).

[9] ONS, *Response to the National Statistician's consultation on options for improving the Retail Prices Index*, February 2013.

Chart 3.21: RPI inflation



Source: ONS, OBR

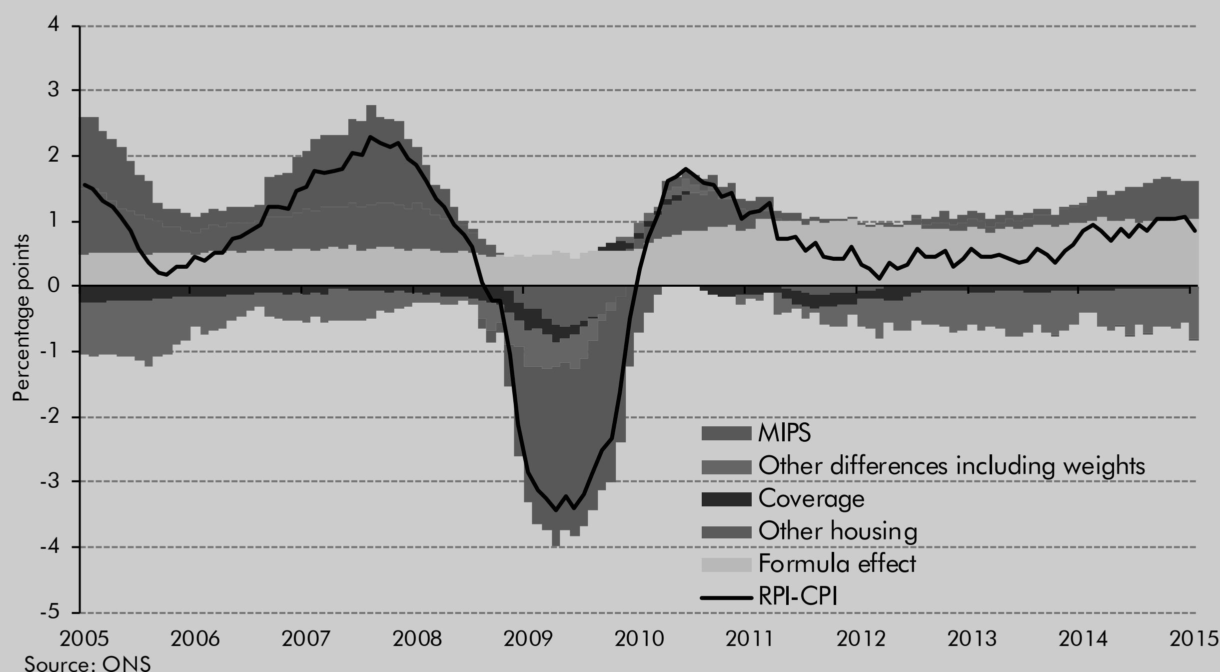
Box 3.3: Revised assumption for the long-run wedge between RPI and CPI inflation

RPI inflation differs from CPI inflation for a number of reasons. The ONS decomposes the wedge between the two measures into the following categories:

- the formula effect – the RPI uses a combination of the 'Dutot' and 'Carli' methods of aggregating prices at the most basic level, while the CPI uses a combination of the Dutot and 'Jevons' methods. Jevons is a geometric averaging technique, Dutot is an internationally accepted arithmetic average, but Carli is an arithmetic average that does not meet international standards since it tends to inject spurious inflation into the index. Since the RPI uses Carli it generally overstates inflation;
- housing – the RPI includes a number of housing components that the CPI does not, including depreciation, council tax and mortgage interest payments;
- other differences in coverage – certain items are included in one index but not the other, for example the CPI includes overseas student tuition fees but the RPI does not and the RPI contains vehicle excise duty but the CPI does not; and
- other differences including weights – different data sources and population bases mean other components have different weights.

Chart A illustrates how these different factors have contributed to the wedge between RPI and CPI inflation since 2005, when the ONS switched to its preferred methodology for measuring the wedge, with some factors fluctuating significantly while others have been reasonably constant.

Chart A: Contributions to the RPI-CPI inflation wedge



Source: ONS

The OBR first published an estimate of the long-run wedge between RPI and CPI inflation in a 2011 working paper.[a] Since then, the ONS has begun producing RPIJ, which recalculates the RPI by replacing the Carli averaging method with Jevons. We have also had more time to assess the impact of the 2010 change in the calculation of clothing prices, which has increased the size of the formula effect.[b] On the basis of the latest evidence, we have revised down our estimate of the long-run wedge between RPI and CPI inflation.

Table A sets out the estimated components of the wedge from our 2011 working paper and our updated estimates, as well as comparing them to the averages since 2005 (when the ONS moved to the preferred methodology for measuring the wedge) and since 2010 (when the ONS changed the collection of clothing prices). It shows that:

- we have kept the **formula effect** unchanged at 0.9 percentage points, in line with the average since 2010, when the method of collecting clothing prices was changed;
- we have slightly lowered our estimate of the **housing effect**. We still expect mortgage interest payments and housing depreciation to grow in line with average earnings, but we have reduced our long-run average earnings projection from 4.7 to 4.4 per cent. We now expect council tax to grow in line with CPI inflation of 2 per cent, as in our fiscal forecast, compared to the 3 per cent assumption in 2011, which was based on the historical average growth rate;
- we still expect **other differences in coverage** to contribute nothing to the wedge in steady state; and
- we have revised down the contribution of **other differences including weights** from zero (as assumed in our 2011 paper) to -0.4 percentage points. The ONS calculates this series as a residual so it will pick up differences in weights other than housing as well as any

interactions between categories. Since 2010, when the method of collecting clothing prices was changed, this component has averaged a -0.4 percentage point contribution to the wedge. This is despite a bottom-up estimate of the difference in weights at the item level (the approach that underpinned our 2011 estimate), suggesting an effect of zero. We believe that part of this difference represents interactions between categories, in particular between the formula and weights effects. This is demonstrated by the gap between RPI and RPIJ (the formula effect using RPI weights), which has averaged 0.6 percentage points since 2010, whereas the published ONS formula effect (the formula effect calculated using CPI weights) remains around 0.9 percentage points. We assume that the average contribution from this category since 2010 will persist.

Summing the contributions gives our new estimate of the long-run wedge between RPI and CPI inflation of 1.0 percentage points. This is lower than our 2011 estimate of 1.4 percentage points. It is also lower than the Bank of England's estimate of 1.3 percentage points. But it is in line with what market participants told the Bank was built into the price of inflation breakevens.[c]

Table A: Long-run assumption for the RPI-CPI inflation wedge

	Percentage points contributions, unless otherwise stated				
	Formula effect	Housing	Coverage	Weights	Total
Bank of England	0.9	0.6	-0.1[1]	-0.1[1]	1.3
2005-current average	0.7	0.3	-0.1	-0.4	0.5
2010-current average	0.9	0.3	-0.1	-0.4	0.7
2011 Working paper	0.9	0.5	0.0	0.0	1.4
New value	0.9	0.5	0.0	-0.4	1.0
Change	**0.0**	**-0.1**	**0.0**	**-0.4**	**-0.4**

[1]The Bank of England assumes a combined coverage and weights contribution of -0.2 percentage points. We have split this evenly between the two categories.

Note: Components may not sum to total due to rounding.

[a] Miller (2011) *Working Paper No. 2: The long-run difference between RPI and CPI inflation*.

[b] More information can be found in the ONS information note, *CPI and RPI: the increased impact of the formula effect in 2010,* January 2011.

[c] For more detail see page 34 of the Bank of England's *Inflation Report,* February 2014: 'The long-run RPI-CPI wedge'.

The GDP deflator

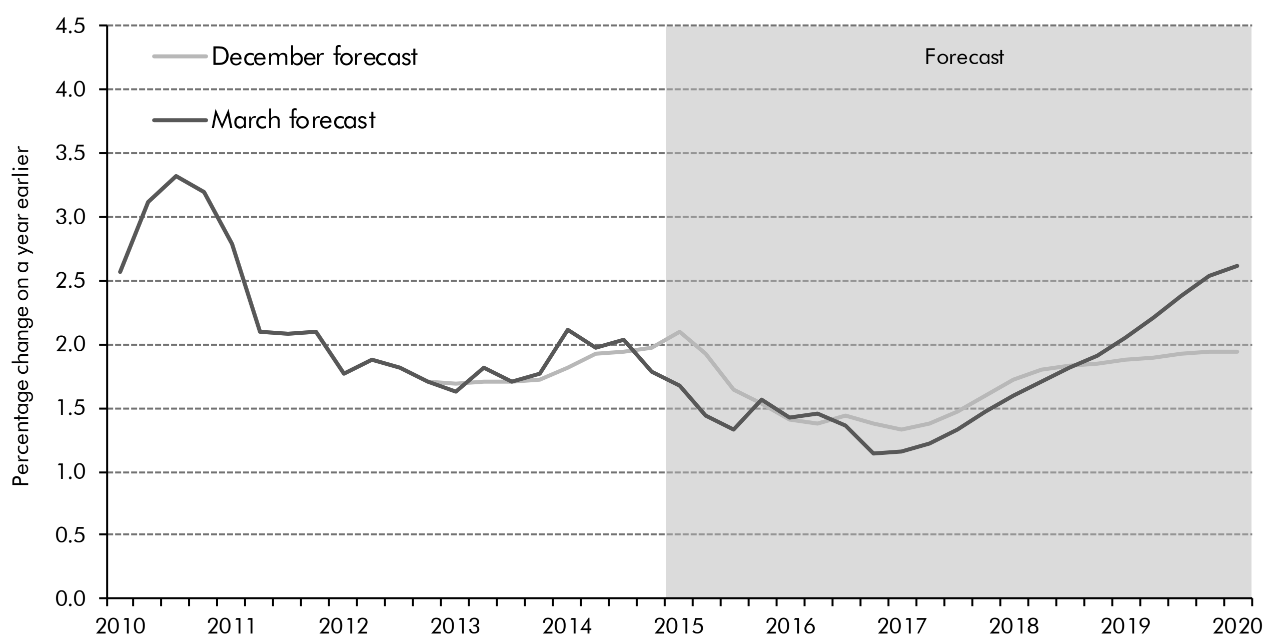
3.66 GDP deflator growth is the broadest measure of inflation in the domestic economy. It measures changes in prices of the goods and services that make up GDP, including price movements in private and government consumption, investment and the relative price of exports and imports – the terms of trade. The GDP deflator plays an important role in our fiscal forecast through its role in the Government's chosen public spending assumption, described in Chapter 4.

3.67 Our forecast for the GDP deflator has been revised down in the near term as lower private consumption and housing investment prices are only partly offset by a stronger terms of trade (Chart 3.22). The lower consumption deflator is due to revisions to our CPI forecast while lower housing investment prices reflect lower house price growth. The stronger terms of trade partly reflects the fact that the UK is a net importer of oil, the price of which has

fallen significantly. (The oil trade balance moved from surplus to deficit in 2003.) The net impact of the fall in oil prices on the GDP deflator is small as most of the consumption price impact comes from imported products, leaving only a fall in the price of exported oil to affect the GDP deflator. An alternative way to think about this is that the GDP deflator only reflects the price of goods and services produced in the UK and the share of oil production in UK GDP is fairly small, hence the small fall resulting from lower oil prices.

3.68 Medium-term GDP deflator growth is then stronger than our December forecast, thanks to higher growth in the price of government consumption, reflecting a smaller squeeze on such spending implied by the Government's medium-term spending assumption, particularly at the end of the forecast period. Higher growth in housing investment prices, reflecting stronger house price growth, also contributes.

Chart 3.22: GDP deflator



Source: ONS, OBR

Prospects for nominal GDP growth

3.69 Most public discussion of economic forecasts focuses on real GDP – the volume of goods and services produced in the economy. But the nominal or cash value of GDP – and its composition by income and expenditure – is more important in understanding the behaviour of the public finances. Taxes are driven more by nominal than real GDP. So too is the share of GDP devoted to public spending, as a large proportion of that spending is set out in multi-year cash plans (public services and administration) or linked to measures of inflation (benefits, tax credits and interest on index-linked gilts).

3.70 The latest ONS data indicate that nominal GDP grew by 4.4 per cent in 2014, weaker than the 5.0 per cent we expected in December. Most of this difference reflects ONS revisions to the first three quarters of 2014, which implied a somewhat weaker path for nominal

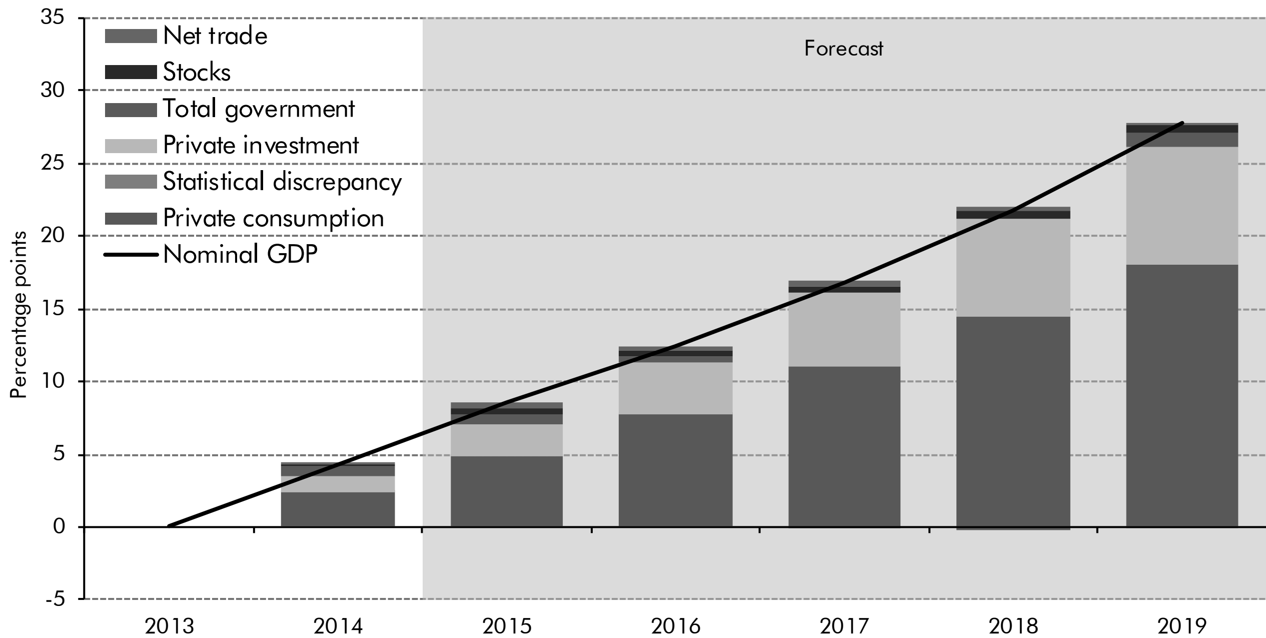
government spending and private consumption, and a stronger path for imports than earlier estimates (see Chapter 2). The latest estimates indicate nominal GDP growth of 0.4 per cent in the fourth quarter, around 0.2 percentage points weaker than we expected in December. The high-level breakdown published so far suggests that the additional weakness of nominal GDP growth in the fourth quarter has been concentrated in stocks and investment on the expenditure side, and profits on the income side.

3.71 We forecast that nominal GDP will grow by 4.1 per cent in 2015, falling back to 3.5 per cent in 2016 as calendar-year real GDP growth slows. We then expect growth of 3.8 per cent in 2017, picking up to 5.0 per cent by 2019 as temporary downward influences – notably the effect of fiscal consolidation on government consumption prices – ease. Overall, cumulative nominal GDP growth between the third quarter of 2014 and the start of 2020 is 1.9 percentage points higher than in our December forecast (25.5 per cent versus 23.6 per cent). Around 0.4 percentage points of this reflects an upward revision to our forecast of real GDP growth, with cumulative growth in the GDP deflator accounting for the rest.

Expenditure

3.72 Chart 3.23 sets out our forecast for cumulative nominal GDP growth by expenditure component. As the largest component of demand, private consumption is expected to be the biggest contributor over the forecast period. However, given the relatively slow growth of disposable incomes, we expect the share of consumption in nominal GDP to remain broadly stable over the forecast period. Private investment is expected to make a growing contribution to nominal GDP growth, as is typical during a recovery, with its share of nominal GDP increasing from just under 15 per cent in 2014 to just over 17 per cent in 2019. This offsets a fall in the contribution of government consumption and investment, which drops from around 22 per cent of nominal GDP in 2014 to just over 18 per cent by 2019. Prospects for individual sectors are set out in more detail later in this chapter.

Chart 3.23: Contributions to cumulative nominal GDP growth: expenditure

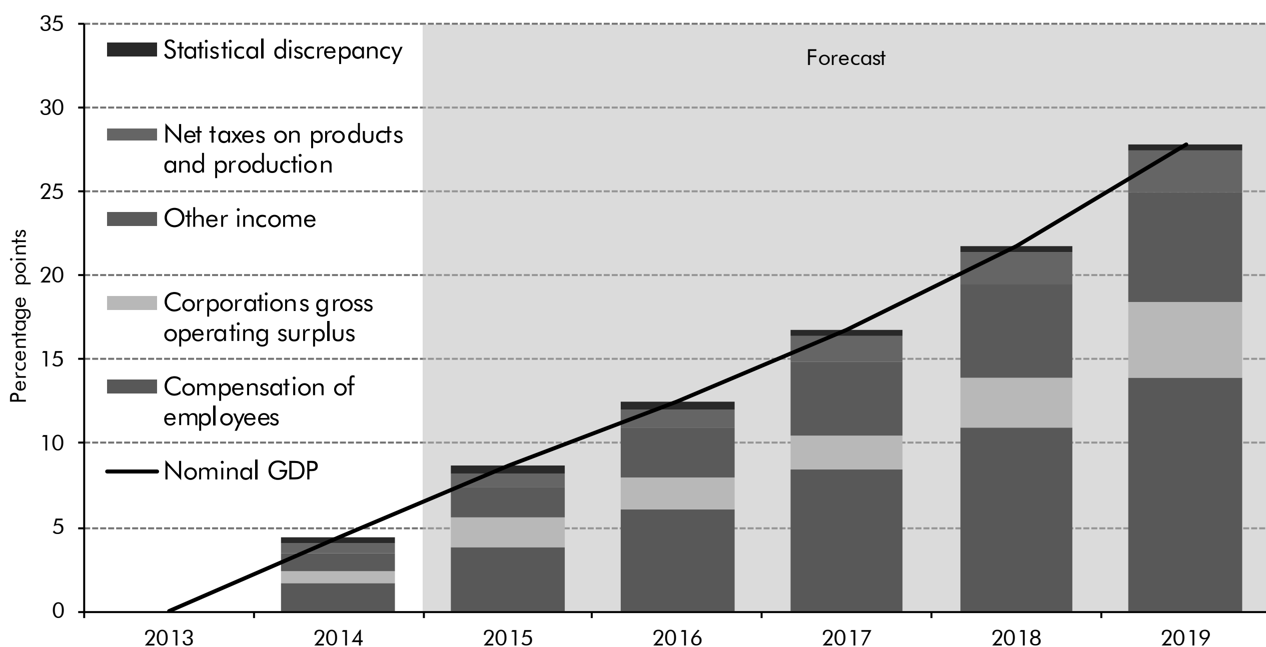


Source: ONS, OBR

Income

3.73 Chart 3.24 shows the contribution of different sources of income to cumulative growth in nominal GDP between 2014 and 2019. As the output gap closes, we expect profit margins to recover, with profit growth slightly outpacing nominal GDP growth in the near term. With real earnings forecast to grow in line with productivity, the share of labour income in nominal GDP is expected to remain broadly stable from 2015.

