HM Treasury

2015-16 Convergence Programme for the United Kingdom:

submitted in line with the Stability and Growth pact

March 2016

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Foreword

The UK is forecast by the Organisation for Economic Co-operation and Development (OECD) to be the fastest growing major advanced economy this year, with employment at a record rate of 74.1%. But the challenges are growing.

Since the Spending Review and Autumn Statement was published in November 2015, the outlook for the global economy has worsened and global growth has slowed, with the International Monetary Fund (IMF) predicting global growth of 3.4% in 2016, 0.2 percentage points lower than its October forecast. In advanced economies, there are growing concerns about productivity growth, high debt levels and deflationary risks. Productivity growth since the financial crisis of 2008 and 2009 has been weaker in all the major advanced economies, including the UK.

In emerging economies risks have also increased, with falling oil prices hitting commodity-exporting economies, Russia and Brazil in recession, and China's rebalancing leading to lower growth in a number of countries.

Uncertainty about global growth prospects has been reflected in volatility in financial markets, with world stock markets seeing $8 trillion wiped off their value at the start of the year. As one of the most open economies in the world, the UK is not immune to global slowdowns and shocks. All this means the challenge of delivering a sustained rise in living standards following the financial crisis is greater here in Britain than the Office for Budget Responsibility (OBR) had previously forecast.

This is precisely why the UK has been working through its long-term economic plan. Since 2010 the plan has been focussed on reducing the deficit, while delivering the supply side reforms necessary to improve long-term productivity growth. That has allowed an active monetary policy to support the economy while ensuring the fiscal position is sustainable in the long-term.

As a result, the 2015-16 deficit at 3.8% (public sector net borrowing) is forecast to be down by almost two thirds from its peak, bank capital ratios have doubled and there are over 2 million new jobs since 2010.

Eight years ago, the UK was one of the worst prepared to face the financial crisis. Today, in the face of a cocktail of global risks, the UK is one of the best prepared. The UK is responding to lower productivity growth and a more difficult global economy by:

- maintaining credible public finances and running a surplus in 2019-20
- cutting taxes for business and enterprise
- investing in infrastructure and devolving power
- improving education and healthcare
- supporting savings
- cutting taxes for working people

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 Summer Budget 2015, Autumn Statement 2015 which also included Spending Review 2015, and Budget 2016. This Convergence Programme draws on those publications, particularly Budget 2016.

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 2016 Economic and fiscal outlook, which was published alongside Budget 2016.

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 five 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 Stability and Growth Pact Code of Conduct.

1.7 Detail on the OBR's economic and fiscal forecasts is set out separately in Annex A of the Convergence Programme, drawing upon the OBR's March 2016 'Economic and fiscal outlook' and 2015 'Fiscal sustainability report'.

1.8 Annex B provides details of the financial impact of Summer Budget 2015, Autumn Statement 2015, and Budget 2016 policy decisions. Annex C provides supplementary data.

2 Overall policy framework and objectives

2.1 This section contains Chapter 1 of Budget 2016.

1 Budget Report

The UK economy and public finances

Britain and the global economy

1.1 Britain is forecast to grow faster than any other major advanced economy in 2016.[1] GDP in Q4 2015 was 12.6% higher than it was in Q1 2010.[2] But the challenges the country faces are growing.

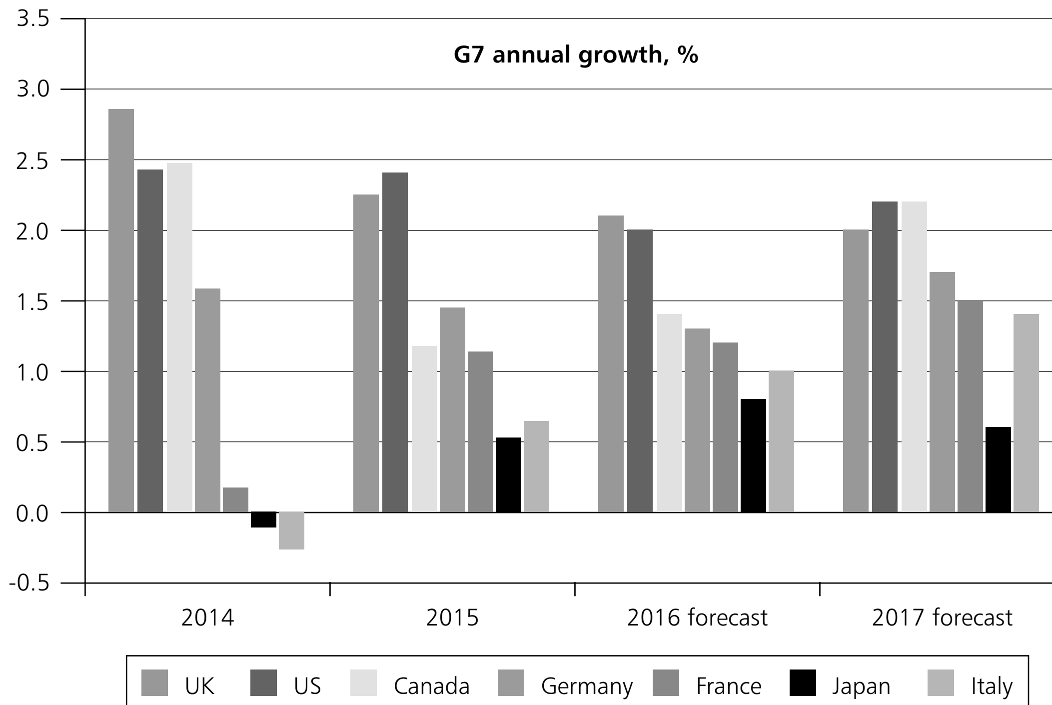
1.2 The global economic outlook has deteriorated since the Spending Review and Autumn Statement 2015. Both the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) have revised down their global forecasts for GDP in 2016. The IMF predicts global growth of 3.4% in 2016, 0.2 percentage points lower than its October forecast while the OECD forecasts growth of 3.0% in 2016, 0.3 percentage points below its November forecast.[3, 4]

1.3 These downgrades, which reflect a pattern of disappointing post-crisis growth in many countries, are partly driven by concerns over productivity growth. Christine Lagarde, Managing Director of the IMF, recently noted that weaker productivity growth – the rate the economy increases output per hour worked – and echoes of the financial crisis of 2008 and 2009, are still holding back global growth.[5] Angel Gurria, Secretary-General of the OECD, said "Productivity growth – a central ingredient in the pursuit of well-being – has been decelerating in a vast majority of countries".[6]

1.4 All G7 economies have seen lower productivity growth since the financial crisis. The UK was hit hard by the financial crisis, and productivity fell 2.2% from its pre-crisis peak.[7] Since 2012, output per hour has grown each year and increased by 0.8% in 2015 to exceed its pre-crisis peak.