Chart 3.24: Contributions to cumulative nominal GDP growth: income



Source: ONS, OBR

Prospects for individual sectors of the economy

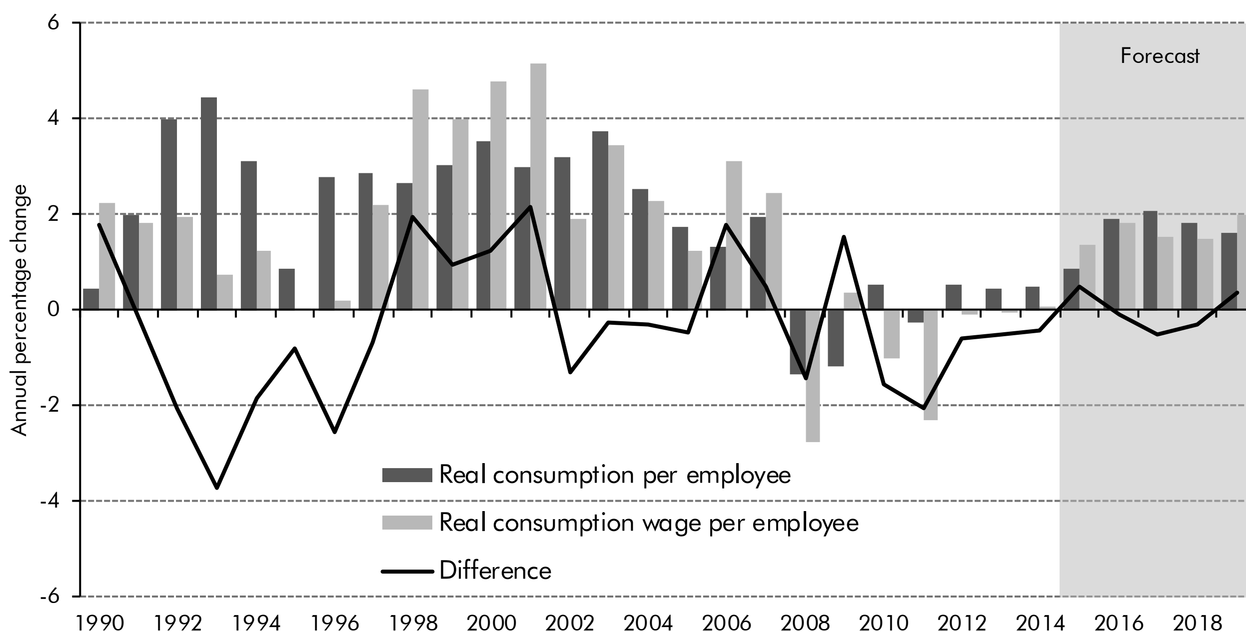
The household sector

3.74 The household sector is the largest source of income and spending in the economy, with consumer spending making up 65 per cent of nominal GDP by expenditure and household disposable income making up 66 per cent of nominal GDP by income in 2013.

Real consumer spending

3.75 Consumption growth slowed to 0.3 per cent in the final quarter of 2014, which implies that it grew by a cumulative 2.0 per cent in real terms through 2014 (Chart 3.25). This was despite little growth in real wages. The real consumption wage per employee is estimated to have been broadly flat in 2014, slightly stronger than we expected in December.

Chart 3.25: Real consumption wage and real consumption



Source: ONS,OBR

The labour market and household income

3.76 The unemployment rate has fallen steadily over recent quarters, reaching 5.7 per cent in the final quarter of 2014. We expect the rate of decline to ease over coming quarters as GDP growth slows and productivity growth picks up, allowing firms to expand output through their existing workforce rather than through recruitment. But the recovery in productivity per worker is likely to be gradual, and we expect sufficient momentum in the labour market for the unemployment rate to drop below its equilibrium level from mid-2015. A small gap is expected to remain until the start of 2018, as productivity growth takes time to fill the slack. The broad picture is similar to our December forecast, but we now forecast that, within productivity per worker, average hours will be somewhat firmer over the near term and hourly productivity growth slightly weaker.

3.77 The Labour Force Survey (LFS) measure of unemployment has fallen in line with our recent expectations, but the claimant count has fallen further relative to both the LFS measure and our December forecast. This mainly reflects a drop in the rate of inflows, although a rise in the rate of outflows has also played a role. The disproportionate decline in the claimant count could be due to some features of the benefit system, including a tightening of the JSA sanctions regime relative to other benefits and tax credits. But it is difficult to isolate the importance of such factors against more general labour market developments.[10] We expect the claimant count to fall even further relative to the LFS measure, but that both measures will be broadly stable from the beginning of 2016.

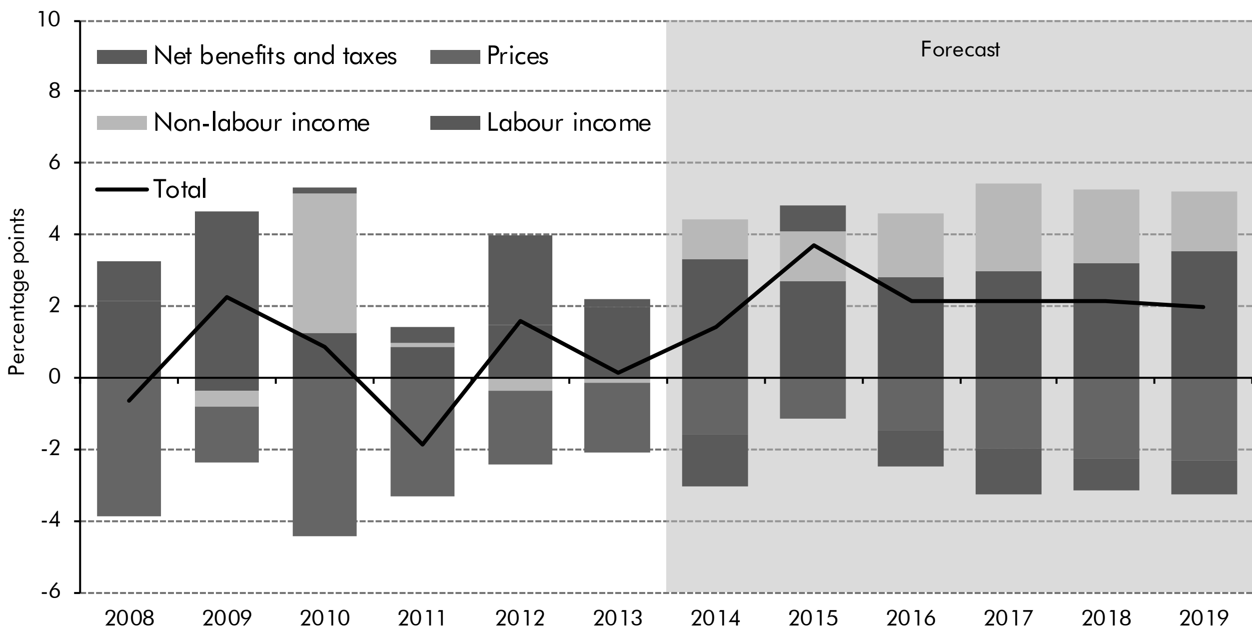
3.78 The National Accounts measure of wages and salaries is currently stronger than would be implied by multiplying employee numbers in the LFS by the average weekly earnings (AWE) measure of earnings. This means that the measure of average earnings growth we forecast – based on the National Accounts – has been stronger than the headline AWE measure, rising by an estimated 2.2 per cent in 2014, relative to 1.2 per cent growth in the AWE. The National Accounts uses AWE data (until administrative tax data become available), so in principle the two should be consistent and we expect this gap to unwind in 2015. But one consequence is that our forecast measure is essentially flat across the two years, masking some underlying momentum in earnings.

3.79 We expect real earnings growth to rise in the near term as inflation continues to fall and nominal earnings pick up, and over the medium term as productivity growth returns to more normal levels. This implies that the real consumption wage will not rise above its pre-crisis peak in the third quarter of 2007 until the end of 2018.

3.80 Over the forecast period, we expect labour income to be the largest contributor to growth in real household disposable income, although to a lesser extent than in the pre-crisis period given weaker productivity growth. We also expect non-labour income growth to pick up, helped by a cyclical recovery in corporate profits supporting dividend income. Lower inflation over the near term will also support real income growth. The result is real household disposable income growth of 3.7 per cent in 2015, and around 2 per cent thereafter, as inflation returns to target and productivity growth picks up.

[10] See Box 8.1 of our 2014 *Welfare trends report* for a fuller discussion.

Chart 3.26: Contributions to real household income growth

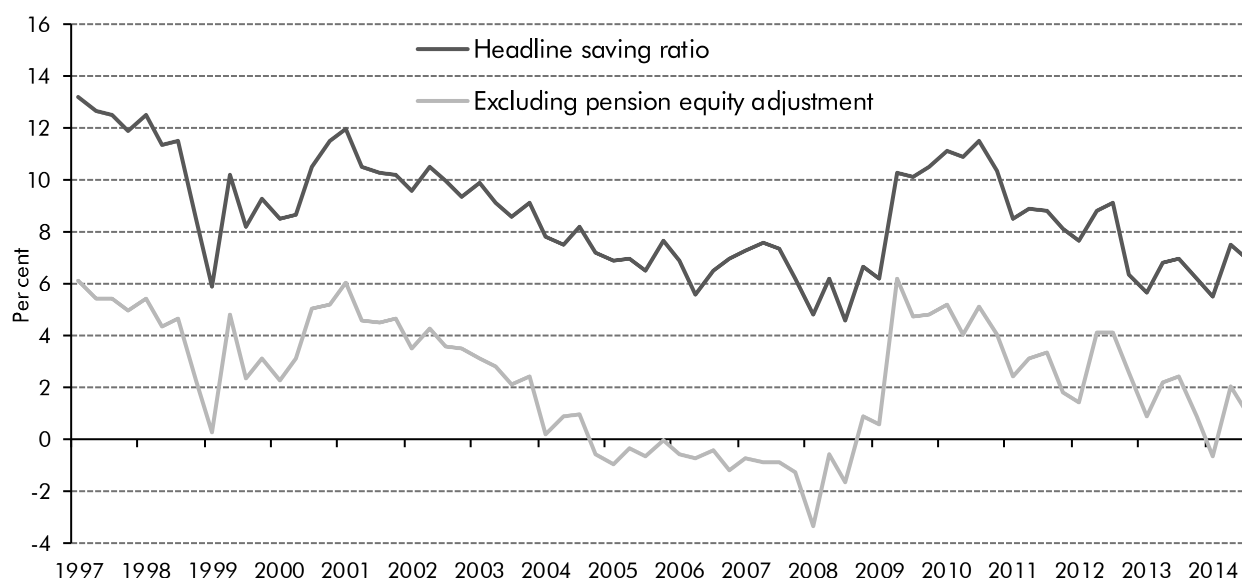


Source: ONS, OBR

The saving ratio

3.81 The headline saving ratio fell back sharply between 2012 and 2013, supporting a pick-up in household consumption despite ongoing weakness in household income growth. Since then, the household saving ratio has stabilised, averaging around 6½ per cent in 2013 and 2014. Nominal household consumption has continued to grow more strongly than household disposable income (with the former growing by around 6½ per cent and the latter by just over 5 per cent between the final quarter of 2012 and the third quarter of 2014), but this has been offset by an increase in measured pension saving. If the adjustment for pension saving is excluded, then the saving ratio continued to decline in 2013 and 2014 (Chart 3.27).

Chart 3.27: The household saving ratio



Note: Estimate of the saving ratio excluding the pension equity adjustment calculated as household disposable income less consumption, as a proportion of houshold disposable income.
Source: ONS, OBR

3.82 With real household disposable income expected to outstrip real consumption over the near term, we expect the saving ratio to pick up slightly in 2015. Thereafter we expect it to remain broadly stable, with consumption growing in line with household incomes. The starting level of the saving ratio is higher than in our December forecast, reflecting the strength of pension saving in the latest data. But from 2015 this is partly offset by a weaker outlook for the *growth* of pension saving, which reflects the direct effect of the fall in gilt yields on investment income.[11]

The housing market and dwellings investment

3.83 House price inflation has eased more quickly than we expected in December, with year-on-year growth of 10.0 per cent in the fourth quarter of 2014, 0.8 percentage points lower than expected (Chart 3.28). Housing market indicators suggest price growth will continue to slow in coming quarters, so we have lowered our near-term house price forecast. But the fundamental factors that drive our house price model thereafter suggest stronger price growth than in December, which has fed through to a higher medium-term forecast.[12]

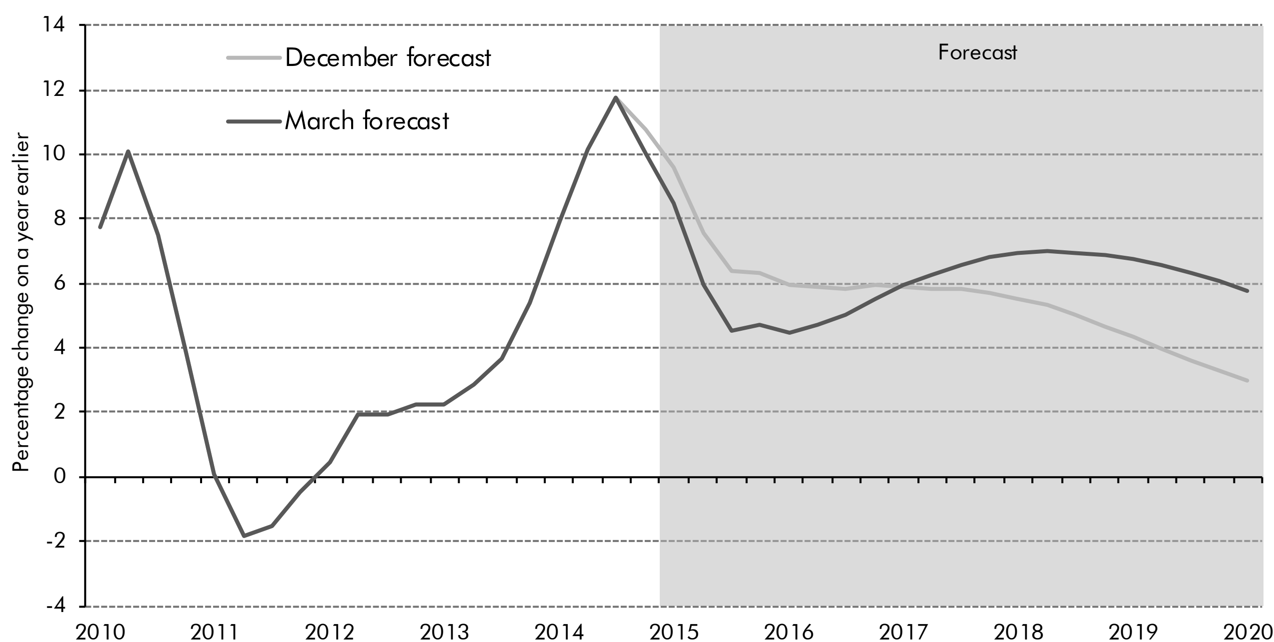
3.84 Relative to our December forecast, there is additional upward pressure on prices from the demand fundamentals with little change in expectations for supply. The additional housing demand mainly comes from stronger real income per household, partly as a result of the recent falls in energy prices, with a partial offset from higher mortgage interest rates over most of the forecast period. The level of house prices in the first quarter of 2020 is 3.9 per cent higher than in our December forecast. Overall, house prices are expected to rise by

[11] Following changes to the treatment of pension saving in Blue Book 2014, investment income is now calculated as opening pension liabilities multiplied by the yield on 15 year gilts. See ONS, *Changes to National Accounts: The Impact of the Changes to the Treatment of Pensions in the National Accounts*, September 2014.
[12] For more information on our house price model see Auterson (2014): *Working paper No. 6: Forecasting house prices*.

35.5 per cent by the first quarter of 2020. Relative to their pre-crisis peaks in 2007, real house prices at the end of the forecast are expected to be 14.4 per cent higher and the ratio of house prices to average earnings 11.2 per cent higher.

3.85 There is a risk that the greater flexibility over people's access to their pension assets, announced in Budget 2014 and due to come into effect in April 2015, could affect the housing market. As we explained in Box 3.1 of the December 2014 *EFO*, we have not adjusted our forecast as we assume that there will be offsetting effects from the flows associated with this policy change, but the effects are highly uncertain and, in reality, are unlikely to net off precisely.

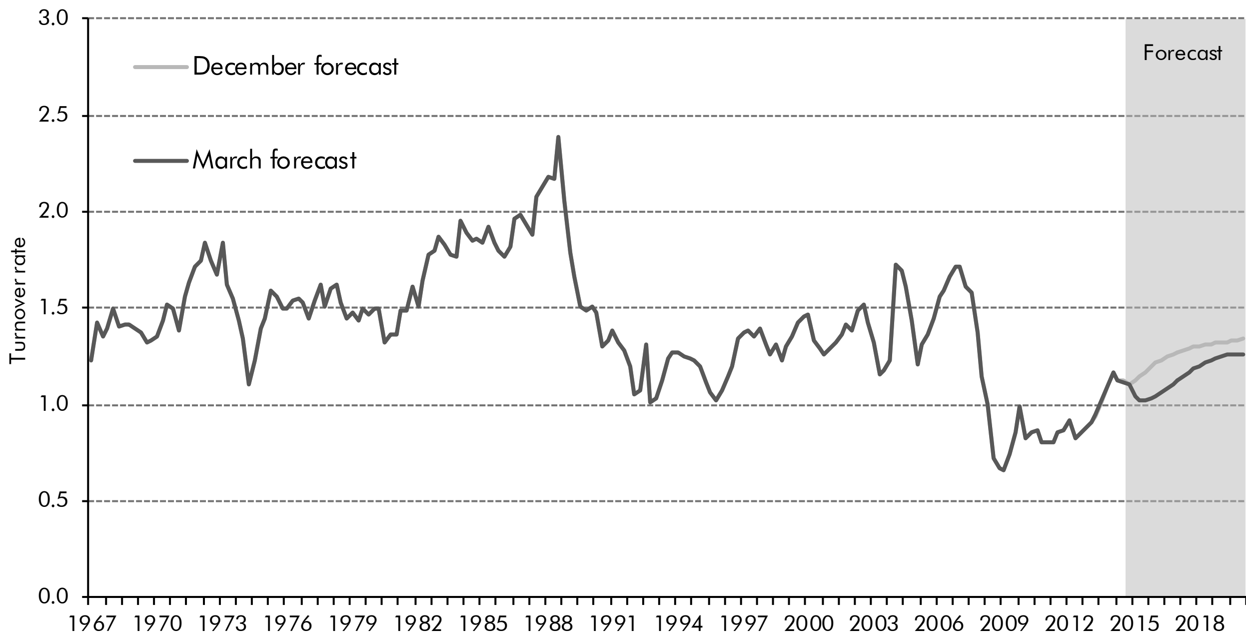
Chart 3.28: House price inflation forecast



Source: ONS, OBR

3.86 We have revised down our near-term residential property transactions forecast again as the latest data have been below our December forecast and mortgage approvals remain subdued. Among other factors, it appears that the Mortgage Market Review regulations on lending have had a larger and more persistent effect than we had assumed. We have also revised down our medium-term transaction forecasts. We assume that the volume of transactions returns towards its historical average as a percentage of the housing stock over the forecast period. Previously the period over which we took the average was 1991 to 2007. We have now excluded the period from 2004 to 2007 – the height of the pre-crisis boom – as a guide to medium-term turnover rates. This has reduced the turnover rate we use to anchor our medium-term forecast (Chart 3.29).