1.5 But as the Office for Budget Responsibility (OBR) says, with a period of weak productivity growth after the financial crisis continuing to lengthen, they have placed more weight on the post-financial crisis period as a guide to future prospects.

[1] 'Interim Assessment', Organisation for Economic Co-operation and Development (OECD), February 2016.
[2] All UK economy data from Office for National Statistics (ONS) unless otherwise stated. Further detail can be found in 'Budget 2016 Data Sources'.
[3] 'World Economic Outlook Update', International Monetary Fund (IMF), January 2016.
[4] 'Interim Assessment', Organisation for Economic Co-operation and Development (OECD), February 2016.
[5] Christine Lagarde, International Monetary Fund (IMF), Article IV press conference, December 2015.
[6] Angel Gurria, Organisation for Economic Co-operation and Development (OECD), February 2016.
[7] From a pre-financial crisis peak in 2007 to its trough in 2009.



Global outlook

1.6 Prospects for key emerging markets have deteriorated recently. For 2016, the IMF forecasts growth in emerging markets to be 4.3%, compared to 4.7% a year ago.[8] These economies face a number of risks. As China rebalances towards domestic consumption, the emerging markets whose exports are geared to China's previous manufacturing and investment-led growth are suffering. And after a decade of cheap debt, emerging markets are facing tighter credit conditions. Over $735 billion in capital flowed out of emerging markets last year.[9]

1.7 These concerns about growth prospects have been reflected in financial market volatility since the turn of the year. Global stock markets had their worst six-week start to the year for more than 45 years, with over $8 trillion wiped off world markets.[10]

1.8 Having fallen by 70% from June 2014 to December 2015, the price of oil fell further to $27 per barrel at the end of January 2016 and has averaged under $33 for the first two months of 2016.[11] At the time of the Spending Review and Autumn Statement 2015, markets expected the price of oil to rise gradually to $50 per barrel in early 2016. While a sustained fall in the oil price is a net benefit to oil importing economies like the UK, it impacts on particular sectors including the North Sea oil and gas industry. The speed and intensity of the falls in commodity prices in the last 18 months have increased financial stress and worsened the economic outlook for commodity exporters like Brazil, Russia and many countries in the Middle East.

1.9 The combination of lower global growth and cheaper oil has meant inflation has fallen across advanced economies, with every major central bank revising down its inflation forecast. As a result, market expectations of the timing of interest-rate rises have been pushed back.

[8] 'World Economic Outlook Update', IMF, January 2016 and January 2015.
[9] Capital Flows to Emerging Markets, Institute of International Finance, January 2016.
[10] MSCI World Index and Bloomberg World Market Capitalisation Index.
[11] ICE Brent Crude Oil Front Month Futures.

1.10 Together, the prospects of weaker growth and inflation have reduced the outlook for GDP measured at current prices, i.e. nominal GDP. Global nominal GDP growth is estimated by the IMF to have been half the rate in 2015 that it was in 2007, making it harder to bring down debt-to-GDP ratios.[12]

OBR economic forecast

Table 1.1: Summary of the OBR's central economic forecast[1]

	Percentage change on a year earlier, unless otherwise stated					
		Forecast				
	2015	**2016**	**2017**	**2018**	**2019**	**2020**
GDP growth	**2.2**	**2.0**	**2.2**	**2.1**	**2.1**	**2.1**
Main components of GDP						
Household consumption[2]	2.9	2.4	2.2	2.1	2.0	1.9
General government consumption	1.7	0.2	0.6	0.5	0.2	0.7
Fixed investment	4.2	2.9	4.5	4.1	4.0	4.3
Business	4.7	2.6	6.1	5.8	5.5	4.4
General government[3]	2.2	0.2	1.9	-0.3	-0.2	6.5
Private dwellings[3]	3.4	5.1	2.8	3.0	3.0	2.9
Change in inventories[4]	-0.4	0.2	0.0	0.0	0.0	0.0
Net trade[4]	-0.5	-0.4	-0.1	-0.1	-0.1	-0.1
CPI inflation	**0.0**	**0.7**	**1.6**	**2.0**	**2.1**	**2.0**
Employment (millions)	**31.2**	**31.6**	**31.7**	**31.9**	**32.0**	**32.1**
LFS unemployment (% rate)[5]	**5.4**	**5.0**	**5.0**	**5.2**	**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 the 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] Labour Force Survey.

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

1.11 The UK is one of the most open trading economies in the world and is not immune to the weaker global outlook. And as in other major advanced economies, the UK's productivity growth has been slower since the financial crisis. Combined, this means that the challenge of delivering a sustained rise in living standards following the financial crisis of 2008 and 2009 is greater here in the UK than the OBR previously forecast, with GDP growth, inflation and nominal GDP growth now forecast to be weaker than at the time of the Spending Review and Autumn Statement 2015.[13]

1.12 The OBR forecasts GDP growth to be 2.0% in 2016, rising to 2.2% in 2017 and 2.1% in 2018.

1.13 The main driver of the reduced GDP forecast is a lower forecast for potential productivity growth – the amount of output growth per hour worked the economy is capable of producing sustainably – with the OBR placing more weight on post-crisis weakness in productivity growth. Productivity is expected to grow by 1.0% in 2016 and 1.7% in 2017, before rising to 2.0% for the remainder of the forecast period.

[12] 'World Economic Outlook', IMF, October 2015.
[13] All forecasts refer to the Office for Budget Responsibility (OBR) 'Economic and fiscal outlook', March 2016, unless otherwise stated.

1.14 Disappointing productivity growth is evident in many other major advanced economies in recent years, leading other forecasters to revise down their expectations. For example, Table 1.2 from the OBR 'Economic and fiscal outlook' March 2016, shows that OBR forecasts for potential productivity growth between 2010 and 2020 have been revised down by 7.5 percentage points. This is similar to the Congressional Budget Office (CBO) in the US which has reduced its forecast for potential productivity growth by 8.9 percentage points. The impact on potential GDP growth has been smaller in the UK, however, largely because the labour market participation rate has held up much more than in the US.

Table 1.2: Contributions to potential output growth between 2010 and 2020

	Potential productivity[1]	Potential average hours	Potential participation rate[2]	Potential unemployment rate[2,3]	Potential population[2]	Potential output growth[4]
OBR estimates for the UK						
June 2010	21.9	-2.0	-1.8	0.0	5.8	24.1
March 2016	14.4	-1.0	0.0	-0.2	6.7	20.6
Change	-7.5	0.9	1.8	-0.2	0.9	-3.5
OBR calculations based on CBO estimates for the US						
August 2010	24.3	-0.8	-3.0	0.0	9.5	30.8
January 2016	15.4	-0.6	-5.6	0.3	10.6	20.0
Change	-8.9	0.2	-2.6	0.3	1.1	-10.8

[1] *Output per hour.*

[2] *Corresponding to those aged 16 and over.*

[3] *Percentage point growth between 2010 and 2020.*

[4] *Changes may not sum due to rounding and interaction effects.*

Note: Non-farm business employment forecasts are not available for the US, and so we have assumed that non-farm business employment grows at the same rate as whole economy employment.

Source: Office for Budget Responsibility.

1.15 The OBR predicts the UK's strong labour market performance to continue. The OBR revised up its forecast for employment in 2016 from 31.5 million to 31.6 million, and in 2017 employment reaches 31.7 million. The OBR forecast employment to rise by 0.9 million by 2020, meaning that employment will have risen by 3 million since 2010. Wages and salaries are forecast to grow faster than inflation, rising by 3.6% in 2016, and thereafter by an average of 4.0% until 2020. The OBR forecasts CPI inflation to be below the 2.0% target in 2016 before returning to target in 2018.

Britain in a stronger position to face the challenge ahead

1.16 Since 2010, the government's long-term economic plan has been focussed on ensuring sound public finances, while delivering the supply-side reforms necessary to improve long-term productivity. That has allowed active monetary policy to support the economy while ensuring the fiscal position is sustainable. As a result of the government's action to date:

- the public finances have improved. In 2010, the IMF forecast the UK to have the largest budget deficit in the G20, at 11.4% of GDP.[14] As a result of the action that the government has taken, the OBR forecast that the UK's deficit as a share of GDP will be reduced by almost two-thirds to 3.8% of GDP in 2015-16

[14] 'Fiscal Monitor', IMF, May 2010.

- the financial sector is much more resilient. Since 2010, the government has legislated for the ring-fencing of large banks' retail arms from their investment banking arms, insulating these core functions vital to households and SMEs, and put the Bank of England back in charge of bank prudential regulation. As the Governor of the Bank of England said, "UK banks are now significantly more resilient than before the global financial crisis. Capital requirements for the largest banks have risen ten-fold. Their holdings of liquid assets have increased four-fold. Their trading assets are down by a third, and inter-bank exposures have shrunk by two-thirds"[15]
- household finances are more robust. Debt-to-income ratios have fallen from 155% in Q1 2010 to 142% in Q3 2015. The share of households with very high mortgage debt-to-income ratios has been falling and is now back at levels seen in the 1990s.[16] Interest payments as a proportion of income were 4.8% in Q3 2015, the lowest on record and down from 6.3% in Q1 2010

1.17 The long-term economic plan has delivered considerable economic gains since 2010. The UK was the fastest growing major advanced economy in 2014, the second fastest in 2015 and the OECD forecast the UK to be the fastest growing in 2016.

Employment and earnings

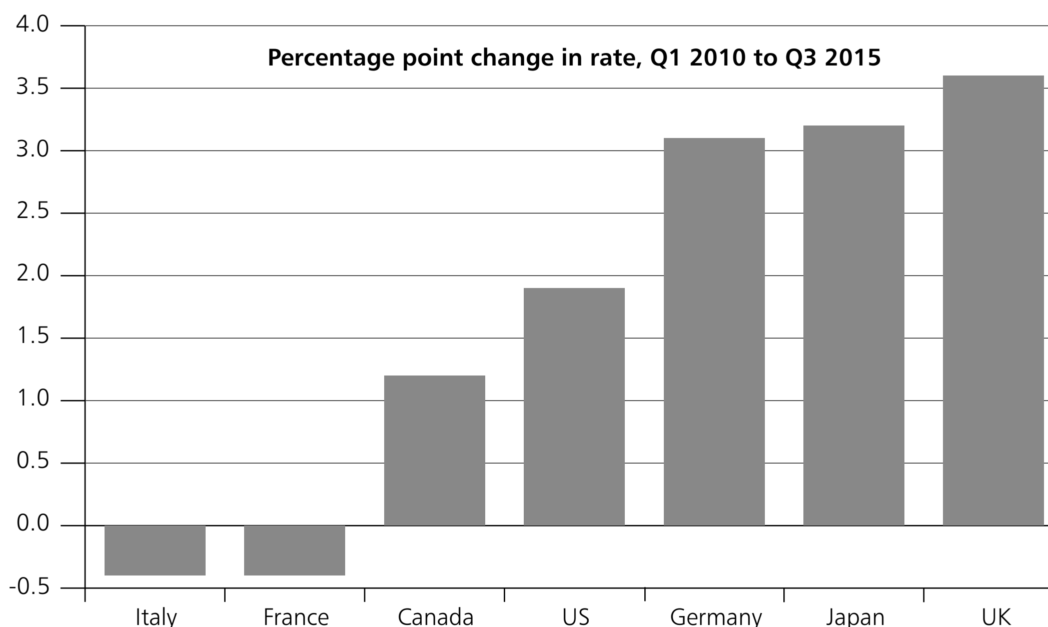
Employment

1.18 Government action to reward work and reform benefits has delivered a stronger labour market in the UK, with an employment rate that has risen faster in the UK than in any other G7 country since 2010 making progress towards the government's goal of full employment.[17] The data for 2015 showed:

- a record employment rate of 74.1% in Q4 2015
- the employment rate of women had risen to 69.1% by the end of 2015, a record high
- 74% of the increase in employment in 2015 was driven by full-time workers
- high and medium skill occupations accounted for 92% of the growth in employment in the year to Q4 2015
- a strong demand for labour with 767,000 vacancies in Q4 2015, a record high
- the claimant count fell to a 40 year low in 2015
- working age inactivity fell by over 600,000 from 2010 to 2015

[15] Mark Carney, Governor of Bank of England, Financial Stability Report Press Conference, December 2015.
[16] Very high mortgage debt-to-income ratio is defined as a ratio greater than 500%. 'Quarterly Bulletin 2015 Q4', Bank of England, December 2015.
[17] 'Short-Term Labour Market Statistics', OECD.

Chart 1.2: International comparison of employment



Source: Organisation for Economic Co-operation and Development.