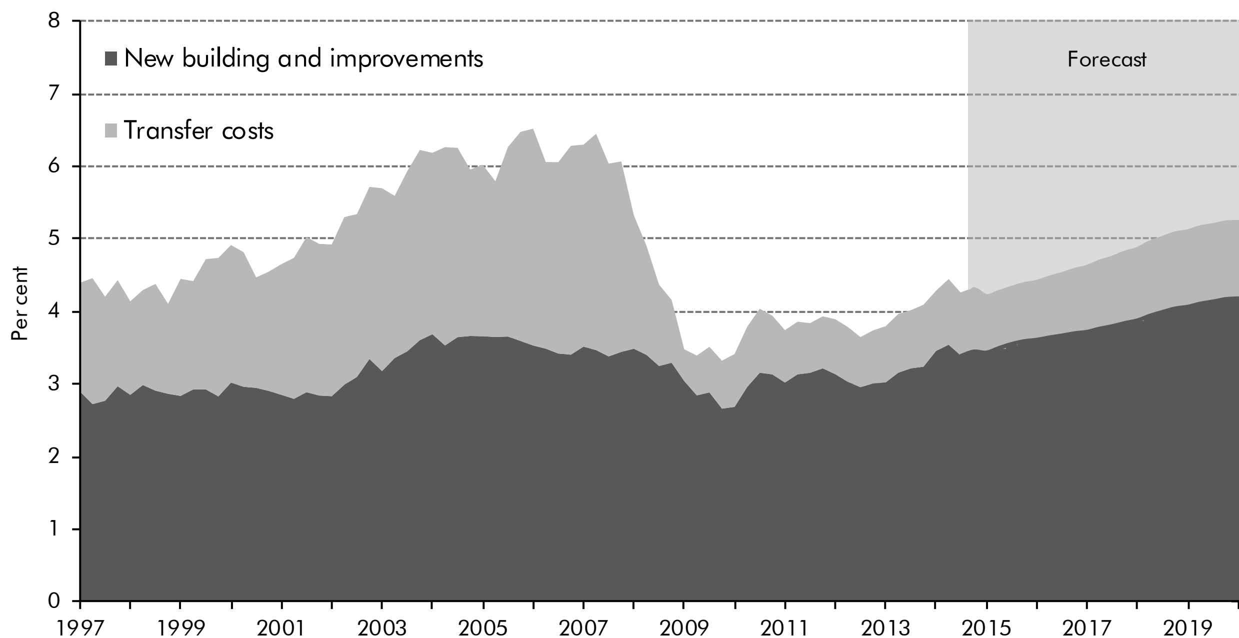
Chart 3.29: Quarterly residential property turnover rate



Source: ONS, OBR

3.87 In line with our forecasts for house prices and property transactions, we expect relatively strong growth in residential investment over the forecast period. Near-term growth in housebuilding is encouraged by recent strong growth in house prices, while medium-term strength is motivated by housing market turnover returning towards its historical average. But, despite relatively strong rates of growth in the forecast, total private residential investment as a share of GDP is expected to remain below its pre-crisis peak throughout the forecast period (Chart 3.30).

Chart 3.30: Residential investment as a share of nominal GDP



Source: ONS, OBR

Net lending and the balance sheet

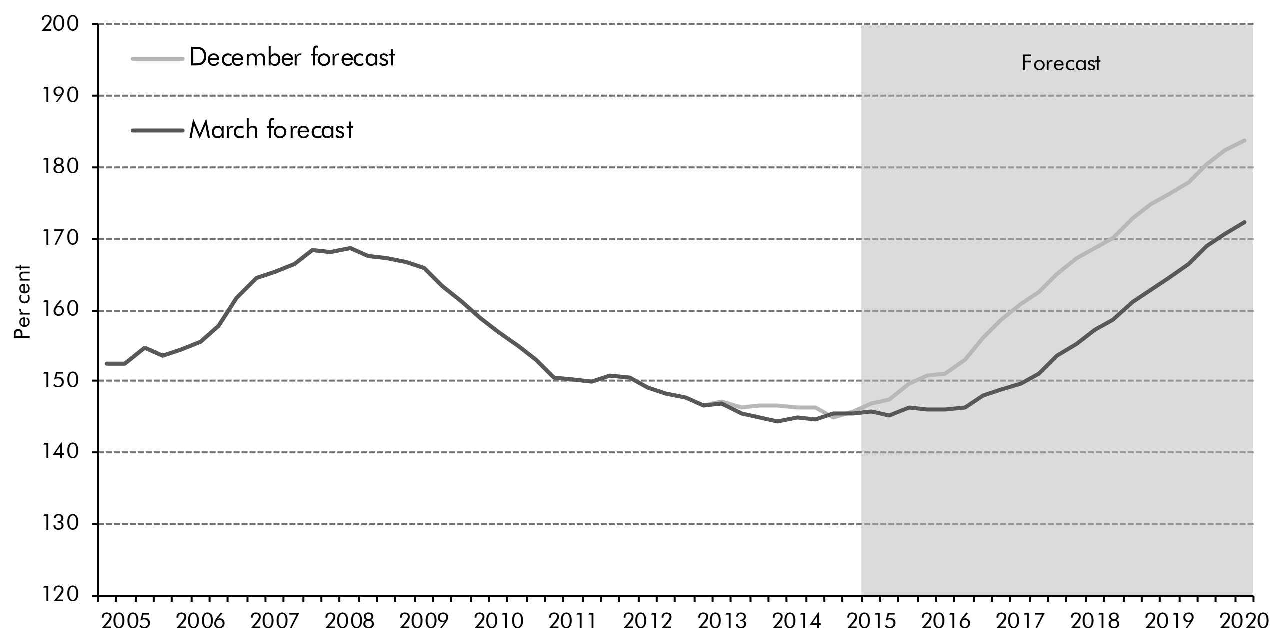
3.88 The saving ratio is expected to fall back slightly between 2015 and 2019. Taken together with strong growth in household investment, this will push households' overall net lending position – total income less total spending – into deficit. In an accounting sense, this, together with a gradual improvement in the current account and a decline in corporate net lending, provides the offset to the Government's fiscal consolidation (Chart 3.39).

3.89 With household net lending negative and relatively strong house price growth driving mortgage borrowing, the ratio of households' gross debt to income is projected to rise again from 2015, having fallen steadily since 2008 (Chart 3.31). Of the 27 percentage point increase in the ratio over the forecast period, around 16 percentage points reflect an increase in secured debt. The remainder reflects higher unsecured debt relative to income, which in turn reflects the deterioration in households' net balance to an historically large deficit over the forecast period.

3.90 The gross household debt to income ratio has been revised down since our December forecast. This reflects a number of factors:

- in cash terms, the level of gross debt is expected to be £144 billion lower by the start of 2020 than we forecast in December, of which £14 billion reflects a lower starting point;
- around £47 billion of this reflects a lower path for secured debt – which in turn reflects lower growth in property transactions;
- around £83 billion reflects less accumulation of unsecured debt – as we have revised down household investment and consumption. We have also factored in an ongoing reduction in households' outstanding unsecured debt through write-offs, which had not been incorporated in our previous forecasts; and
- the level of household disposable income at the end of the forecast is expected to be around 1 per cent higher than expected in our December forecast.

Chart 3.31: Household gross debt to income



Source: ONS, OBR

The corporate sector

Business investment and stockbuilding

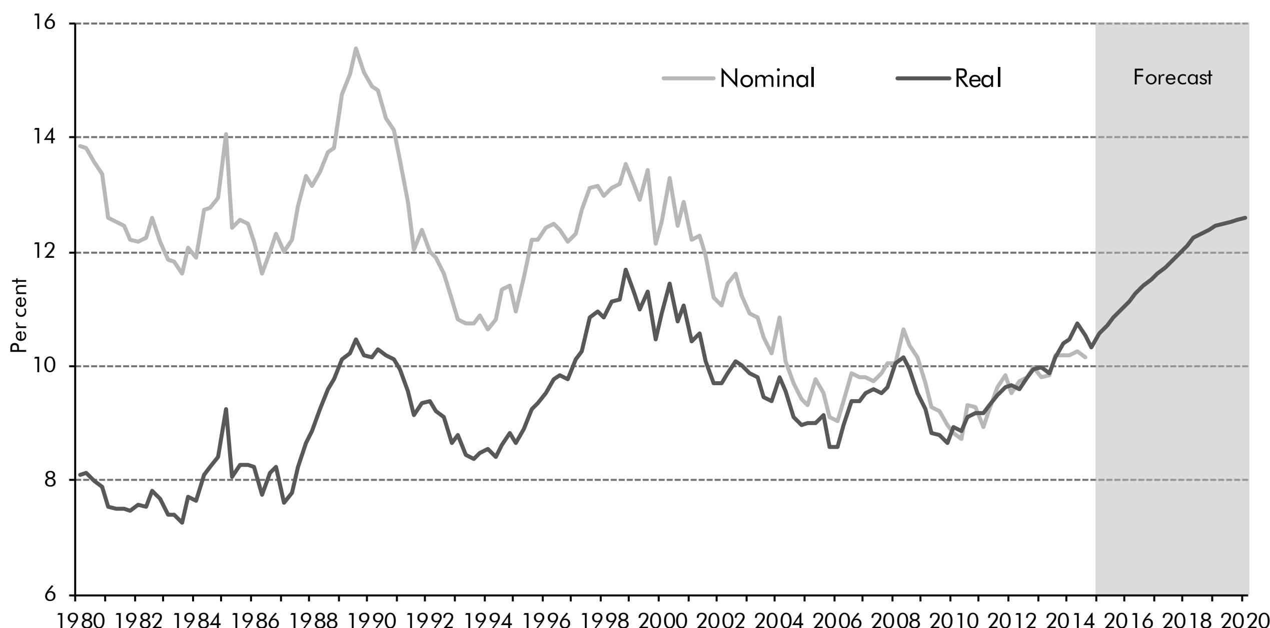
3.91 The latest data show that business investment fell by 1.4 per cent in the fourth quarter of 2014 after a 1.2 per cent fall in the third quarter. Despite that, business investment is estimated to have increased by 6.8 per cent in 2014 as a whole. We expect business investment to continue to grow relatively strongly in 2015, albeit at a slower rate than we forecast in December. Business investment growth has been revised up between 2016 and 2018, but is lower in 2019 than we forecast in December.

3.92 The weight of activity in the North Sea in whole economy investment is much higher (above 7 per cent) than its weight in GDP (less than 2 per cent), in part due to the unusually high North Sea investment of recent years. We therefore expect the boost to onshore investment from lower energy costs to be more than offset by the direct effect of lower investment in the North Sea. (Prospects for investment in the North Sea are covered in more detail in Chapter 4.) As usual, the latest ONS data are subject to potentially large revisions, so our forecast is subject to considerable uncertainty. The Bank of England's *Agents' Summary* reports investment intentions consistent with modest growth over the next twelve months, although investment intentions have eased since our December forecast.

3.93 As Chart 3.32 shows, our forecast implies real business investment rising as a share of GDP, as typically occurs during the later stages of a recovery. It also shows how the nominal share has tended to fall relative to the real share because investment goods price inflation has tended to be lower than whole economy inflation.

3.94 The latest ONS data indicate that stocks contributed 0.2 percentage points to GDP growth in 2014. We expect inventories to make a contribution to GDP growth of 0.1 percentage points in 2015 and assume they will be neutral from 2016.

Chart 3.32: Business investment as a share of GDP



Source: ONS, OBR

Corporate profits

3.95 Non-oil, non-financial company profits are forecast to grow more quickly than GDP in 2014 and 2015 as the output gap continues to narrow. Relative to our December forecast, we have revised down profit growth in 2015, in line with the downward revision to our forecast of nominal GDP growth and latest outturns. From 2016 we expect profits to grow broadly in line with nominal GDP.

The government sector

3.96 Total public spending amounted to 41.7 per cent of GDP in 2013-14.[13] But not all government spending contributes directly to GDP. Spending on welfare payments and debt interest, for example, merely transfers income from some individuals to others. The government sector contributes directly to GDP via consumption of goods and services, and investment. These together accounted for 22.4 per cent of GDP in 2013-14.

Real government consumption

3.97 Real government consumption is estimated to have grown by 1.5 per cent in 2014, compared with estimated growth of 1.1 per cent at the time of our December forecast, and is forecast to grow by 0.8 per cent in 2015, having been forecast to fall in our December forecast. Our government consumption forecast is similar to December between 2016 and

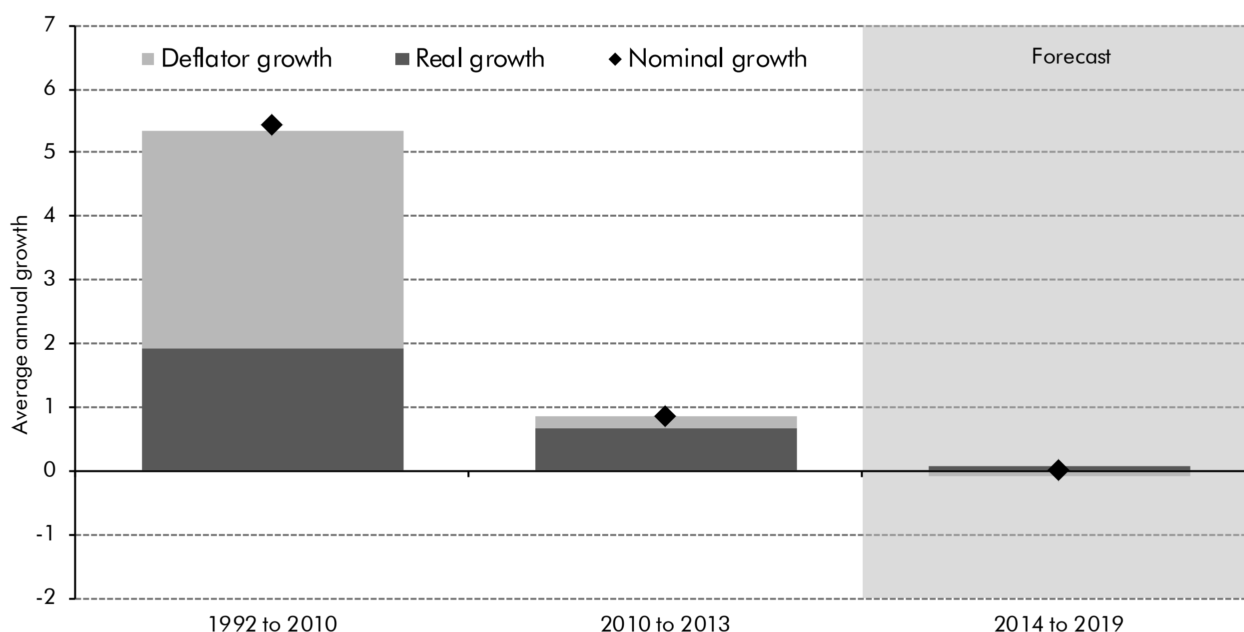
[13] Total managed expenditure (TME).

2018, but has been revised up significantly in 2019, reflecting the Government's decision to change the assumption it applies to total spending in that year.

Nominal government consumption

3.98 Growth in the implied price of government consumption – the ratio of nominal spending to real government consumption – has been subdued as cash spending growth has slowed. The government consumption deflator is not expected to fall to the same extent as in our December forecast (Chart 3.33). The upward revision in 2019 is especially large, with the Government having decided to change its total spending assumption in that year, so that the government consumption deflator rises by 3.5 per cent in 2019. It was flat in December. This change adds around 0.6 percentage points to growth in the GDP deflator and nominal GDP in that year.

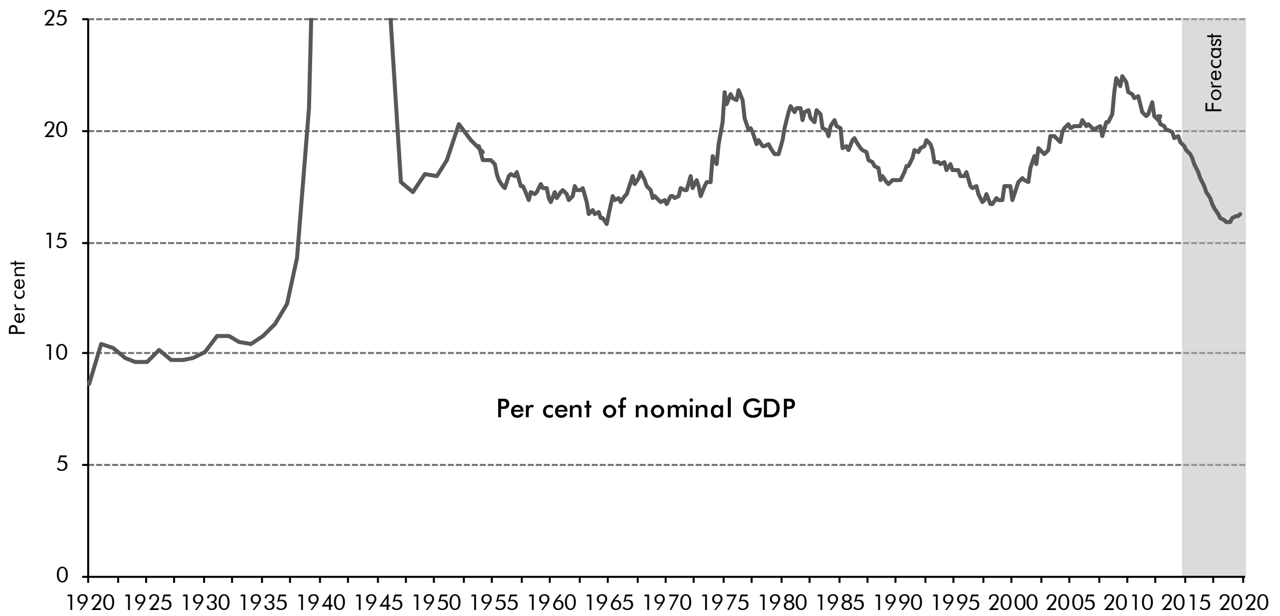
Chart 3.33: Government consumption



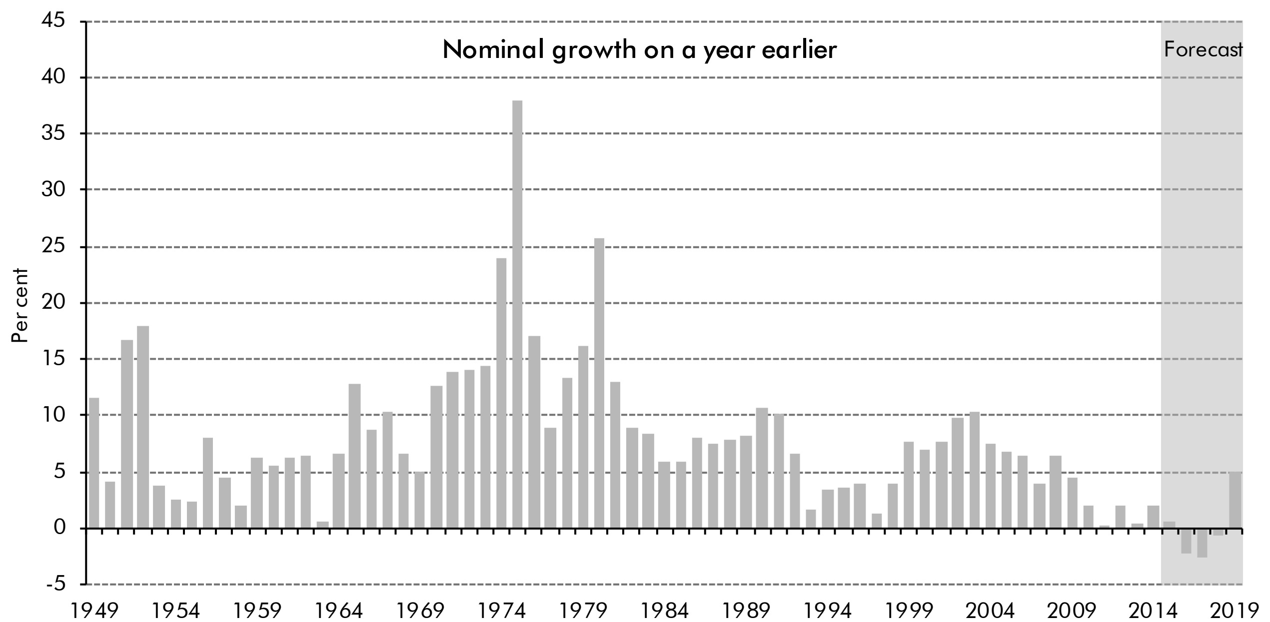
Source: ONS, OBR

3.99 Relative to the size of the economy, nominal government consumption is forecast to fall from 19.7 per cent of GDP in 2014 to 16.1 per cent of GDP by 2019. This is less of a fall than we forecast in December, but would still leave government consumption as a share of GDP equal to its level in 1964 and would be the joint lowest level in consistent National Accounts data going back to 1948. On a quarterly basis, government consumption falls to 15.9 per cent of GDP at the end of 2018. This is marginally above its previous low of 15.8 per cent, again in 1964. Chart 3.34 also shows pre-war estimates taken from the Bank of England's historical dataset.