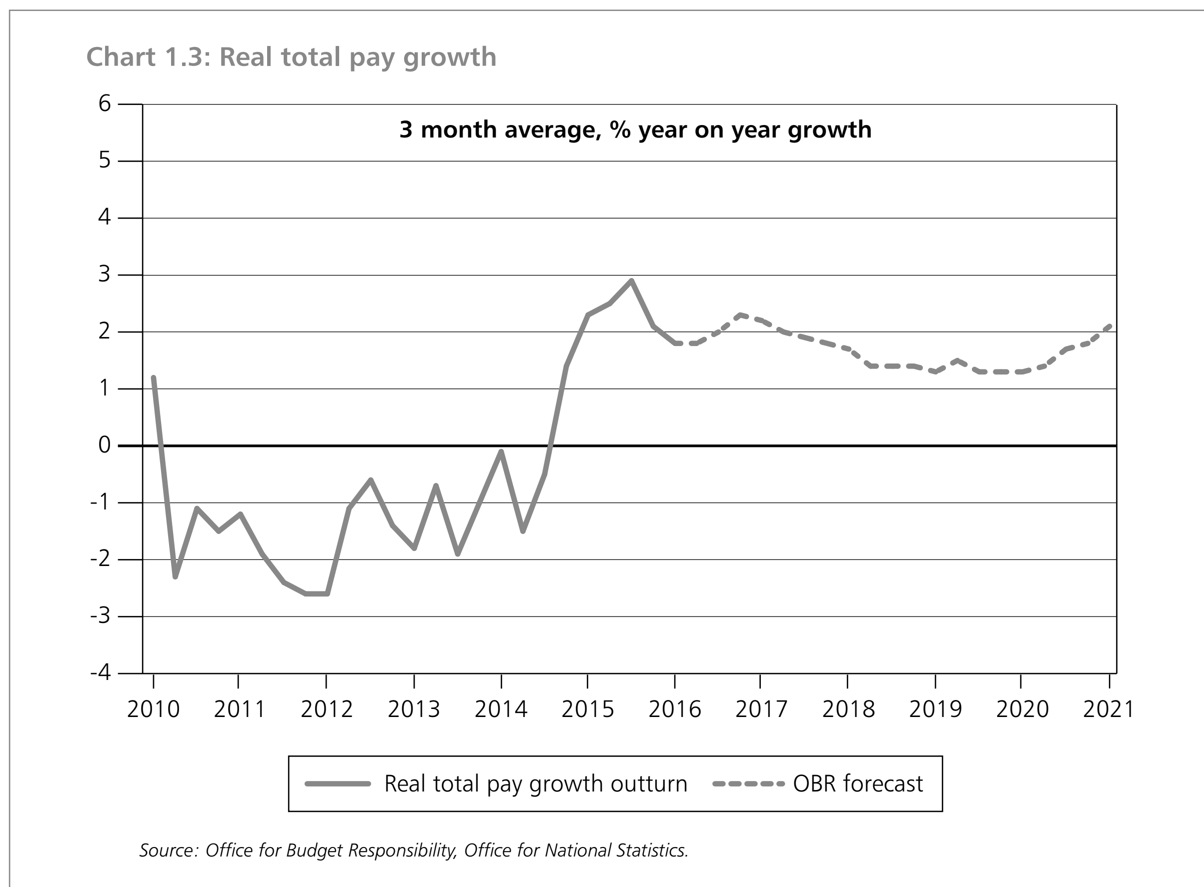
Earnings

1.19 This strong employment performance has been accompanied by rising real wages (see Chart 1.2). Earnings growth picked up in much of 2015, with total annual pay rising 2.5% on the year in nominal terms, and 2.3% in real terms. This represents the highest annual growth in nominal and real earnings since 2008.

1.20 Wages had been rising above inflation for 15 consecutive months by the end of 2015. Living standards, as measured by real household disposable income (RHDI) per capita, are expected to have risen in 2015 at their fastest rate in 14 years, driven by rising earnings and low inflation.

1.21 The government has taken unprecedented action to support those on lower pay. From 1 April 2016, low wage workers aged 25 and above will see a pay rise as a result of the introduction of the National Living Wage (NLW). Initially set at £7.20, it will mean a £900 cash increase for a full-time worker on the current National Minimum Wage (NMW) – the largest annual increase in a minimum wage rate across any G7 country since 2009, in cash and real terms.[18] 2.9 million workers are expected to benefit directly, and the OBR estimated up to 6 million could see a pay rise as a result of a ripple effect causing pay to rise further up the earnings distribution.[19]

[18] HMT calculations using OECD minimum wage statistics, 2016.
[19] 'Economic and fiscal outlook', OBR, March 2016 and 'Economic and fiscal outlook', OBR, July 2015.



Long-term solutions to long-term problems

1.22 Given the concerns over slowing growth in advanced economies, policymakers face a choice over how to respond. The OBR forecasts little spare capacity in the economy – as measured by the output gap – for the forecast period. This suggests that there is little benefit to policy increasing overall demand without taking measures to expand supply. Attempting to spend more than the country can afford would not address the challenges Britain faces.

1.23 In the UK, debt levels remain high. Short-term, discretionary fiscal stimulus would simply increase public debt without expanding supply.

1.24 Furthermore, the Monetary Policy Committee (MPC) forecasts inflation to return to the 2% target in the medium term. As the Governor of the Bank of England has recently said, "the G20 needs to use the time purchased by monetary policy to develop a coherent and urgent approach to supply-side policies".[20]

1.25 The long-term solution is structural reform. These policies seek to make economies more efficient, competitive and productive. Both the IMF and OECD recognise that structural reform is needed to boost long-term growth.[21] Their research shows that the most effective structural reforms include lowering the rates of distortive taxes, ensuring that product markets are flexible and competitive, and cutting or simplifying business regulation.[22] These policies are critical to delivering sustainable growth for the next generation.

[20] Mark Carney, Governor of the Bank of England, 'Redeeming an unforgiving world', G20 conference speech, February 2016.
[21] 'World Economic Outlook', IMF, October 2015; 'Economic Outlook', OECD, November 2015.
[22] 'Economic Growth and the Role of Taxation – Disaggregate Data', OECD, 2009; 'The New Normal: A Sector-Level Perspective on Productivity Trends in Advanced Economies', IMF, 2015; 'Raising potential growth after the crisis: A quantitative assessment of the potential gains from various structural reforms in the OECD area and beyond', OECD, 2010.

1.26 Since 2010 the government has acted to reform the supply side of the UK economy including by lowering taxes, cutting regulation, investing in infrastructure, and introducing the National Living Wage and Apprenticeship levy. The government set out comprehensive reforms to support productivity growth in 'Fixing the Foundations: creating a more prosperous nation'.[23] In October 2015 the National Infrastructure Commission was established to provide the government with expert independent advice on the country's infrastructure needs.

1.27 This Budget announces further measures to drive productivity growth across the UK:

- reducing distortive taxes by continuing to lower both income tax and business taxes
- improving education by accelerating fairer schools funding and committing to full academisation of schools in England
- promoting enterprise through business rate cuts for small businesses, cutting Capital Gains Tax and extending entrepreneurs' relief to external investors in unlisted trading companies
- delivering long-term infrastructure improvements, by giving the green light to major projects recommended by the National Infrastructure Commission including Crossrail 2, and High Speed 3 between Leeds and Manchester
- improving economic decision-making by devolving power to cities and regions, including new devolution deals for the East and West of England

Economic rebalancing

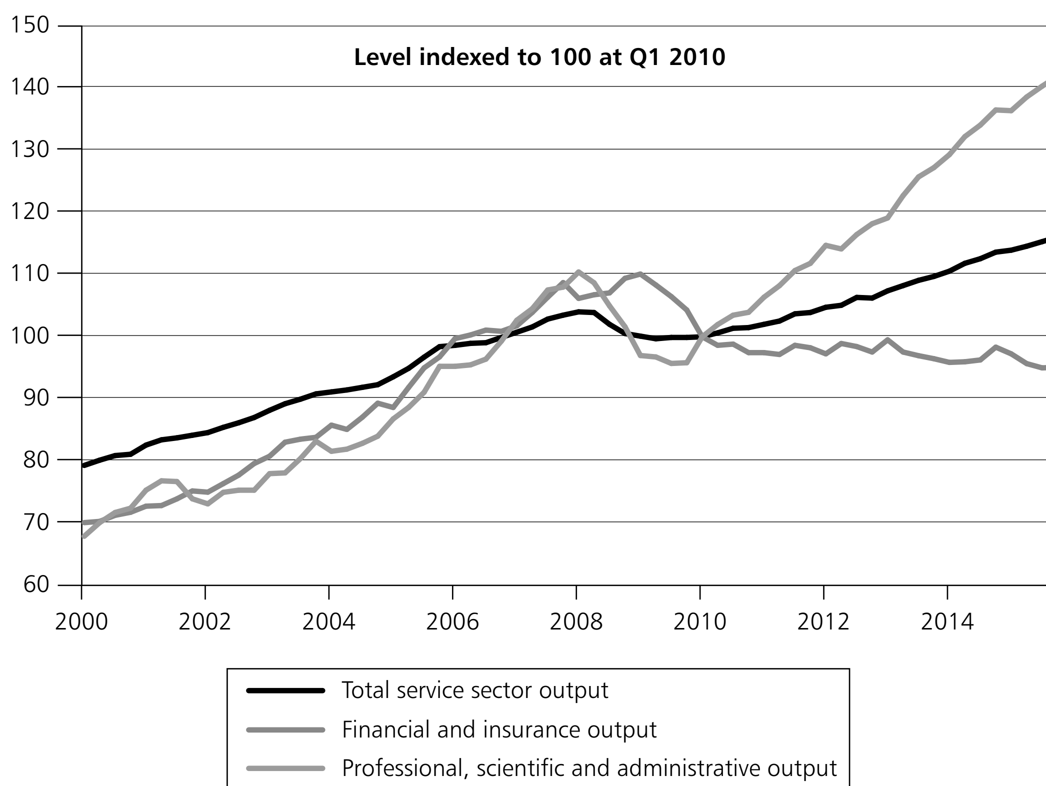
1.28 The financial crisis of 2008 and 2009 revealed an unstable and unbalanced model of economic growth in the UK. Since 2010 the government has taken steps to support more balanced growth across sectors and regions and to promote savings and investment.

Sector rebalancing

1.29 The UK is making progress in shifting towards high-value added sectors in both manufacturing and services. The manufacturing, construction and service sectors are now all larger than at the beginning of 2010. By the end of 2015, 62.6% of all employment growth since 2010 has been in high skilled occupations. Within manufacturing, aerospace production has grown by almost 30% and car production has increased by over 60% since the start of 2010. Between 2010 and 2014, 16,000 new jobs in car production have been created and in 2015 car manufacturing exports reached a record high.

1.30 Within services, output has been strong across different high-value added sectors. Scientific research and development has grown by 24.4% and architecture and engineering activities have grown by 42.5% since 2010. Rebalancing within the services sector has been particularly strong.

[23] 'Fixing the foundations: creating a more prosperous nation', HM Treasury, July 2015.



1.31 Investment in productive assets, from plant and machinery to software and patents, is vital for a thriving economy. During the financial crisis investment was hit hard in the UK, falling by 24%. Since then it has picked up, and investment grew faster than in any other major advanced economy in 2015 and is forecast by the OECD to continue to increase at the fastest rate in 2016 and 2017.[24] Business investment has continued to pick up as the economy has recovered, increasing by 25.8% since Q1 2010, more than twice as fast as household consumption. In 2015, business investment increased by 4.7% and it is now 4.2% higher than its pre-crisis peak.

Regional rebalancing

1.32 Regional economic disparities have long been a problem, with London and the South East having higher growth than the UK average for decades. The government is determined to rebalance the economy by building the Northern Powerhouse and the government's devolution revolution is creating powerful elected mayors, allowing local governments to reduce and retain business rates, and giving local leaders across the country new powers and rewards for driving local growth.

1.33 Since 2010, unemployment in the North of England has fallen by a third and the median earnings of full-time employees grew faster in all regions of the North than they did in London.[25] In 2015, employment grew faster in the North than the South and by the end of 2015, the employment rate in the North was at its highest on record, at 72.2%.

[24] 'Economic Outlook No 98', OECD, November 2015.
[25] The North is defined as the North East, North West, and the Yorkshire and the Humber regions. The South is defined as London, the South East and South West regions.

1.34 Between 2010 and 2015, labour markets in the regions have performed strongly. Unemployment fell and employment rose in every region, with two-thirds of the increase in employment from outside London and the South East. Labour markets in the regions strengthened in 2015, with every region reaching a record number of people in work.[26]

1.35 In 2015 there were over half a million more businesses outside London and the South East compared to 2010, including nearly 160,000 more businesses in the North and over 95,000 more businesses in the Midlands.[27, 28] The South West has had the fastest rate of business growth outside of London.

External rebalancing

1.36 The outlook for world trade continues to be revised down, reflecting both cyclical and structural factors. This weighs on the outlook for UK trade, as the external demand for UK exports is expected to be weaker. In 2015, the sum of UK exports and imports amounted to 57% of GDP, twice the US level. As an open economy, the UK is not immune to developments in the global economy. The OBR have revised down their outlook for UK export markets compared to their November forecast as the inevitable result of lower global growth.

1.37 The UK's current account deficit has narrowed, falling to -3.7% in Q3 2015, but it remains high. This has been driven by a deterioration in the UK's net investment income. This likely reflects the relatively strong performance of the UK economy compared to its trading partners, which has meant that the income earned on the UK's overseas assets has been relatively weaker. The current account deficit is forecast to narrow gradually over the forecast period.

The UK and the EU

1.38 On 23 June, the British people will be asked whether they think the UK should remain a member of the EU or leave, in the first referendum on the UK's membership of the EU since 1975. The government position is to recommend that Britain remains in a reformed EU.

[26] Between 3 months to December 2014 and 3 months to December 2015.
[27] The Midlands is defined as the East Midlands and the West Midlands regions.
[28] 'Business Population Estimate for the UK and Regions', BIS, October 2015.