Chart 3.34: Government consumption of goods and services



Note: Government consumption as a share of GDP is estimated to have peaked at 52.2 per cent of GDP in 1944.



Note: Government consumption on a National Accounts basis, excluding Network Rail
Source: ONS, OBR

General government employment

3.100 In the absence of specific workforce plans, we project general government employment based on some simple and transparent assumptions. We begin by taking our forecasts of government spending on total pay – the paybill, which we proxy using a measure of current government expenditure. We then combine these top-down numbers with our forecasts of government wage growth to derive paybill per head. From this we derive a projection of general government employment – headcount. In reaching a judgement on general government wage growth, we take into account stated government policy (such as pay freezes), historical rates of pay drift and recent data. Reflecting the uncertain timing of

employment cuts and wage changes, we simply assume that the profile of government employment will match the profile of government consumption, which largely comprises pay and procurement costs.

3.101 Applying the Government's latest medium-term spending assumptions to our fiscal forecast implies an unusual year-to-year profile for government employment. Overall, our government consumption forecast implies that general government employment will fall by 0.8 million by the first quarter of 2019, making a total fall from early 2011 of 1.1 million, before rising by 150,000 in the final year of the forecast period. This represents an overall 20 per cent fall in headcount, consistent with departmental and local authorities' cash spending remaining broadly flat, and modest annual wage growth. Again, we expect the fall to be more than offset by a 1.7 million rise in market sector employment, making a rise in total employment of 1.1 million by the start of 2020.[14] Even more than usual, we would emphasise the stylised nature of the assumptions underpinning these numbers, which imply sharp falls in general government employment in 2016-17 and 2017-18 but also a rise in 2019-20. If, when detailed spending plans are set by a future Government, any of the simplifying assumptions described above did not hold (as will inevitably be the case) the scale and profile of these reductions would be expected to change.

The external sector

Export and import volumes

3.102 The latest ONS data contained upward revisions to export growth in 2014 relative to our December forecast. Strong growth in exports in the fourth quarter of 2014 also means that our forecast for exports has been revised up substantially in 2015. Given that we have lowered our forecast for growth in UK export markets in 2015, this implies a higher export market share (Chart 3.35). Lower expected growth in UK export markets is expected to feed through to lower growth in exports from 2016 onwards, which means that the declining path for the UK export market share is similar to our December forecast.

[14] These estimates exclude a classification change introduced in the second quarter of 2012, which moved around 196,000 employees from the public to the private sector. Further details about the assumptions for public sector wages and employment can be found in the supplementary economy tables available on our website.

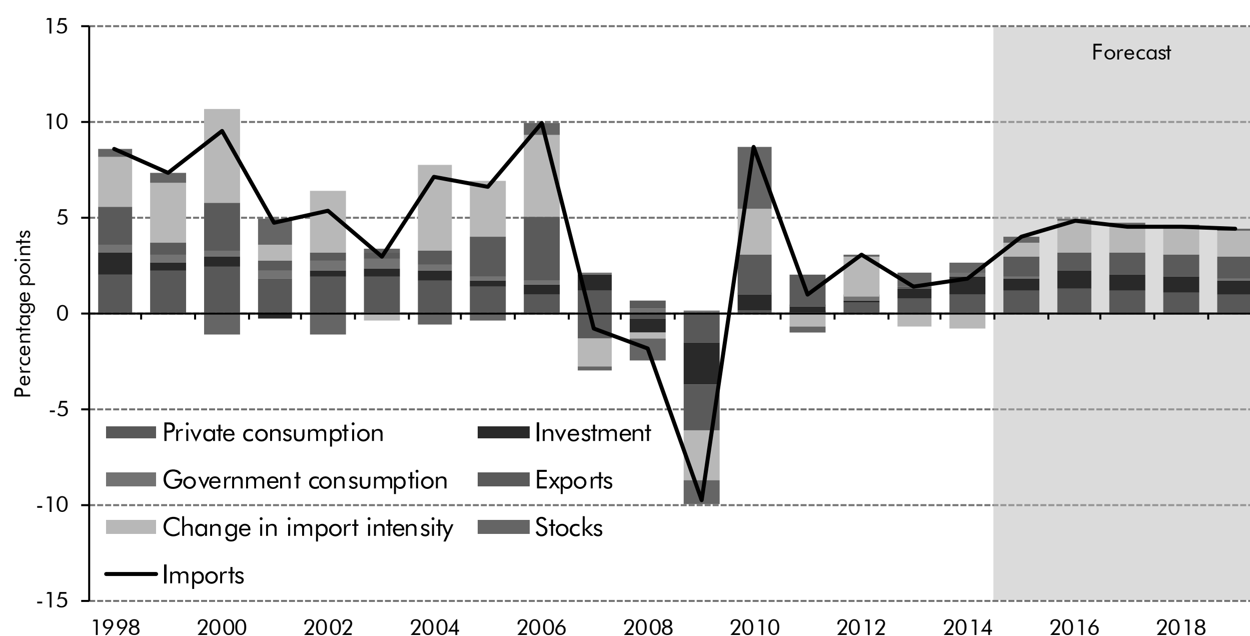
Chart 3.35: UK export market share

Note: UK export share defined as exports divided by UK export markets, where exports series have been adjusted to account for the effect of VAT Missing Trader Intra Community (MTIC) fraud.
Source: OECD, ONS, OBR

3.103 Outturn data show that imports grew strongly in the fourth quarter of 2014. Revisions to outturn data also suggests that imports growth was stronger over the first three quarters of 2014 than was estimated at the time of our December forecast.

3.104 Our forecast for imports is determined by the outlook for import-weighted domestic demand and a trend rise in the import intensity of that demand. Import-weighted domestic demand has been revised up in 2015, due largely to the boost to real consumer spending from lower oil prices and the data-driven revision to exports growth (which are import intensive).

Chart 3.36: Contributions to import-weighted domestic demand and import growth



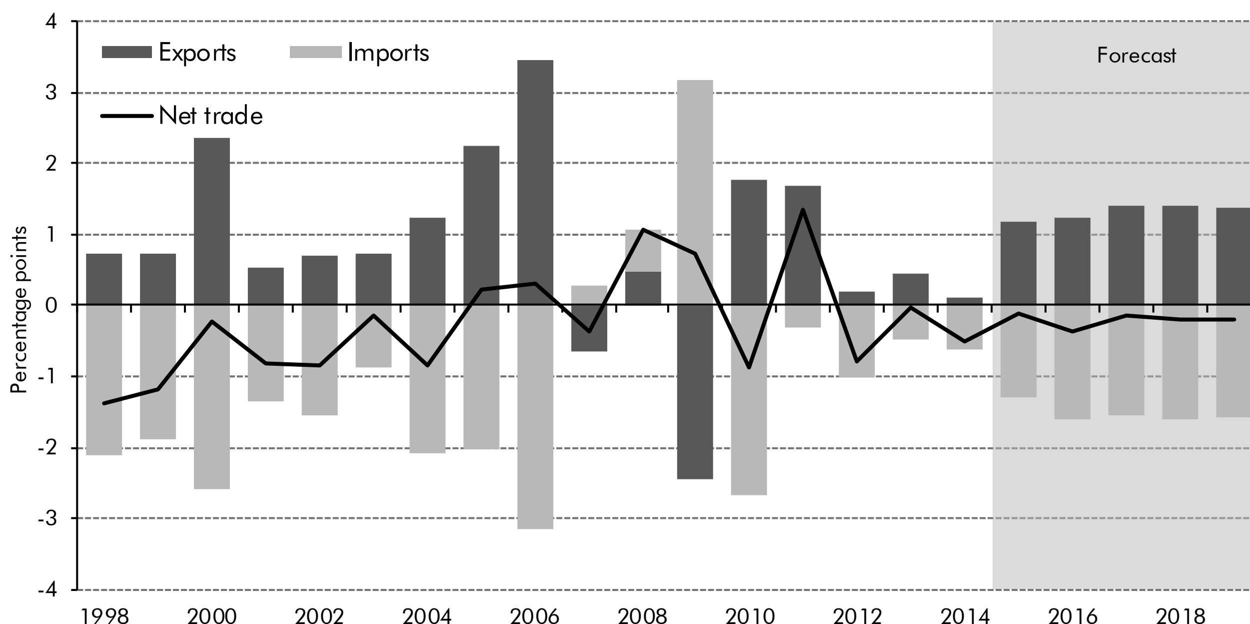
Source: ONS, OBR

The terms of trade and the trade balance

3.105 Since our December forecast, the terms of trade have been revised up slightly in 2014 due to stronger export prices more than offsetting higher import prices. The fall in the oil price boosts the terms of trade slightly in 2015, but it is broadly unchanged thereafter. Compared with our December forecast, we have revised up our forecast for exports growth in 2015, whereas our forecast for imports growth is little changed. Net trade is therefore expected to make a smaller negative contribution to GDP growth in 2015. Thereafter, net trade is expected to make a small negative contribution to annual GDP growth in each year, reflecting the weakness of export market growth, a gradual decline in export market share and a gradual increase in the ratio of imports to import-weighted domestic demand.

3.106 Our trade forecast includes estimates of oil imports and oil exports that are produced in a relatively mechanistic way. In volume terms, oil exports are determined by oil production and the share of North Sea output that is exported, while oil imports are derived from an assumption about the oil intensity of domestic activity and the proportion of North Sea production that is consumed domestically. These volumes are inflated to nominal exports and imports using our oil price assumption. Based on these assumptions, trade in oil subtracts 0.3 percentage points from GDP growth in 2015. This means that the trade deficit widens in 2015, subtracting 0.1 percentage points from GDP growth. Details are available in the supplementary economy tables on our website.

Chart 3.37: Net trade contribution to real GDP



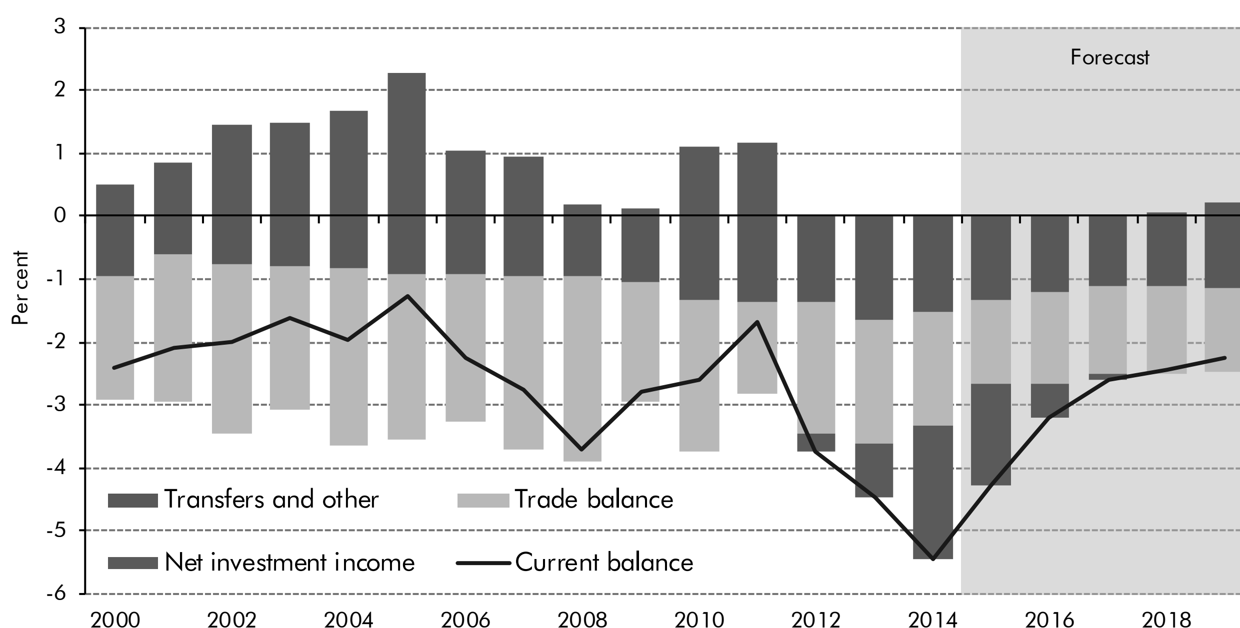
Source: ONS, OBR

The current account balance

3.107 The current account deficit remains wide by historical standards. It increased to around 6 per cent of GDP in the third quarter of 2014, the second largest quarterly deficit in National Accounts data stretching back to 1955. While this in part reflects the ongoing weakness in net trade, much of the recent deterioration reflects a significant worsening of the income balance: the income account deficit widened to 2.7 per cent of GDP in the third quarter of 2014, compared to an average *surplus* of around 1 per cent in the pre-crisis decade. The main source of the deterioration has been weaker rates of return on the UK's assets relative to its liabilities. Box 3.4 discusses recent developments in investment income in more detail.

3.108 We continue to expect the income account to improve gradually over the forecast period. But relative to our December forecast, we now expect a much slower return to typical net rates of return, consistent with the downward revision to our near-term forecast for global growth and movements in global interest rate expectations. The income account forecast remains subject to significant uncertainty, and is based on the assumption that relative rates of return have been temporarily depressed and will normalise as global growth gathers momentum. This has led us to revise our forecast of the current account deficit wider over the forecast period relative to December – by an average of around ½ per cent of GDP between 2014 and 2019.

Chart 3.38: Current account balance as a share of GDP



Source: ONS, OBR

Box 3.4: Recent movements in the income balance

We expect the current account deficit in 2014 as a whole to have been 5.4 per cent of GDP. This would be the largest peace-time deficit since at least 1830, based on the Bank of England's historical dataset. [a]

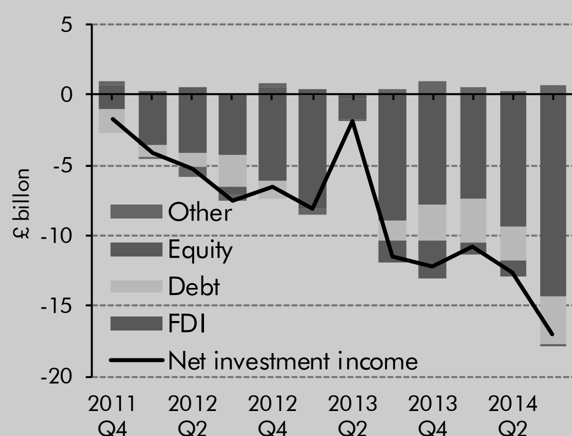
Much of the widening of the deficit in recent years reflects a significant deterioration in the net income earned on cross-border investment. Net investment income – the income earned on the UK's overseas investments, minus the income earned by overseas investors on their UK investments – averaged a surplus of 1.2 per cent of GDP between 2000 and 2008. Since mid-2011, the income balance has deteriorated from a 2.2 per cent of GDP surplus to a 2.7 per cent deficit in the third quarter of 2014.

In assessing changes in the income balance it is useful to decompose net investment income into its four components: net income on foreign direct investment (FDI); net income on debt securities; net income on equity; and net income on other assets. Chart B shows that the deterioration in the net investment income balance since 2011 is largely attributable to the deterioration in net income earned on FDI, with a smaller negative contribution from net income earned on debt securities.

Changes in the net income earned on investments can reflect changes in the stocks of those investments or changes in the net rate of return on them. Since the end of 2011, the stock of FDI assets has fallen while the stock of liabilities has continued to rise. All else equal this will have served to reduce net FDI income. In addition, the net rate of return on FDI has fallen sharply in recent quarters and remains well below pre-crisis levels (Chart C): between 2000 and 2007, the net rate of return on FDI averaged 1.9 percentage points; this compares to an average of 1.6 percentage points since 2012 and 1.2 percentage points so far in 2014.