Economic opportunities and risks linked to the UK's membership of the European Union

Membership of the EU has increased the UK's openness to trade and investment, reinforcing the dynamism of the economy. The Treasury has highlighted openness as a key driver of productivity, wages and living standards.[29] The UK's full access to the single market, through its EU membership, clearly increases the openness of the British economy, creating jobs and supporting livelihoods.

At the February 2016 European Council, the Prime Minister secured a new settlement for the UK in a reformed EU. The agreement covered four key areas: economic governance; competitiveness; sovereignty; and welfare and free movement. Together, the new settlement and the UK's existing opt-outs from the single currency and common border-free area give the UK a special status in the EU.[30]

Voting to leave the EU would create a profound economic shock and years of economic uncertainty.[31] Such a vote would be the start of a series of lengthy, interlocking negotiations with the EU and with other international partners. The associated uncertainty would have a material effect on jobs, the economy and the public finances. Some of the concerns related to such an outcome are already becoming apparent in financial markets. In their discussion of external analysis of the impact of an exit from the EU the OBR conclude that "Leaving aside the debate over the long-term impact of 'Brexit', there appears to be a greater consensus that a vote to leave would result in a period of potentially disruptive uncertainty while the precise details of the UK's new relationship with the EU were negotiated".[32]

The UK's current full access to the single market cannot be matched by any existing alternative. UK firms and consumers enjoy tariff-free trade and reductions in non-tariff barriers across the EU. The UK is also inside the customs union, eliminating the need for customs compliance for trade between EU member states. None of the alternative arrangements with the EU would provide the same level of access, particularly for services, which accounts for 79% of the UK economy. A new relationship which gives the UK the access to the single market that it needs would involve contributing financially to the EU, accepting the free movement of people and adopting EU rules without having any say over them.

In their discussion of current risks and uncertainties the OBR highlight that "whatever the long-term pros and cons of the UK's membership of the European Union, a vote to leave in the forthcoming referendum could usher in an extended period of uncertainty regarding the precise terms of the UK's future relationship with the EU. This could have negative implications for activity via business and consumer confidence and might result in greater volatility in financial and other asset markets".[33] The OBR note that, reflecting their statutory remit to prepare forecasts based on current government policy, it is not for them to judge at this stage what the impact of leaving the EU might be on the economy and public finances.

Remaining in a reformed EU will make the UK stronger, safer and better off. It will allow a reformed EU to continue supporting UK productivity. And it will offer certainty for UK businesses and consumers and those foreign firms investing in the UK. As Christine Lagarde, the Managing Director of the IMF has made clear, a vote to leave the EU would create uncertainty in the UK: "no economic player likes uncertainty. They don't invest, they don't hire, they don't make decisions in times of uncertainty."[34]

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[29] 'Fixing the foundations: creating a more prosperous nation', HM Treasury, July 2015.
[30] 'The best of both worlds: the United Kingdom's special status in a reformed European Union', HM Government, February 2016.
[31] 'The process for withdrawing from the European Union', HM Government, February 2016.
[32] 'Economic and fiscal outlook', OBR, March 2016.
[33] 'Economic and fiscal outlook', OBR, March 2016.
[34] Christine Lagarde, International Monetary Fund (IMF) Managing Director, CNN interview, 24 February 2016.

1.39 The Treasury will set out a comprehensive assessment of the costs and benefits of membership of a reformed EU in the coming months.

Monetary policy and credit easing

1.40 The steps taken by the government to fix the public finances and put banks and household finances on a surer footing have allowed monetary policy to play an active role in supporting the recovery.

1.41 The MPC has full operational independence to set policy to meet the inflation target. **Budget 2016 reaffirms the inflation target of 2.0% 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 2016-17.**

1.42 Inflation was 0.3% in January, well below the 2.0% target. In February, as required by the MPC remit, the Governor of the Bank of England wrote to the Chancellor a fifth open letter setting out that the current low level of inflation predominantly reflects the effect of external inflationary pressure, citing falling food, energy and other goods prices as explaining 'the vast majority of the deviation of inflation from the target'.[35]

1.43 Some measures of banks' funding costs, in particular the price that banks pay in wholesale markets to fund lending to the wider economy, have increased in recent months. However, they remain much lower than at the time of the launch of the Funding for Lending Scheme (FLS) in 2012. The FLS will continue to support lending to small and medium-sized enterprises (SMEs) until 2018. Annual growth in the stock of lending to SMEs continues to improve, and reached 1.4% in January. This is up from a low of -4.5% in August 2012.[36] Net lending to SMEs by participants in the FLS extension was also positive for the fourth quarter in a row, at £0.6bn in Q4 2015.[37]

1.44 The government fundamentally restructured the UK's system of financial regulation in 2013. As part of this, the government created the Financial Policy Committee (FPC) as the UK's macroprudential authority, within the independent Bank of England. This macroprudential role did not feature in the regulatory architecture before the government took action. The FPC is responsible for identifying, monitoring and addressing risks to the system as a whole. In 2014 and 2015, the FPC undertook stress tests of the UK banking system. The FPC concluded that the UK's banking system has become more resilient and has the capacity to maintain its core functions, including lending capacity, in these stress scenarios.[38]

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[35] Open letter from the Governor of the Bank of England to the Chancellor of the Exchequer, February 2016.
[36] 'Monetary financial institutions loans to non-financial businesses, by business size', Bank of England, February 2016.
[37] 'Funding for Lending Scheme usage and lending data publication – Q4 2015', Bank of England, March 2016.
[38] 'Financial Stability Report', Bank of England, December 2015.