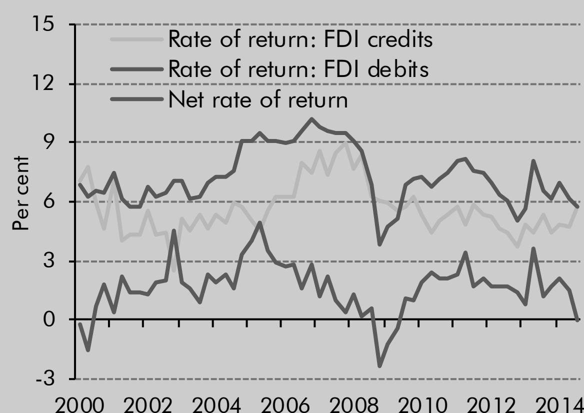
Analysing why the income balance has deteriorated so sharply is complicated both by the volatility of the series and by revisions to early estimates. One possibility is that relatively weak growth in the UK's trading partners – most notably the euro area – has depressed returns on the UK's overseas foreign direct investments relative to overseas foreign direct investment in the UK. Regional analysis of income flows suggests that a large part of the deterioration in FDI earnings can be attributed to lower earnings in Europe – most notably in the information and communications sector.[b] While not verifiable in the published data, it seems likely that the very large cross-border fines and compensation paid by BP and some large banks (to the United States in particular) will also have depressed measured rates of return on those sectors' overseas assets. The deterioration in net income on debt securities may reflect changes in the composition of the debt held by UK residents or issued by UK companies.[c]

Chart B: Change in net investment income since 2011



Note: Change in the level of net investment income relative to its average level in 2011
Source: ONS, OBR

Chart C: Rates of return on foreign direct investment



Note: Annualised earnings as a proportion of the stock of FDI assets/liabilities

[a] Bank of England, *Three centuries of data on the UK economy*, 2010.
[b] ONS, *Economic Review*, February 2015.
[c] Bank of England, *Inflation Report*, May 2014.

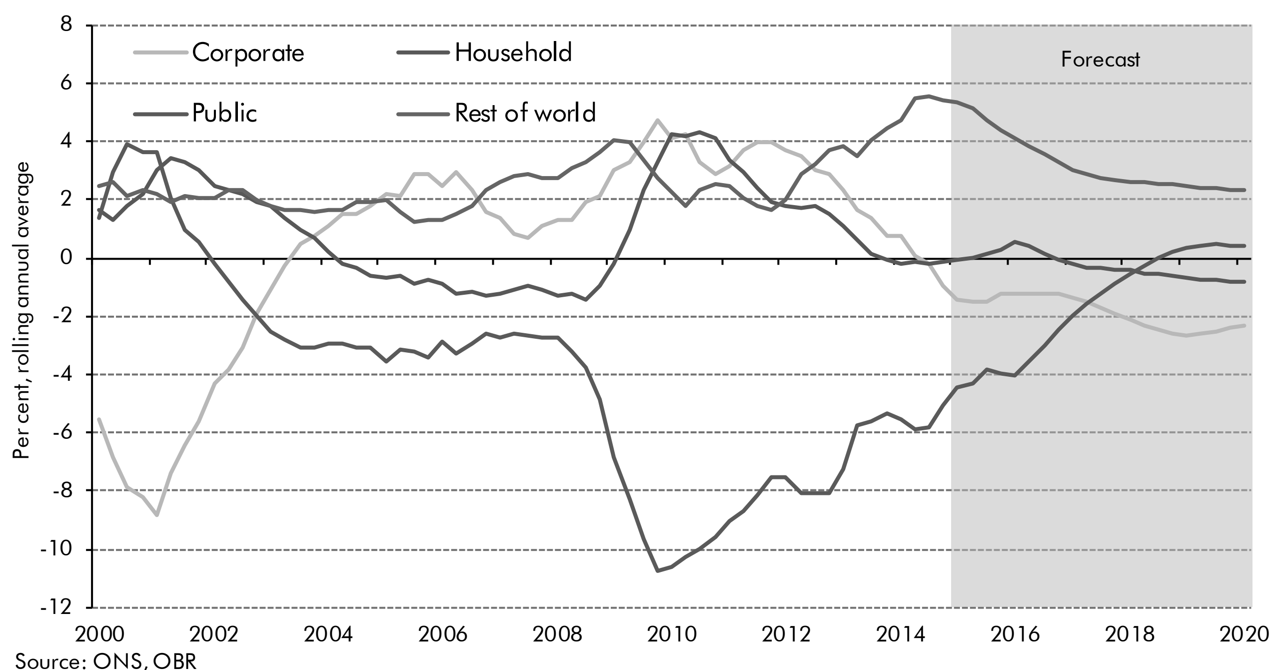
Sectoral net lending

3.109 In the National Accounts framework that we use for our economic forecast, the income and expenditure of the different sectors imply paths for each sector's net lending or borrowing from others. By identity, these must sum to zero – for each borrower, there must be a lender. In 2014, we estimate the public sector to be in deficit, households and companies close to balance, and the rest of the world to be in surplus (Chart 3.39).

3.110 By the end of the forecast period, we expect the public sector's balance to have moved into surplus as the fiscal consolidation continues (see Chapter 4). The household sector provides part of the offsetting change, with household net lending moving from a deficit of -0.1 per cent of GDP in 2014 to a larger deficit of -0.8 per cent of GDP in 2019. The gradual narrowing of the current account deficit over the forecast period means that the external sector also plays a role in offsetting the fiscal consolidation, while the rising share of

business investment in GDP means that corporate sector net lending is also expected to decline over the forecast period.

Chart 3.39: Sectoral net lending



Source: ONS, OBR

Risks and uncertainties

3.111 As always, we emphasise the uncertainties that lie around our central forecast for the economy, and the implications that these can have for the public finances (see Chapter 5). There are some risks and uncertainties common to all forecasts: conditioning assumptions may prove inaccurate; shocks may prove asymmetric; and previously stable relationships that have described the functioning of the economy may change.

3.112 In addition, prevailing economic circumstances suggest some specific risks to the forecast. In this *EFO*, we consider the following to be among the key risks:

- further instability in euro area economies and banking systems remains a key risk. Recent developments in Greece have once again highlighted concerns about the sustainability of the public finances in the region – particularly in an environment of very low inflation and weak medium-term growth prospects, with a number of euro area countries yet to complete the adjustment toward sustainable growth and competitiveness;

- geopolitical tensions continue to pose risks through trade linkages and financial exposures to affected countries;

- while the UK's main export markets are weighted heavily towards oil-importing countries, the significant fall in the oil price may have adverse implications for the

outlook if deteriorating prospects for oil producers have significant spillover effects via trade or financial markets;

- domestically, productivity and real wages remain weak and the pick-up we forecast from 2015 is a key judgement. If productivity fails to pick up as predicted, consumer spending and housing investment could falter as the resources to sustain them would be lacking;

- we expect some significant changes in the composition of expenditure associated with the fiscal consolidation and, in particular, with the fact that on current policy so much of that consolidation is delivered through cuts to day-to-day spending on public services that will directly reduce GDP. The scale and speed of the adjustments this switch in spending implies may also represent a risk to the economy evolving in line with our central forecast; and

- strong growth of residential investment and ongoing growth in house prices and property transactions leave households' gross debt to income ratio rising back towards its pre-crisis peak by the forecast horizon. That seems consistent with supportive monetary policy and other interventions (such as Help to Buy and further support for first-time buyers announced in this Budget), but it could pose risks to the sustainability of the recovery over the medium term.

Comparison with external forecasters

3.113 In this section, we compare our latest projections with those of selected outside forecasters. The differences between our forecast and external forecasters are generally small compared with the uncertainty that surrounds them.

3.114 In its February *Economic Review*, the National Institute for Economic and Social Research (NIESR) forecasts GDP growth of 2.9 per cent in 2015, higher than our central forecast. Much of the difference is attributable to NIESR expecting both stronger consumption and investment growth in 2015. The European Commission expects growth of 2.6 per cent in 2015, slightly above our central forecast. The Commission forecasts weaker government consumption growth in 2015, but this is more than offset by stronger forecasts for both private consumption and investment. Global oil prices have fluctuated significantly in the period during which these forecasts were produced. These changes and their assumed impacts on the real economy – both directly via North Sea production and indirectly via changes in real incomes and business input costs – are likely to have been a key reason for differences between the reported forecasts.

Table 3.4: Comparison with external forecasts

	Per cent					
	2013	2014	2015	2016	2017	2018
OBR (March 2015)						
GDP growth	1.7	2.6	2.5	2.3	2.3	2.3
CPI inflation	2.6	1.5	0.2	1.2	1.7	1.9
Output gap	-2.2	-1.0	-0.4	-0.2	-0.1	0.0
IMF (October 2014)[1]						
GDP growth	1.7	3.2	2.7	2.4	2.4	2.4
CPI inflation	2.6	1.6	1.8	2.0	2.0	2.0
Output gap	-2.7	-1.2	-0.4	-0.3	-0.1	0.0
OECD (November 2014)						
GDP growth	1.7	3.0	2.7	2.5		
CPI inflation	2.6	1.6	1.8	2.1		
Output gap	-1.4	-0.3	0.1	0.0		
European Commission (February 2015)						
GDP growth	1.7	2.6	2.6	2.4		
CPI inflation	2.6	1.5	1.0	1.6		
Output gap	-2.4	-1.1	-0.1	0.6		
NIESR (February 2015)[2]						
GDP growth	1.7	2.6	2.9	2.3	2.3	2.5
CPI inflation	2.6	1.4	0.6	1.6	2.1	2.0
Oxford Economics (February 2015)						
GDP growth	1.7	2.6	2.8	2.7	2.7	2.5
CPI inflation	2.6	1.5	-0.1	1.8	1.9	1.9
Output gap	-4.1	-4.3	-3.7	-3.4	-3.2	-3.1
Bank of England (February 2015)[2,3]						
GDP growth (mode)[4]		3.1	2.9	2.9	2.7	
CPI inflation (mode)		0.9	0.5	1.8	2.1	

[1] The IMF updated its short-term forecasts in the January 2015 *World economic outlook* update. For the UK, it revised GDP growth down to 2.6 per cent in 2014 reflecting latest data, but left its forecasts for 2015 and 2016 at 2.7 per cent and 2.4 per cent.

[2] Output gap not published.

[3] Forecast based on market interest rates and the Bank of England's 'backcast' for GDP growth.

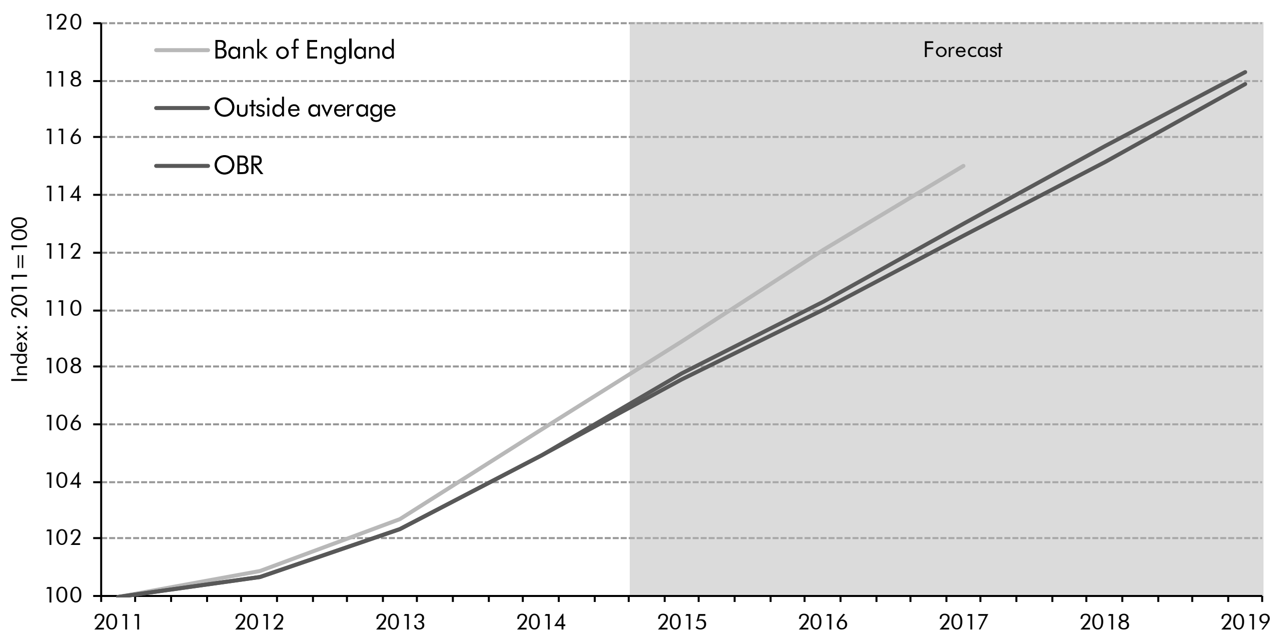
[4] Fourth quarter year-on-year growth rate.

Comparison with the Bank of England's *Inflation Report* forecast

3.115 Alongside its February 2015 *Inflation Report*, the Bank of England published additional information about its projections against which we can compare our own (see Table 3.5). This included information on the Bank staff's forecast for the expenditure composition of GDP, consistent with the MPC's central forecasts of GDP, CPI inflation and the LFS unemployment rate.

3.116 The table shows that the Bank's modal expectation for household consumption growth and business investment growth are somewhat stronger than our forecast in 2015 and 2016, helping to explain the Bank's stronger GDP growth forecast relative to our central forecast.

Chart 3.40: Comparison of forecasts for the level of GDP



Source: Bank of England, HM Treasury, ONS, OBR

Table 3.5: Comparison with the Bank of England's illustrative projections

	Per cent			
	2014[1]	2015	2016	2017
Bank of England February *Inflation Report* forecast				
Household consumption	2¼	3¾	3½	2½
Business investment	7	6¼	8½	9
Housing investment[2,3]	11¼	2	6¼	5¾
Exports	-¾	3¼	5½	4½
Imports	¾	2	6¼	5
Employment[4]	2	1½	1	¾
Average weekly earnings[3,4]	1¾	3½	4	4
Difference from OBR forecast				
Household consumption	0.2	1.2	0.8	0.0
Business investment	0.2	1.1	1.0	2.5
Exports	-1.1	-0.7	1.5	0.0
Imports	-1.1	-2.0	1.5	0.4
Employment[4]	0.0	0.3	0.4	0.3

[1] 2014 estimates contain a combination of data and projections.

[2] Whole economy measure. Includes transfer costs of non-produced assets.

[3] We have not shown a comparison for housing investment and average weekly earnings as the definitions of these variables differ and are therefore not directly comparable.

[4] Four-quarter growth rate in Q4.

Table 3.6: Detailed summary of forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2013	2014	2015	2016	2017	2018	2019
UK economy							
Gross domestic product (GDP)	1.7	2.6	2.5	2.3	2.3	2.3	2.4
GDP level (2013=100)	100.0	102.6	105.1	107.6	110.1	112.7	115.3
Nominal GDP	3.5	4.4	4.1	3.5	3.8	4.3	5.0
Output gap (per cent of potential output)	-2.2	-1.0	-0.4	-0.2	-0.1	0.0	0.0
Expenditure components of GDP							
Domestic demand	1.8	2.9	2.6	2.6	2.4	2.5	2.5
Household consumption[1]	1.7	2.0	2.6	2.7	2.5	2.3	2.2
General government consumption	-0.3	1.5	0.8	-0.7	-0.9	-0.2	1.5
Fixed investment	3.4	6.8	4.3	6.2	5.6	5.7	4.4
Business	5.3	6.8	5.1	7.5	6.5	6.4	4.4
General government[2]	-8.1	7.3	2.3	1.9	1.6	1.5	2.8
Private dwellings[2]	6.2	6.6	3.5	5.4	5.5	6.2	5.2
Change in inventories[3]	0.3	0.2	0.1	0.0	0.0	0.0	0.0
Exports of goods and services	1.5	0.4	3.9	4.0	4.5	4.4	4.3
Imports of goods and services	1.4	1.8	4.0	4.8	4.6	4.6	4.4
Balance of payments current account							
Per cent of GDP	-4.5	-5.4	-4.3	-3.2	-2.6	-2.4	-2.3
Inflation							
CPI	2.6	1.5	0.2	1.2	1.7	1.9	2.0
RPI	3.0	2.4	1.0	2.1	2.8	3.1	3.1
GDP deflator at market prices	1.8	1.8	1.6	1.1	1.5	1.9	2.5
Labour market							
Employment (millions)	30.0	30.7	31.1	31.4	31.5	31.7	31.9
Productivity per hour	-0.1	0.1	0.9	2.1	2.5	2.5	2.4
Wages and salaries	2.9	3.8	4.0	3.9	4.1	4.5	4.9
Average earnings[4]	1.6	2.2	2.3	3.1	3.7	4.0	4.4
LFS unemployment (% rate)	7.6	6.2	5.3	5.2	5.3	5.3	5.3
Claimant count (millions)	1.42	1.04	0.77	0.74	0.76	0.77	0.77
Household sector							
Real household disposable income	0.1	1.4	3.7	2.1	2.2	2.1	2.0
Saving ratio (level, per cent)	6.4	6.7	7.4	7.3	7.2	7.2	7.2
House prices	3.5	10.0	5.9	4.9	6.4	6.9	6.4
World economy							
World GDP at purchasing power parity	3.3	3.3	3.5	3.6	3.9	4.0	4.0
Euro area GDP	-0.4	0.9	1.2	1.4	1.6	1.6	1.6
World trade in goods and services	3.4	3.1	4.0	4.9	5.3	5.4	5.4
UK export markets[5]	2.5	3.1	3.7	4.7	5.1	5.2	5.2

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

[2] Includes transfer costs of non-produced assets.

[3] Contribution to GDP growth, percentage points.

[4] Wages and salaries divided by employees.

[5] Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.

Table 3.7: Detailed summary of changes to the forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2013	2014	2015	2016	2017	2018	2019
UK economy							
Gross domestic product (GDP)	-0.1	-0.5	0.1	0.2	-0.1	0.0	0.0
GDP level (2013=100)[1]	0.0	-0.4	-0.4	-0.2	-0.3	-0.2	-0.2
Nominal GDP	0.0	-0.7	0.1	-0.1	-0.2	0.1	0.6
Output gap (per cent of potential output)	0.0	0.0	0.1	0.3	0.2	0.1	0.0
Expenditure components of GDP							
Domestic demand	-0.2	-0.3	-0.3	0.4	0.0	0.1	0.0
Household consumption[2]	0.1	-0.3	-0.2	0.6	0.1	0.0	-0.2
General government consumption	-1.0	0.5	1.2	0.0	0.0	0.1	1.5
Fixed investment	0.2	-1.3	-4.0	0.3	0.0	0.6	-0.4
Business	0.5	-1.0	-3.3	1.2	0.2	0.1	-1.9
General government[3]	-0.9	5.2	-1.0	0.3	-0.5	-0.1	0.6
Private dwellings[3]	0.2	-6.4	-7.5	-1.6	-0.1	2.2	2.8
Change in inventories[4]	0.0	0.0	0.3	0.0	0.0	0.0	0.0
Exports of goods and services	0.9	1.9	1.5	-0.7	-0.4	-0.3	-0.1
Imports of goods and services	0.9	2.7	0.0	0.1	-0.2	-0.2	-0.1
Balance of payments current account							
Per cent of GDP	-0.2	-0.8	-0.8	-0.3	-0.1	-0.2	-0.3
Inflation							
CPI	0.0	-0.1	-0.9	-0.5	-0.3	-0.1	0.0
RPI	0.0	0.0	-1.1	-0.8	-0.5	-0.5	-0.4
GDP deflator at market prices	0.0	-0.2	0.0	-0.2	-0.1	0.1	0.6
Labour market							
Employment (millions)	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Productivity per hour	-0.1	-0.4	-0.4	0.2	0.1	0.2	0.0
Wages and salaries	-0.2	0.4	0.3	0.1	-0.1	0.2	0.7
Average earnings[5]	-0.2	0.4	0.3	0.0	-0.2	0.0	0.5
LFS unemployment (% rate)	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0
Claimant count (millions)	0.00	0.00	-0.08	-0.09	-0.08	-0.08	-0.08
Household sector							
Real household disposable income	0.4	-0.8	1.8	0.4	0.4	0.1	-0.1
Saving ratio (level, per cent)	0.0	0.1	2.0	1.8	2.1	2.3	2.4
House prices	0.0	-0.2	-1.5	-1.0	0.6	1.8	2.6
World economy							
World GDP at purchasing power parity	0.0	0.1	-0.3	-0.4	-0.1	0.0	0.0
Euro area GDP	0.0	0.1	0.0	-0.2	-0.1	0.0	0.0
World trade in goods and services	0.3	-0.7	-1.1	-0.5	-0.3	-0.2	-0.2
UK export markets[6]	0.2	-0.6	-0.6	-0.3	-0.2	-0.1	0.0

[1] Per cent change since December.

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

[3] Includes transfer costs of non-produced assets.

[4] Contribution to GDP growth, percentage points.

[5] Wages and salaries divided by employees.

[6] Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.

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.

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.

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.

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.

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.

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.

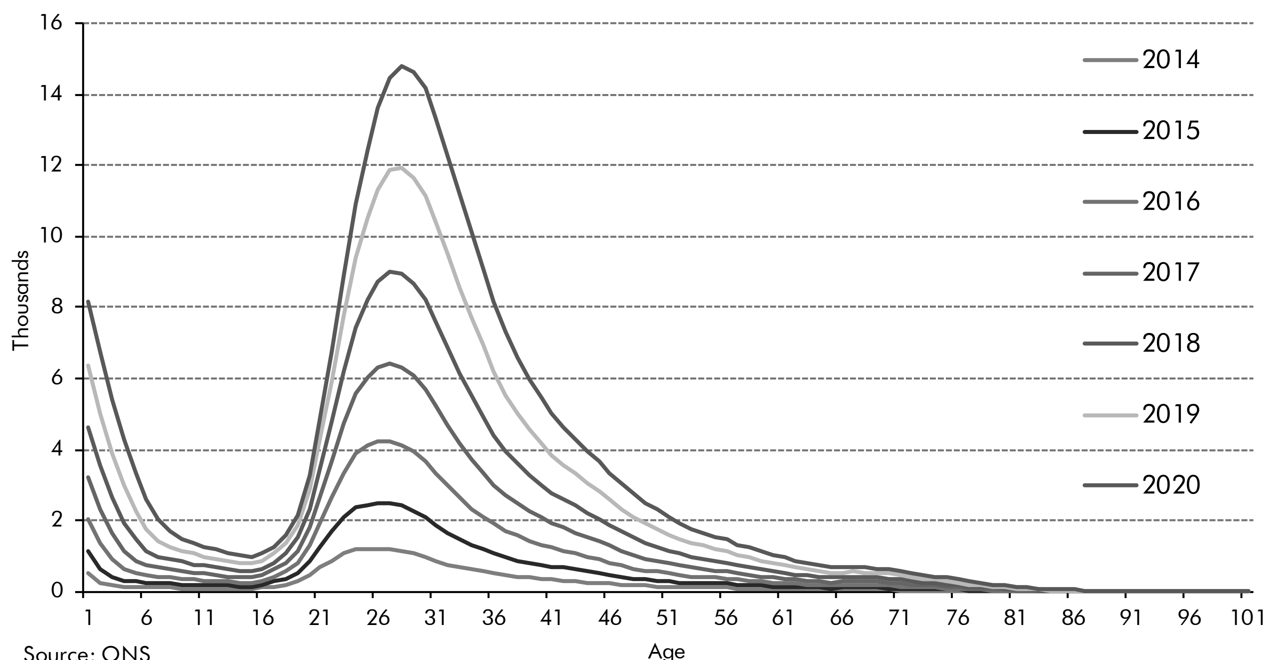
Interest rates

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



Source: ONS

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.

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.

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).

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.

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.

[a] 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

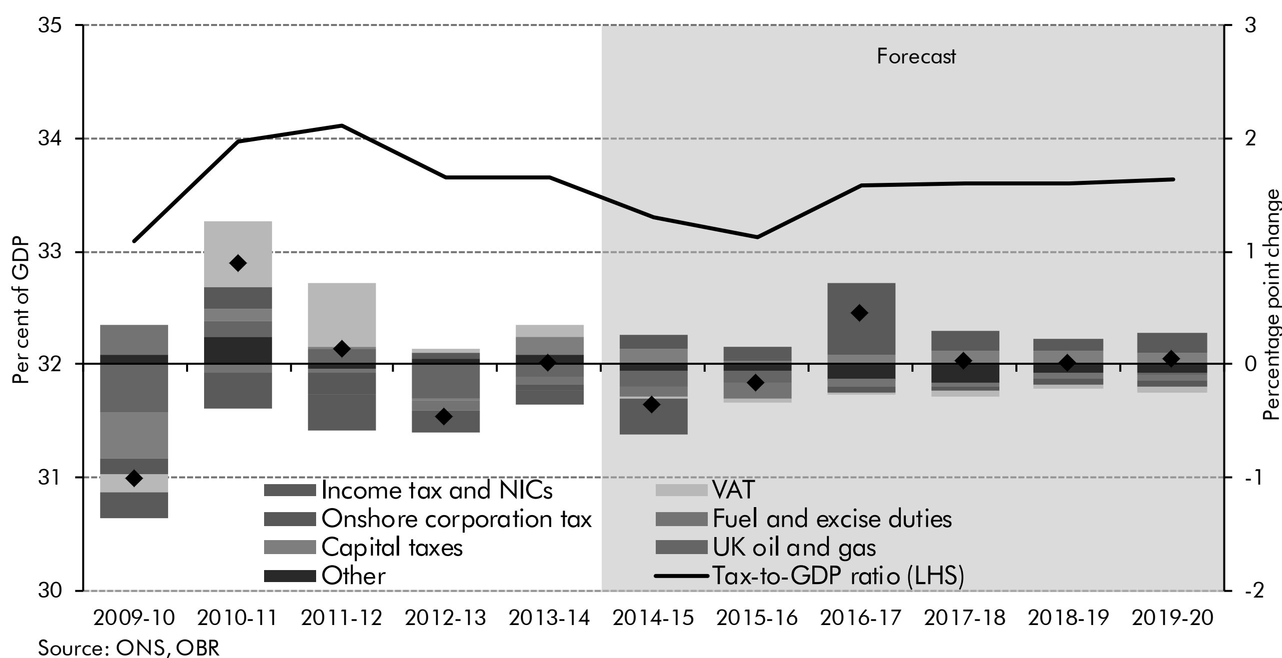
4.32 Table 4.4 summarises our receipts forecast. We expect taxes to have fallen by 0.5 per cent of GDP between 2013-14 and 2015-16, but then to return to just below their 2013-14 level by the end of the forecast period (due in part to the abolition of the NICs contracting out rebate in 2016-17). This 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

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

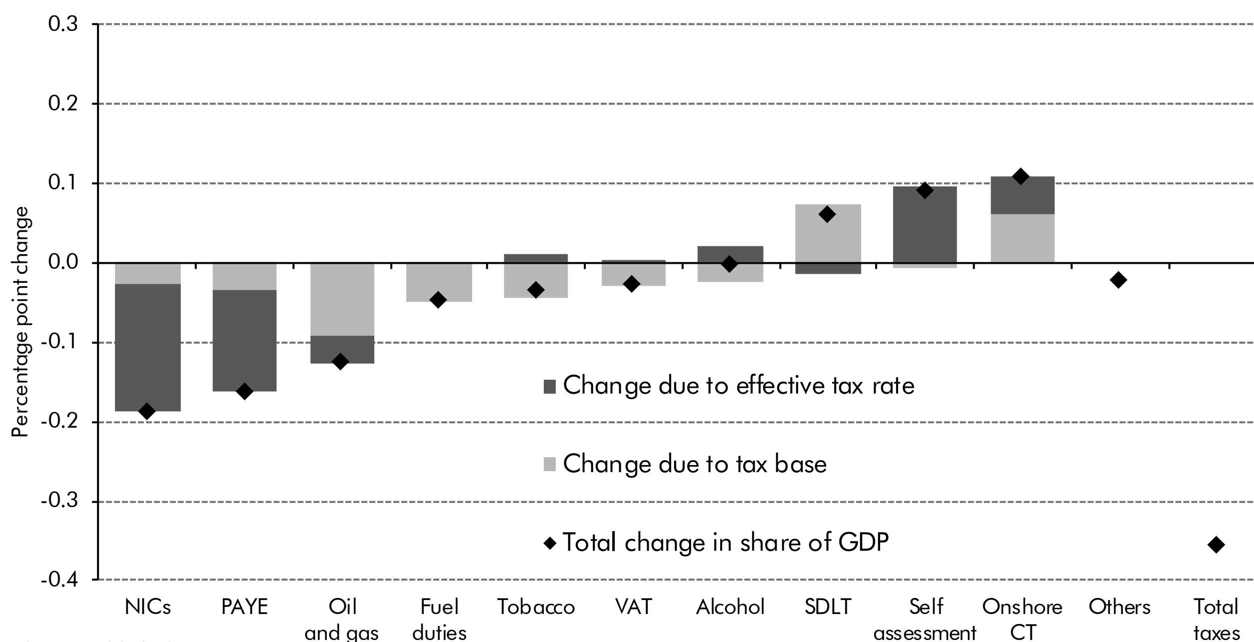
drop in the effective tax rate paid. The effective tax rate will have been reduced by the increase in the income tax personal allowance to £10,000. It is also likely to have been affected by changes in the composition of employment – lower paid age groups and lower paid occupations and industries have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

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

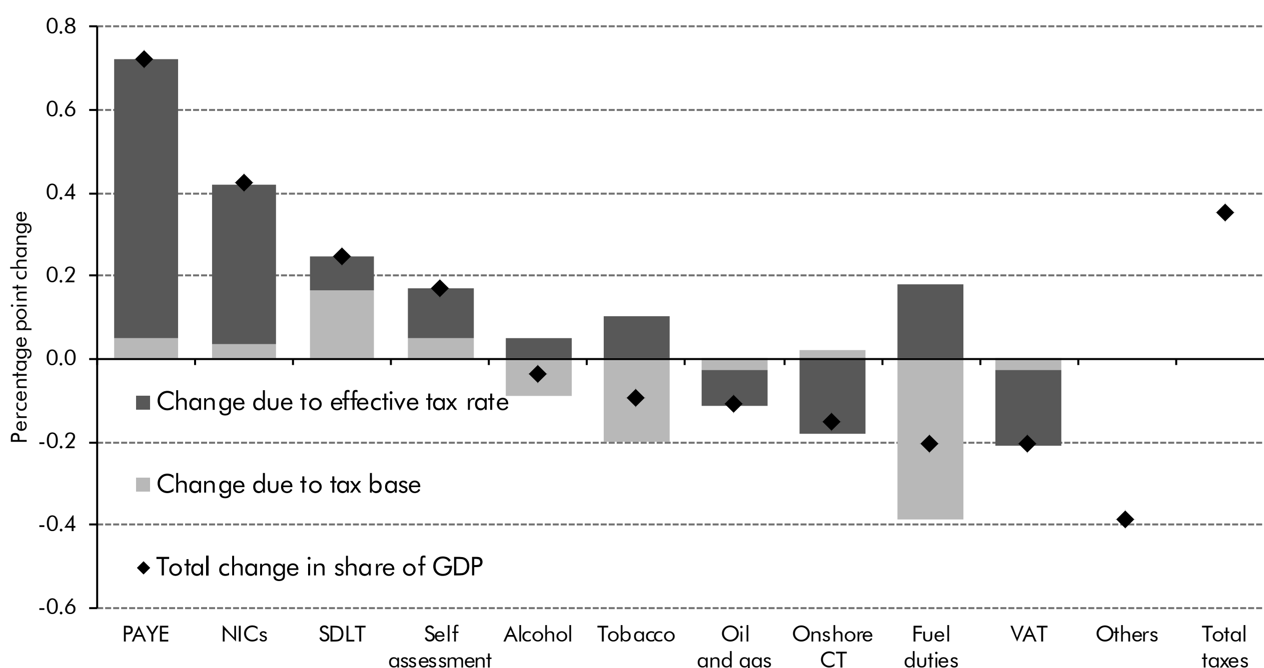
- a 0.2 per cent of GDP rise in SA receipts, again driven by the effective tax rate.

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;

- 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.

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.

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

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.

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.

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

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

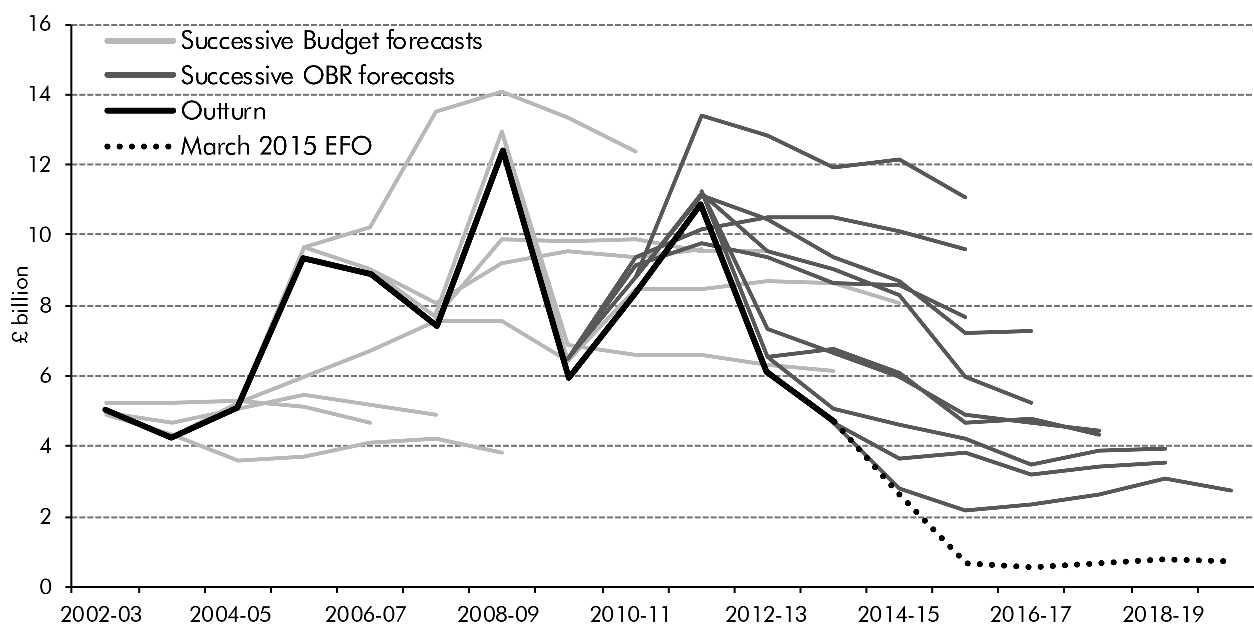
[1] December forecast has been adjusted to remove diverted profits tax.

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.

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.

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.

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.

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.

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.

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

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)

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

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.

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.

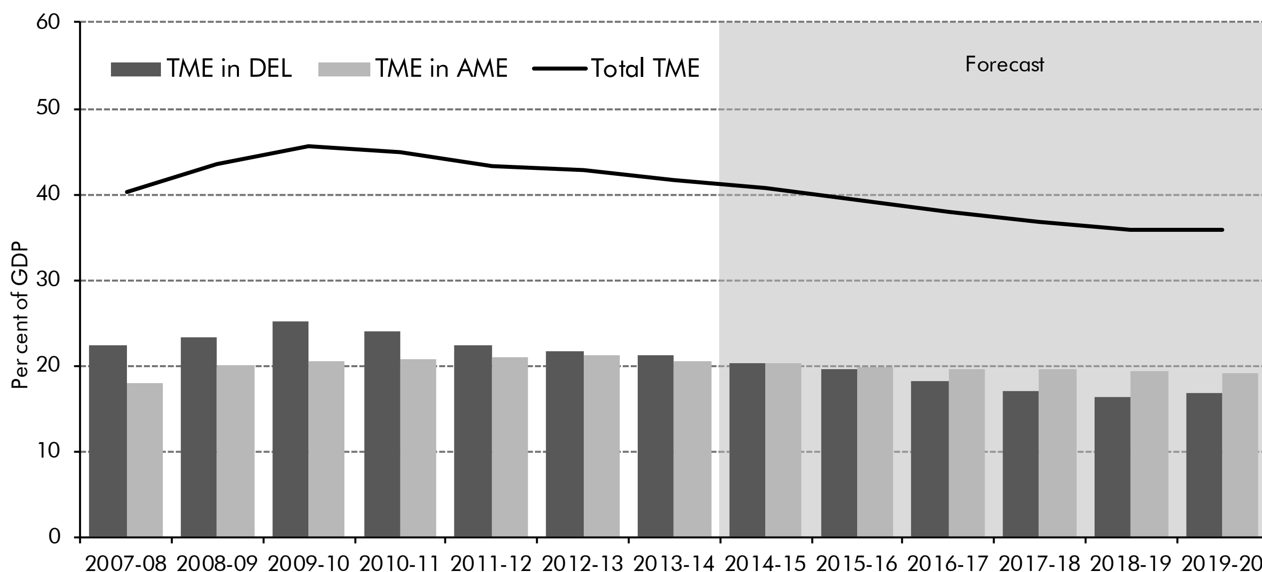
[6] Our presentation of expenditure only shows those components of RDEL, CDEL and AME that are included in the fiscal aggregates of PSCE and PSGI. For budgeting purposes, the Treasury also includes other components in DEL and AME such as non-cash items.
[7] Our forecasts for PSCE in RDEL and PSGI in 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.

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*.

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.

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.

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 –

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.

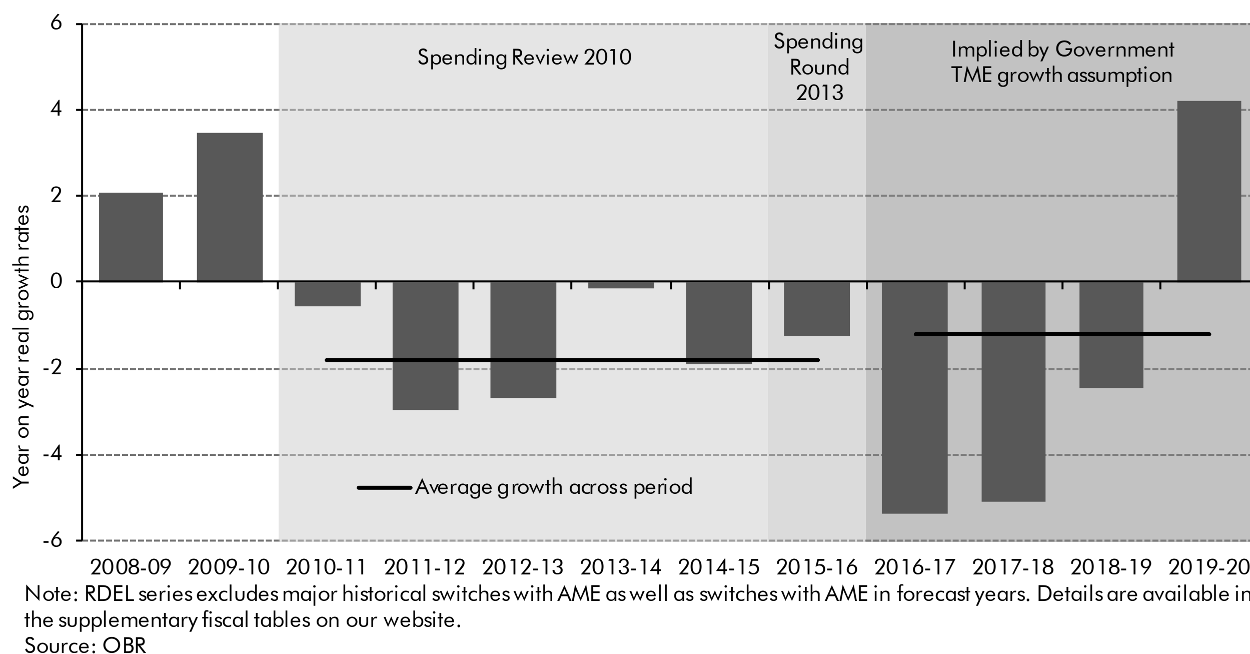
Table 4.18: Spending: real growth rates and as a per cent of GDP

	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.