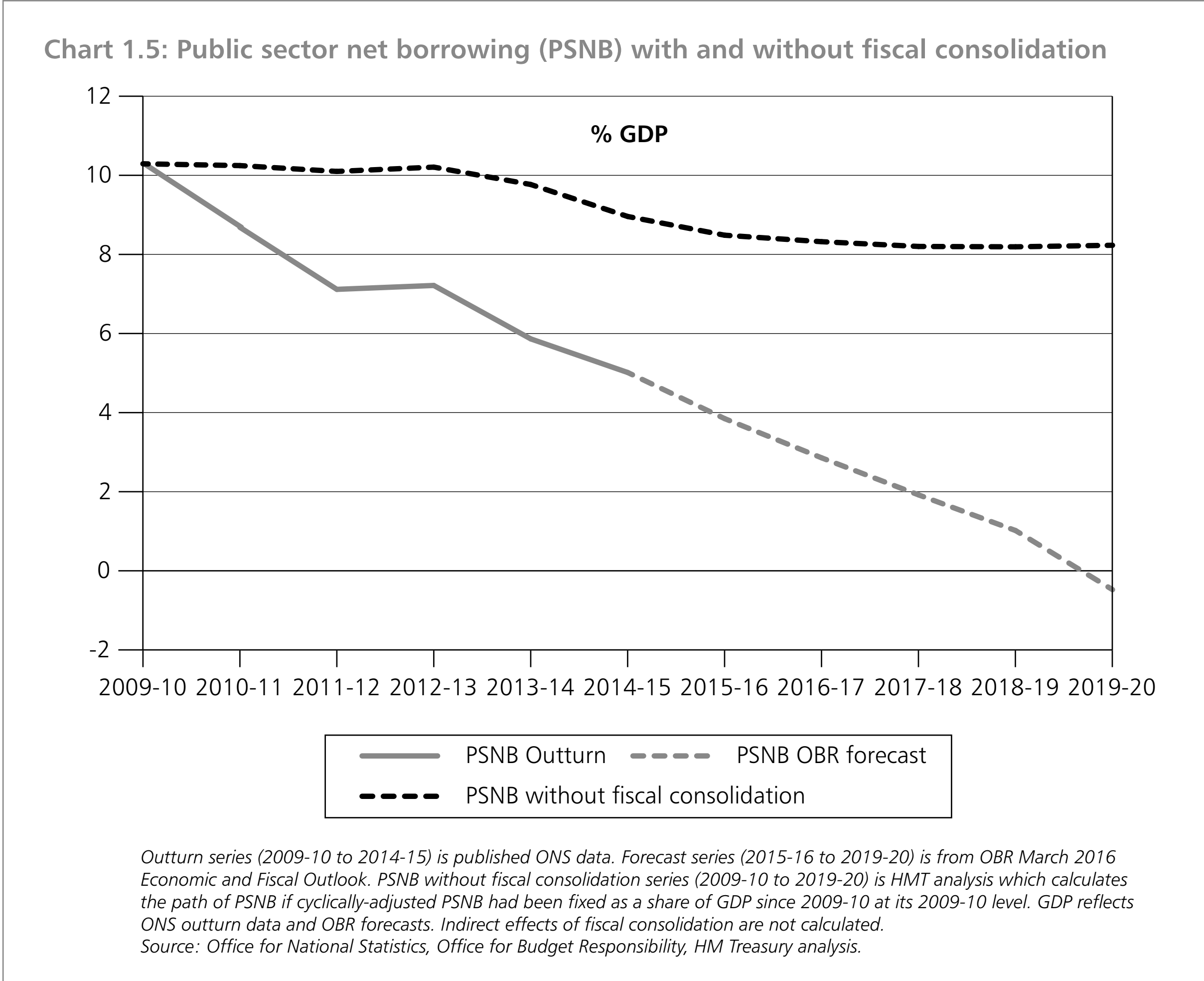
The government's fiscal plan

1.45 Significant progress has been made since 2010 in fixing the public finances. In 2009-10, the government borrowed around £1 in every £4 it spent. In 2015-16 the government is forecast to borrow around £1 in every £10 it spends and this is expected to reduce to around £1 in every £14 in 2016-17.[39]

1.46 The deficit as a share of GDP is forecast to be cut by almost two thirds from its 2009-10 post-war peak and will reach 3.8% of GDP in 2015-16.[40] The government has addressed the rapid rise in public sector net debt (PSND) which more than doubled as a share of GDP between 2007-08 and 2011-12. Net debt as a share of GDP is forecast to fall over this Parliament, reaching 77.2% of GDP by the end of 2019-20.[41]

1.47 The public finances would be in a much worse position had the government not undertaken the fiscal consolidation that has occurred since 2010. Analysis in Chart 1.5 shows that the government would have borrowed an additional £930 billion over the period 2010-11 to 2019-20 compared to the outturn and the OBR forecast.[42] This is calculated as the path of public sector net borrowing if cyclically adjusted public sector net borrowing (the structural deficit) had been fixed as a share of GDP since 2009-10 at its 2009-10 level. The chart shows the cyclical improvement in the economy since 2009-10 which would have reduced public sector net borrowing from its post war peak of 10.3% of GDP. However, the persistence of the structural deficit means that borrowing would have been higher in every year from 2010-11.

Chart 1.5: Public sector net borrowing (PSNB) with and without fiscal consolidation



Outturn series (2009-10 to 2014-15) is published ONS data. Forecast series (2015-16 to 2019-20) is from OBR March 2016 Economic and Fiscal Outlook. PSNB without fiscal consolidation series (2009-10 to 2019-20) is HMT analysis which calculates the path of PSNB if cyclically-adjusted PSNB had been fixed as a share of GDP since 2009-10 at its 2009-10 level. GDP reflects ONS outturn data and OBR forecasts. Indirect effects of fiscal consolidation are not calculated.
Source: Office for National Statistics, Office for Budget Responsibility, HM Treasury analysis.

[39] 'Public Sector Finances', ONS, January 2016; 'Economic and fiscal outlook', OBR, March 2016.
[40] 'Public Sector Finances', ONS, January 2016; 'Economic and fiscal outlook', OBR, March 2016.
[41] 'Public Sector Finances', ONS, January 2016; 'Economic and fiscal outlook', OBR, March 2016.
[42] 'Public Sector Finances', ONS, January 2016; 'Economic and fiscal outlook', OBR, March 2016 and HM Treasury calculations.

1.48 However more work needs to be done – the deficit and debt levels are still too high. The government remains committed to continuing the job of returning the public finances to surplus by 2019-20 and running a surplus thereafter in normal times so Britain bears down on its debt and is better placed to withstand future economic shocks. In a low inflationary environment, with the risk of economic shocks, the only reliable way to bring debt down as a share of GDP is to run a surplus.

1.49 This Budget sets out the action the government is taking to meet the fiscal mandate, achieving an overall surplus of £10.4 billion on the headline measure of public sector net borrowing in 2019-20 and a surplus of £11.0 billion in 2020-21.

1.50 Table 1.3 sets out the OBR forecast of the key fiscal aggregates at March Budget 2016.

Table 1.3: Comparison of key fiscal aggregates between Budget 2016 and Autumn Statement 2015

	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public sector net borrowing (£ billion)							
Budget 2016	91.9	72.2	55.5	38.8	21.4	-10.4	-11.0
Autumn Statement 2015[1]	94.7	73.5	49.9	24.8	4.6	-10.1	-14.7
Change compared to Autumn Statement 2015	*-2.8*	*-1.3*	*5.5*	*14.0*	*16.8*	*-0.3*	*3.7*
Public sector net borrowing (% GDP)							
Budget 2016	5.0	3.8	2.9	1.9	1.0	-0.5	-0.5
Autumn Statement 2015[1]	5.2	3.9	2.5	1.2	0.2	-0.5	-0.6
Change compared to Autumn Statement 2015	*-0.2*	*0.0*	*0.3*	*0.7*	*0.8*	*0.0*	*0.1*
Public sector net debt (% GDP)[2]							
Budget 2016	83.3	83.7	82.6	81.3	79.9	77.2	74.7
Autumn Statement 2015[1]	83.1	82.5	81.7	79.9	77.3	74.3	71.3
Change compared to Autumn Statement 2015	*0.2*	*1.3*	*0.9*	*1.4*	*2.6*	*2.9*	*3.4*

[1] Outturn figures for Autumn Statement are given as estimated at Autumn Statement.
[2] Debt at end March. GDP centred on end March.
Source: Office for Budget Responsibility and Office for National Statistics.