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.

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.

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.

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.

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.

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
PSCE in RDEL	-2.3	-0.6
PSGI in CDEL	-1.2	-0.5
TME in DEL	-3.5	-1.1

Previous underspends in our December forecast	2014-15	2015-16
PSCE in RDEL	-2.0	-0.6
PSGI in CDEL	-0.5	-0.5
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

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	Forecast	Outturn	Forecast	Outturn	Forecast
	13-14	14-15	13-14	14-15	13-14	14-15
Budget Exchange carried forward	1.6	2.2	0.6	1.0	2.3	3.2
Gross underspend against PESA plans	**-4.5**	**-4.5**	**-1.0**	**-2.2**	**-6.8**	**-6.7**
of which:						
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.

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

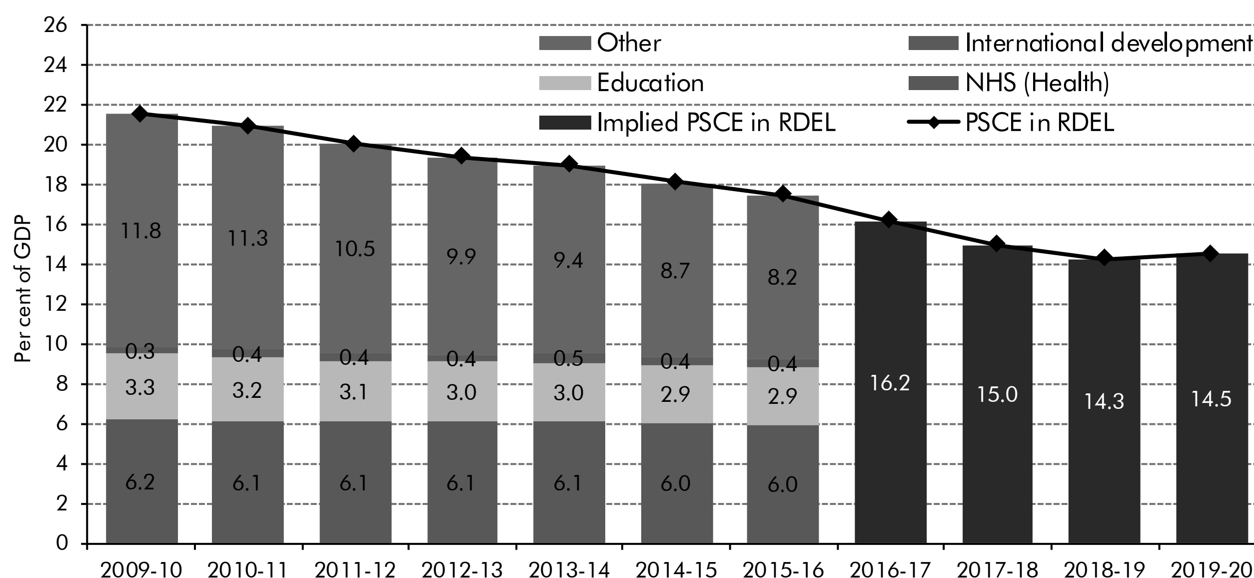
4.119 From 2016-17 onwards, DELs are inferred from the Government's spending policy assumptions and our AME forecast. Changes since December therefore reflect interaction between those assumptions and other changes to the forecast. Between 2016-17 and 2019-20, the main changes to implied DELs reflect:

- 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.

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.

- 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.

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.

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.

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.

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

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.

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.

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.

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.

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

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

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

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

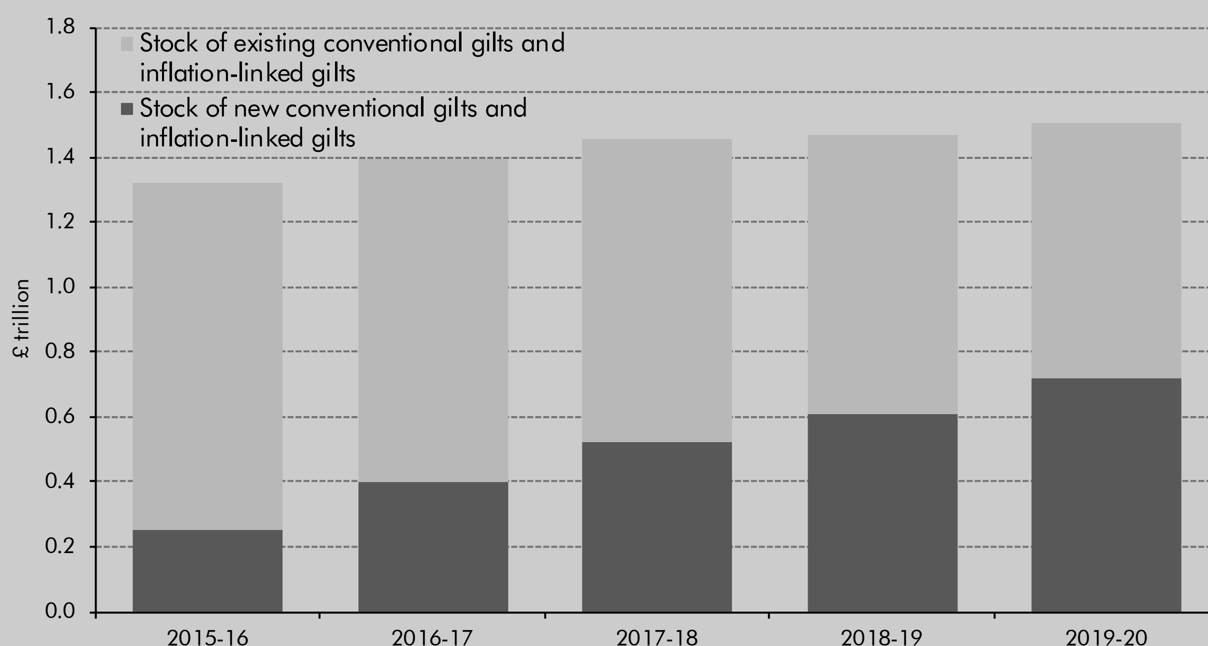
	£ billion				
	Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20
1 per cent increase in gilt rates	0.5	1.6	2.6	3.4	4.2
1 per cent increase in short rate	4.7	4.6	4.4	4.1	3.8
1 per cent increase in inflation	3.6	3.9	4.7	5.2	5.9
£5bn increase in CGNCR	0.0	0.2	0.3	0.4	0.5

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.

Chart A: Outstanding stocks of conventional and index-linked gilts



Source: OBR

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.

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.

- **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.

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.

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)*,

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

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.

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

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.

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.

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

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.

Table 4.37: Public sector net borrowing

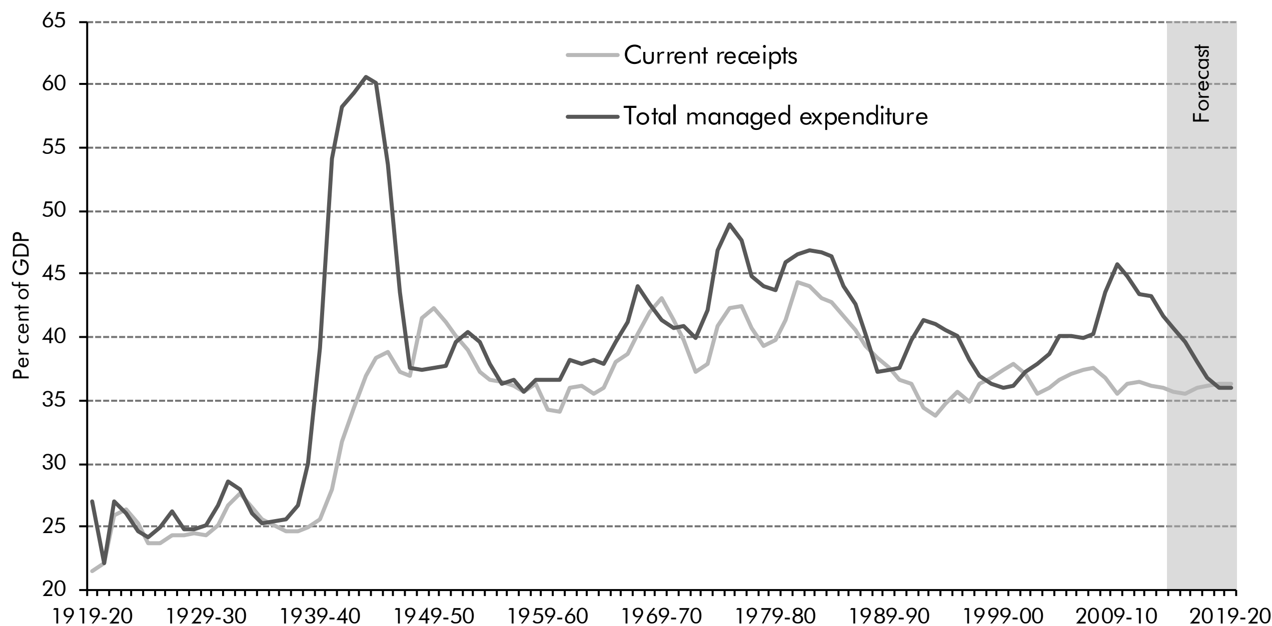
	£billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	91.3	75.9	40.9	14.5	-4.0	-23.1
March forecast	90.2	75.3	39.4	12.8	-5.2	-7.0
Change	**-1.1**	**-0.7**	**-1.5**	**-1.8**	**-1.2**	**16.1**
Underlying OBR forecast changes						
Total	**-1.1**	**0.1**	**0.5**	**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.

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.

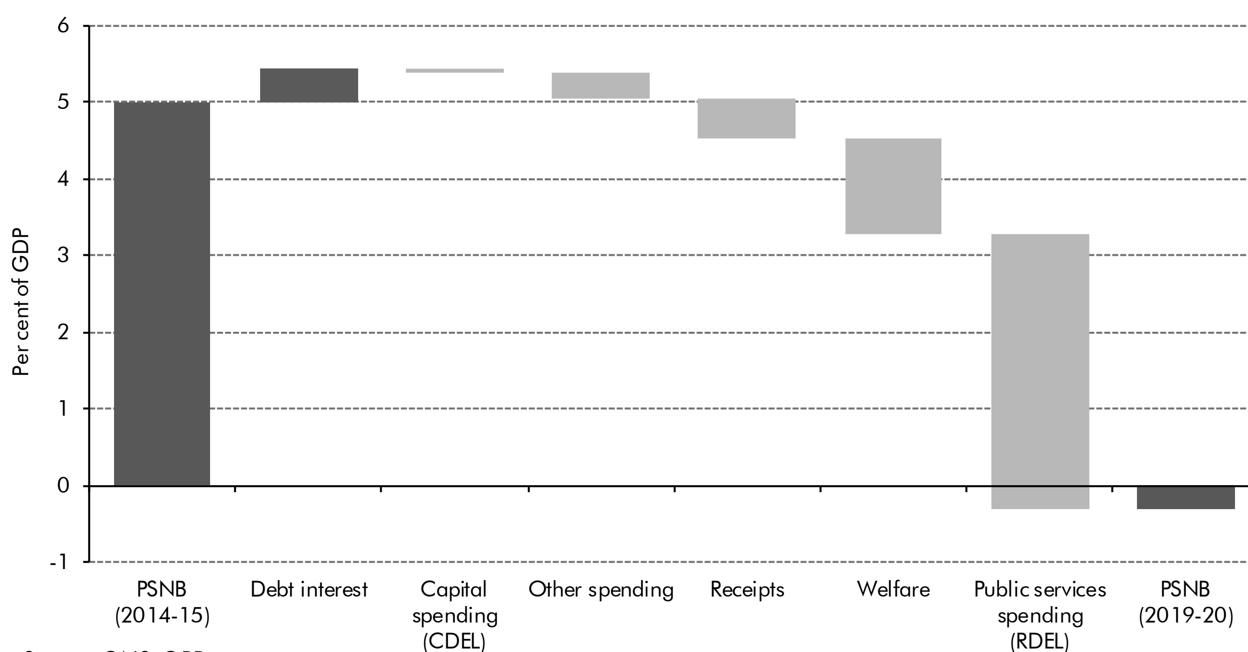
4.187 Over the five years of our forecast period up to 2019-20, the main factors contributing (negatively and positively) to the removal of the remaining deficit and the move into budget surplus will include (Chart 4.10):

- 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;

- 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.

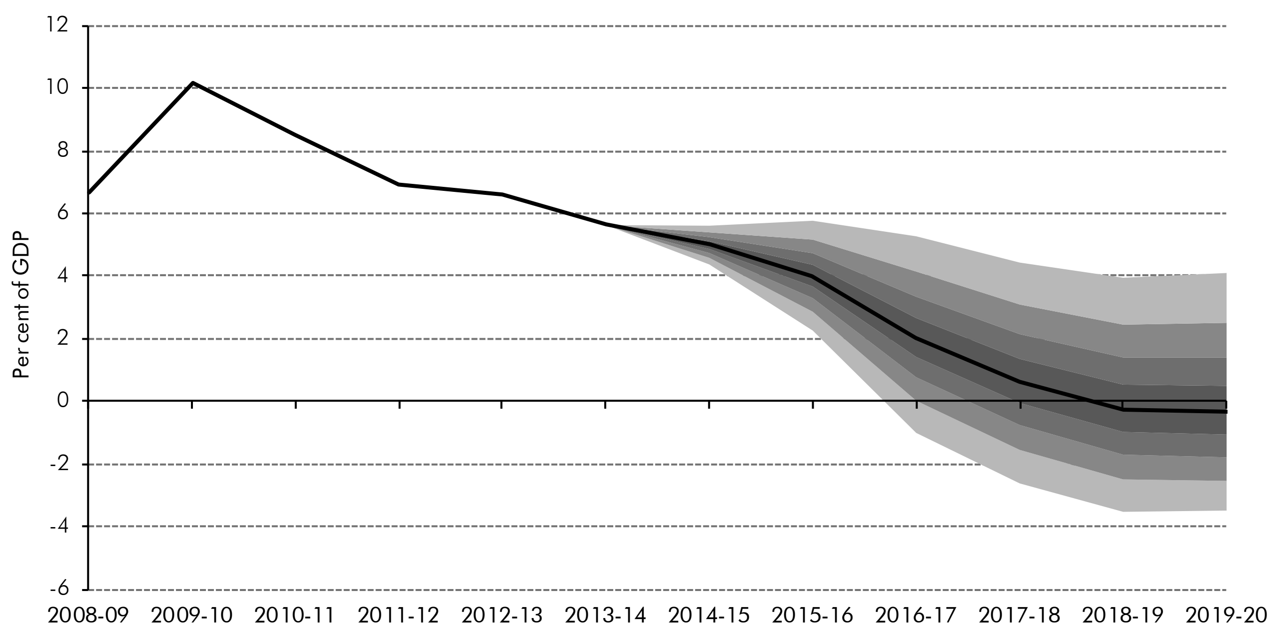
Chart 4.10: Sources of deficit reduction



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:

- 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.

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.

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);

- 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

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

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.

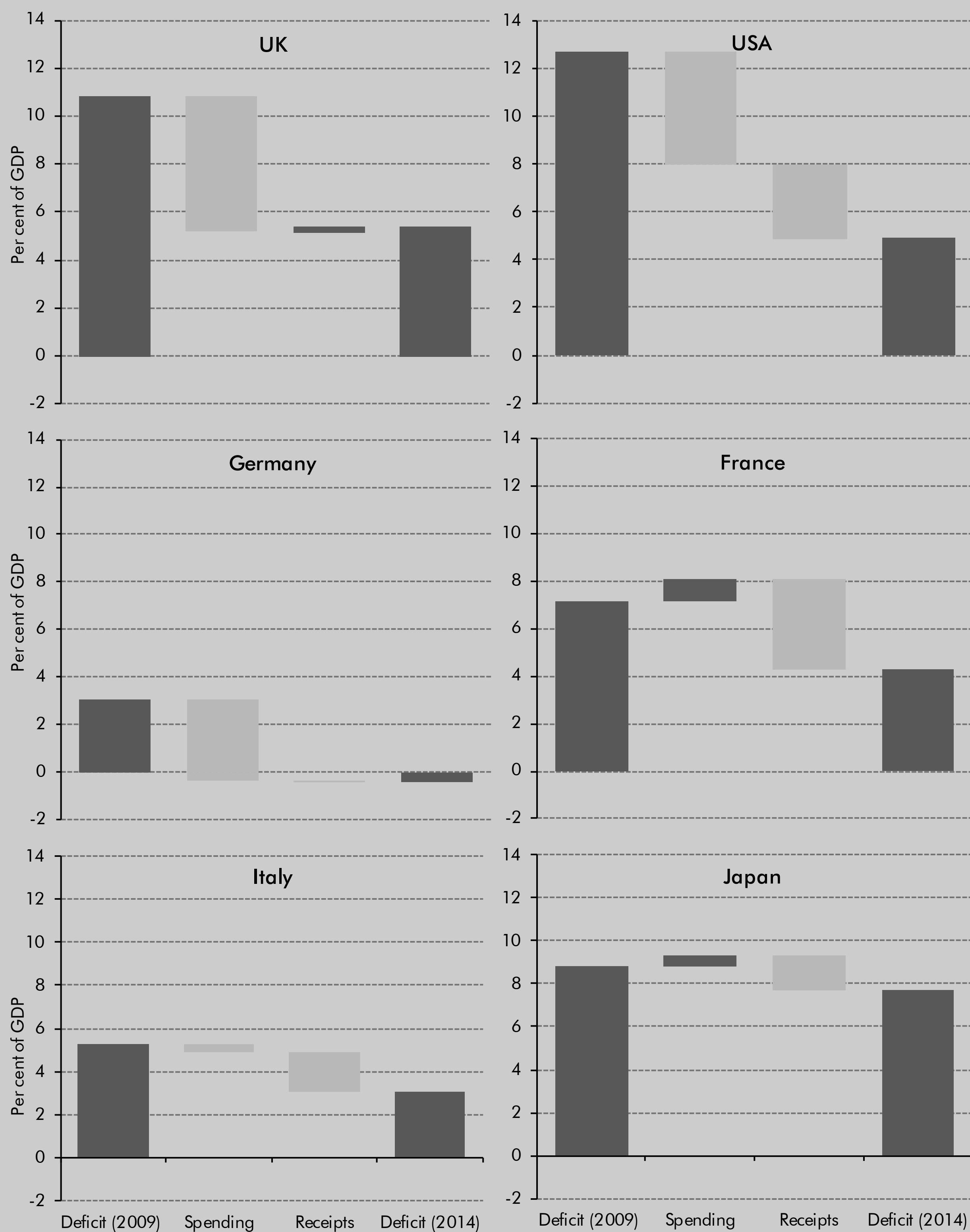
In the UK, general government net borrowing almost quadrupled from 2007 to reach a post-war high of 10.8 per cent of GDP in 2009, the drivers of which we discussed in *Working Paper No.7: Crisis and consolidation in the public finances*. Since then, borrowing on this measure has fallen by 5.3 per cent 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



Source: European Commission

Note: red bars indicate upward effect on borrowing, yellow bars indicate downward effect

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'".

- *"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.

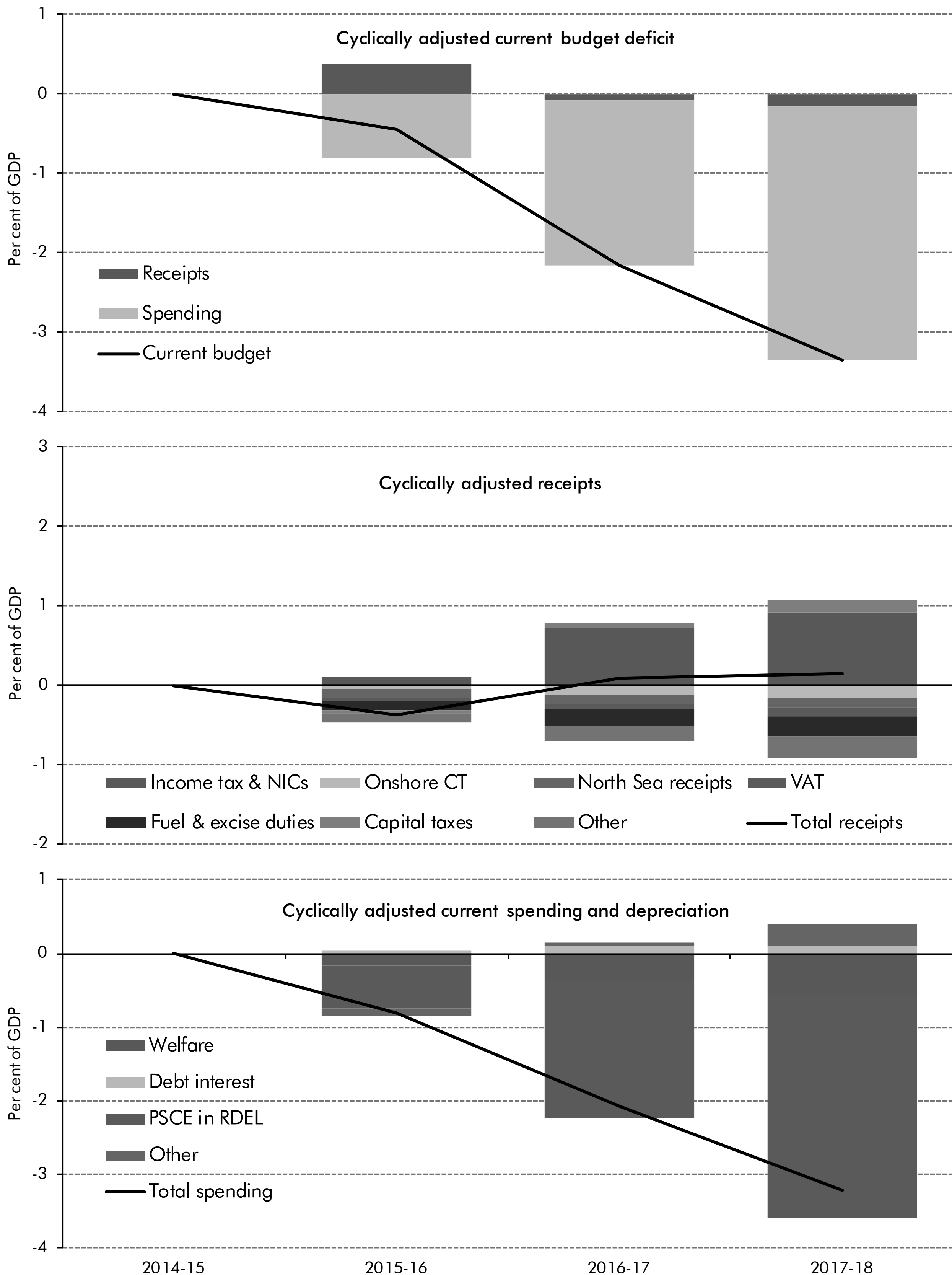
5.7 We estimate that the output gap was just -0.7 per cent of GDP at the end of 2014 and that it will narrow slowly over the next few years, closing in late 2017. The path of the structural deficit therefore closely matches changes in the headline deficit.

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*.

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

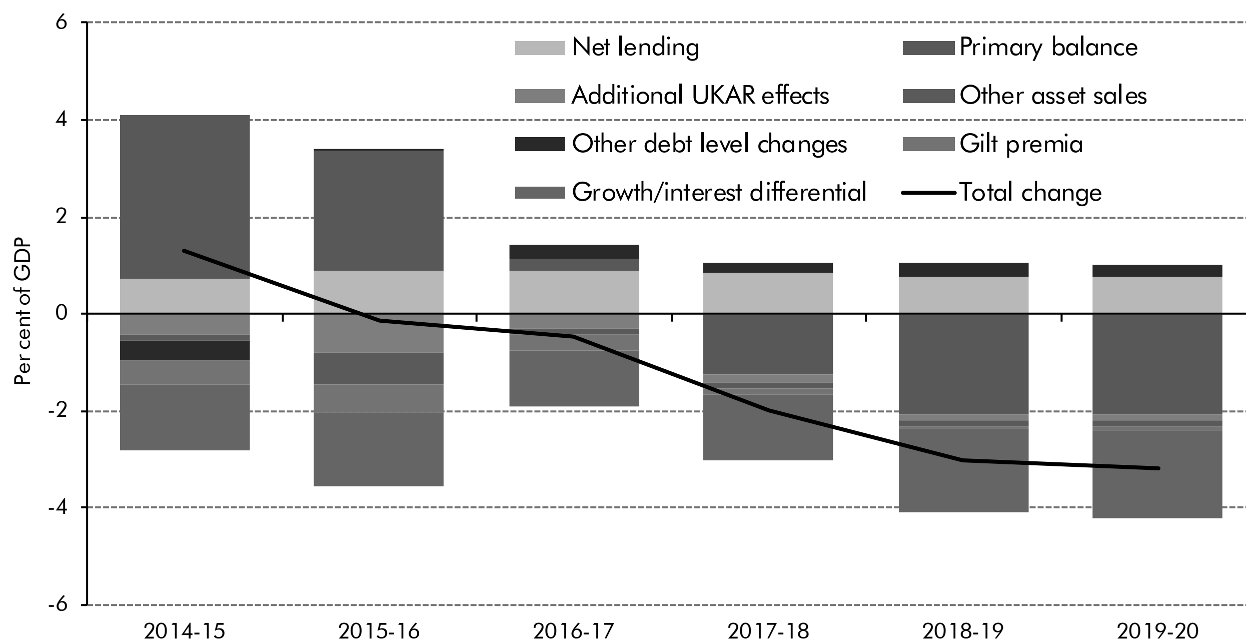
Supplementary target

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).

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

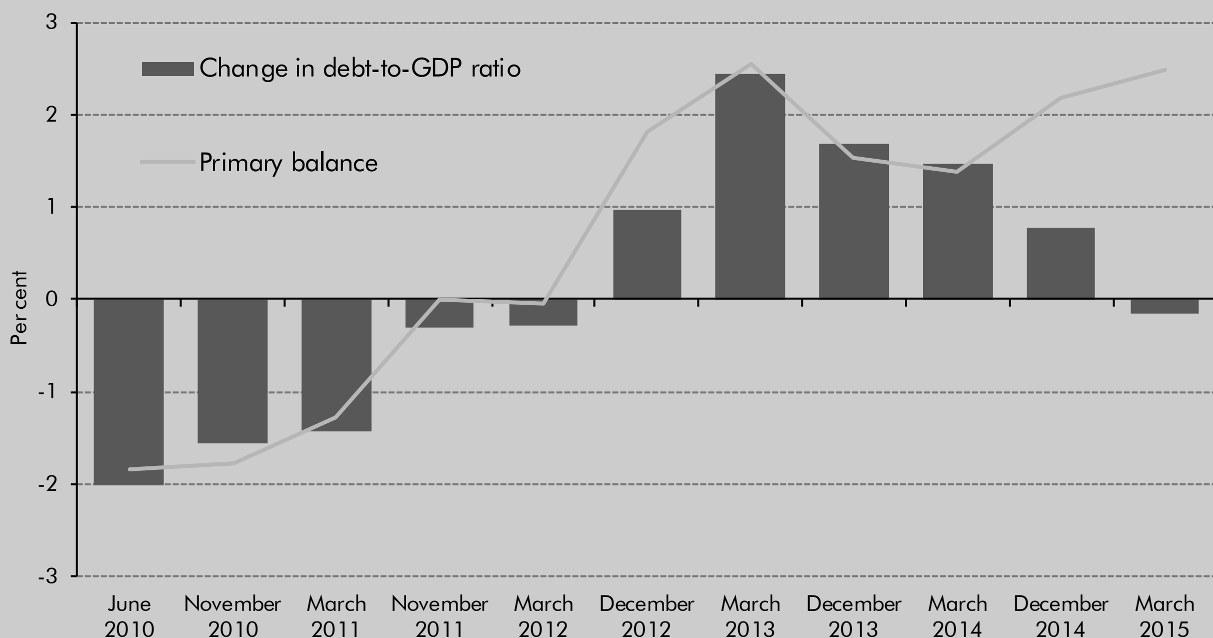
	Change on a year earlier (per cent of GDP)					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	1.6	0.8	-0.5	-1.9	-2.6	-3.3
March forecast	1.3	-0.2	-0.5	-2.0	-3.0	-3.2
Change	**-0.2**	**-0.9**	**0.0**	**-0.1**	**-0.4**	**0.1**
of which:						
Nominal GDP[1]	0.3	-0.1	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

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

- 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.

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:

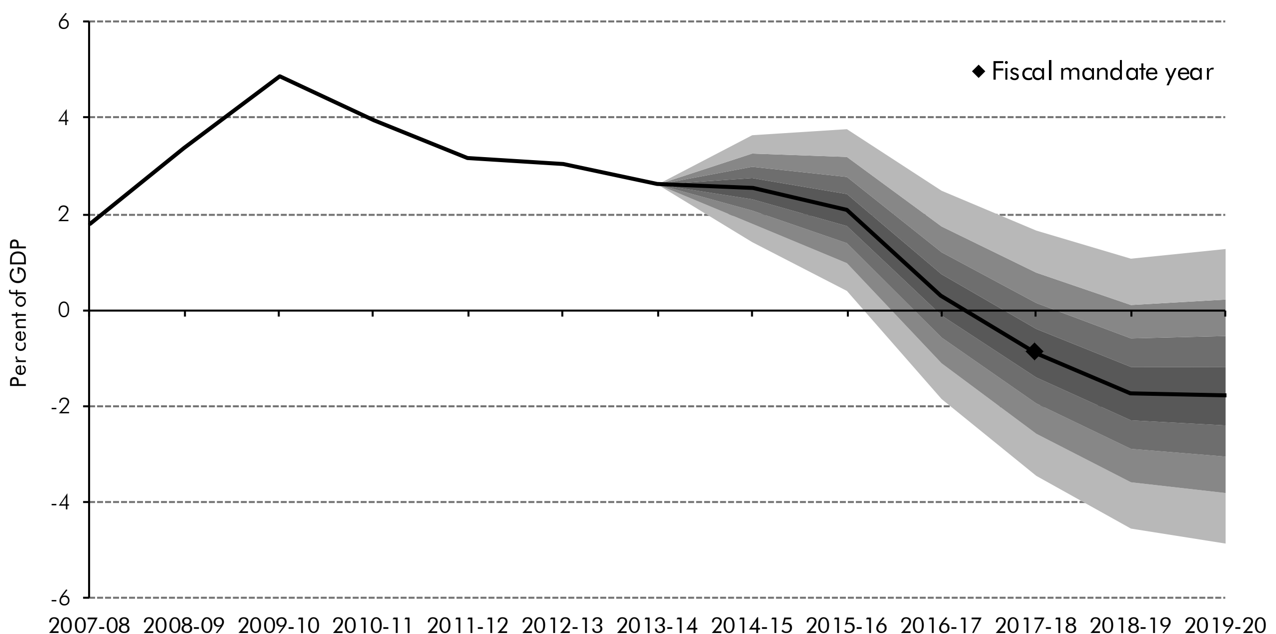
- by looking at the evidence from past forecast errors;
- by seeing how our central forecast would change if we altered some of the key judgements and assumptions that underpin it; and
- by looking at alternative economic scenarios.

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

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

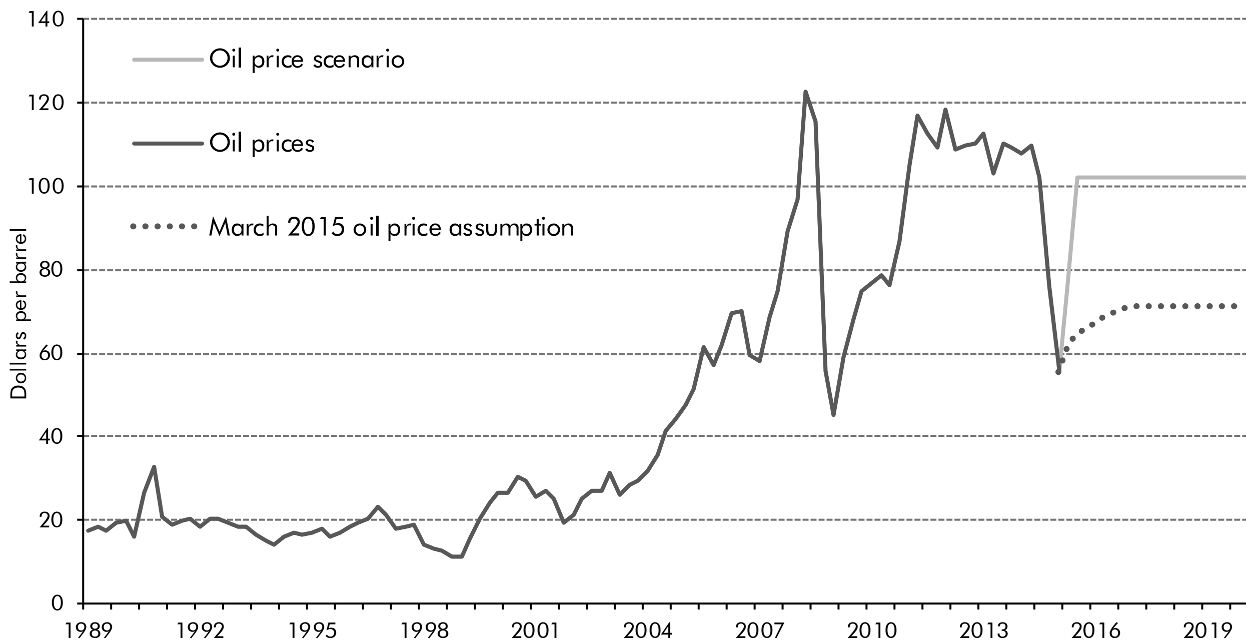
5.39 The sensitivity analysis discussed above focuses on individual factors and therefore only offers a partial assessment of potential uncertainty. In this section, we set out the fiscal implications of two illustrative alternative economic scenarios, designed to test how dependent our conclusions are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

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.

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

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

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

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

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);

- 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.

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.

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.

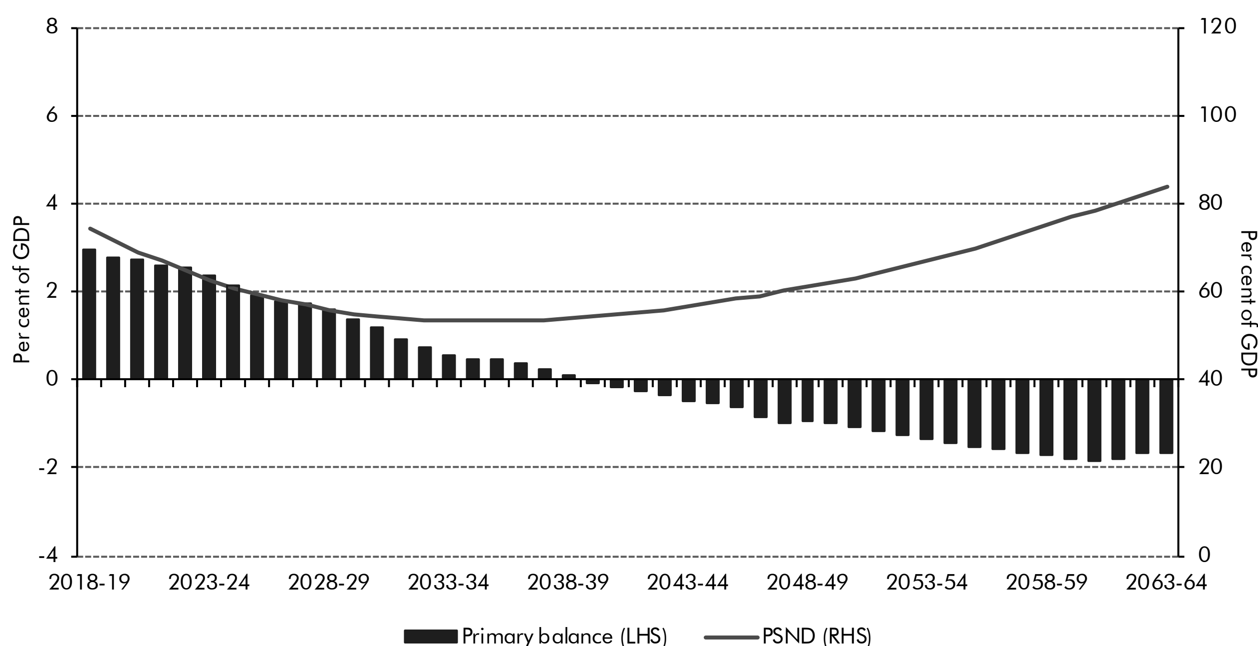
41 In Annex B, we look in more detail at student loans, including how they are treated in the National Accounts, the Whole of Government Accounts and the Government's budgeting framework. We test the sensitivity of our projections to different assumptions about the uprating of fees, the number of students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

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.

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

		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

	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]

		Head	£ million				
			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

		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.

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

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

[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

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

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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This document can be downloaded from www.gov.uk

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