1.51 At the Summer Budget 2015 and Spending Review and Autumn Statement 2015, the government set out detailed measures to secure a surplus in 2019-20. As a result of the revision in the OBR's fiscal forecast, the government is taking action to ensure a surplus is still achieved in 2019-20. Table 2.1 shows £14 billion of new measures by 2019-20.

1.52 The government is maintaining a balanced pace of deficit reduction, with public sector net borrowing forecast to fall as a share of GDP at the same average annual rate over 2015-16 to 2019-20 as was achieved over 2010-11 to 2014-15.[43]

Fixing the public finances and achieving a surplus

Public spending

1.53 The government will build on the measures set out at Spending Review 2015 to deliver a surplus and ensure the sustainability of the public finances. Over the last five years government expenditure was reduced from the unsustainable level of 45% of GDP in 2010-11.[44] Spending

[43] 'Public Sector Finances', ONS, January 2016, 'Economic and fiscal outlook', OBR, March 2016.
[44] 'Public Sector Finances', ONS, January 2016.

Review 2015 set out savings of £21.5 billion, of which £9.5 billion was reinvested in the government's priorities. This Budget sets out that the government is adjusting those plans and will **find a further £3.5 billion of savings from public spending in 2019-20, in line with continuing action to ensure maximum efficiency from every pound of public spending.** This is equivalent to less than 0.5% of total spending, in 2019-20.

1.54 Total Managed Expenditure (TME) as a share of GDP will be 37.0% in 2019-20 and 36.9% in 2020-21.[45] After the public finances move into surplus in 2019-20, total departmental resource spending will grow in line with inflation from 2019-20 to 2020-21. Departmental spending will fall in real terms by an average of 0.9% per annum from 2015-16 to 2019-20, compared to 1.7% from 2010-11 to 2015-16.[46]

1.55 The government has already shown that savings can be delivered from spending while protecting core services and that a well-run state can do more for less – crime has fallen by more than a quarter since 2010, there are more young people going to study full time at university than ever before and record numbers of children are now taught in good or outstanding schools.[47]

Delivering further efficiency savings

1.56 The Chief Secretary to the Treasury, with the support of the Paymaster General, will lead an efficiency review, which will report in 2018. This will review the efficiency of all departmental spending to inform future expenditure decisions.

1.57 The government's spending priorities remain unchanged. As set out in Spending Review 2015, the defence and overseas aid commitments, the real-terms protections for the NHS in England, schools funding in England, the police and science will be maintained. The NHS has an ambitious programme of work underway to deliver £22 billion of efficiency savings and this is unchanged.

Sound financial management

1.58 The government's policy is to review the discount rate used to set employer contributions to the unfunded public service pension schemes every 5 years. The discount rate is based on the OBR's long term projections of GDP growth. **Budget 2016 sets out that the recent assessment has resulted in a reduction in the discount rate which will increase the contributions employers pay to the schemes from 2019-20 onward**. This will ensure that the costs of providing pension benefits in the future are fairly reflected in the contributions paid by employers, and that the pension promises made today are on a sustainable basis to ensure fairness to future tax payers.

1.59 As set out in the Spending Review, the government will continue to meet the commitment to spend 0.7% of Gross National Income (GNI) on Official Development Assistance (ODA) in every year of the Parliament. **In line with the commitment, the ODA budget will be adjusted to reflect the latest economic forecasts, taking existing plans into account.** The ODA budget will therefore be reduced by £650 million in 2019-20.

1.60 At Spending Round 2013, the government announced a control total to limit payments under PFI and PF2 contracts in nominal terms in each future Parliament. The control total is set at £70 billion and the Treasury is on track to meet this target, with forecast cumulative

[45] 'Economic and fiscal outlook', OBR, March 2016.
[46] HM Treasury analysis based on OBR Budget 2016 forecasts.
[47] Crime Survey for England and Wales, ONS, April 2014. https://www.gov.uk/government/news/record-number-of-pupils-in-good-or-outstanding-schools; https://www.ucas.com/corporate/data-and-analysis/ucas-undergraduate-releases/ucas-undergraduate-end-cycle-data-resources.'

spending from 2015-16 to 2019-20 for payments on all PFI and PF2 contracts funded by central government standing at £51.7 billion.[48]

Capital investment

1.61 The Spending Review prioritised long term investment over day-to-day spending. This Budget accelerates its commitment to invest £100 billion in infrastructure by 2020-21. The government is now accelerating its investment plans in priority areas to deliver **around £1.5 billion investment in areas such as housing, schools and transport over the next three years that would otherwise have taken place at the end of the decade.** This will include bringing forward funding for the Highways Maintenance Challenge Fund and the Pothole Action Fund, and enabling the delivery of thirteen thousand shared ownership homes two years early. As set out in Spending Review 2015, capital budgets will be £12 billion higher than planned at Summer Budget 2015.

Overview of the OBR central fiscal forecast

1.62 As a result of the measures the government is taking, the OBR forecast a surplus of £10.4 billion will be achieved in 2019-20. Table 1.4 sets out the OBR forecasts for key fiscal aggregates.

Table 1.4: Overview of the OBR's central fiscal forecast

	% GDP, unless otherwise stated						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Deficit							
Public sector net borrowing	5.0	3.8	2.9	1.9	1.0	-0.5	-0.5
Public sector net borrowing (£ billion)	91.9	72.2	55.5	38.8	21.4	-10.4	-11.0
Cyclically-adjusted net borrowing	4.3	3.6	2.7	1.9	1.0	-0.5	-0.5
Primary balance	-3.4	-2.2	-1.1	-0.1	0.9	2.2	2.1
Treaty deficit[1]	5.0	3.9	2.9	2.0	1.1	-0.3	-0.4
Debt							
Public sector net debt[2]	83.3	83.7	82.6	81.3	79.9	77.2	74.7
Treaty debt[3]	87.4	88.9	88.3	87.1	85.6	83.0	80.3
Memo: Output gap	*-0.7*	*-0.3*	*-0.1*	*0.1*	*0.0*	*0.0*	*0.0*
Memo: Total policy decisions[4]	-	-	*0.0*	*-0.4*	*-0.2*	*-0.6*	*-0.2*

[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.

[4] Equivalent to the 'Total policy decisions' line in Table 2.1.

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

Performance against the government's fiscal targets

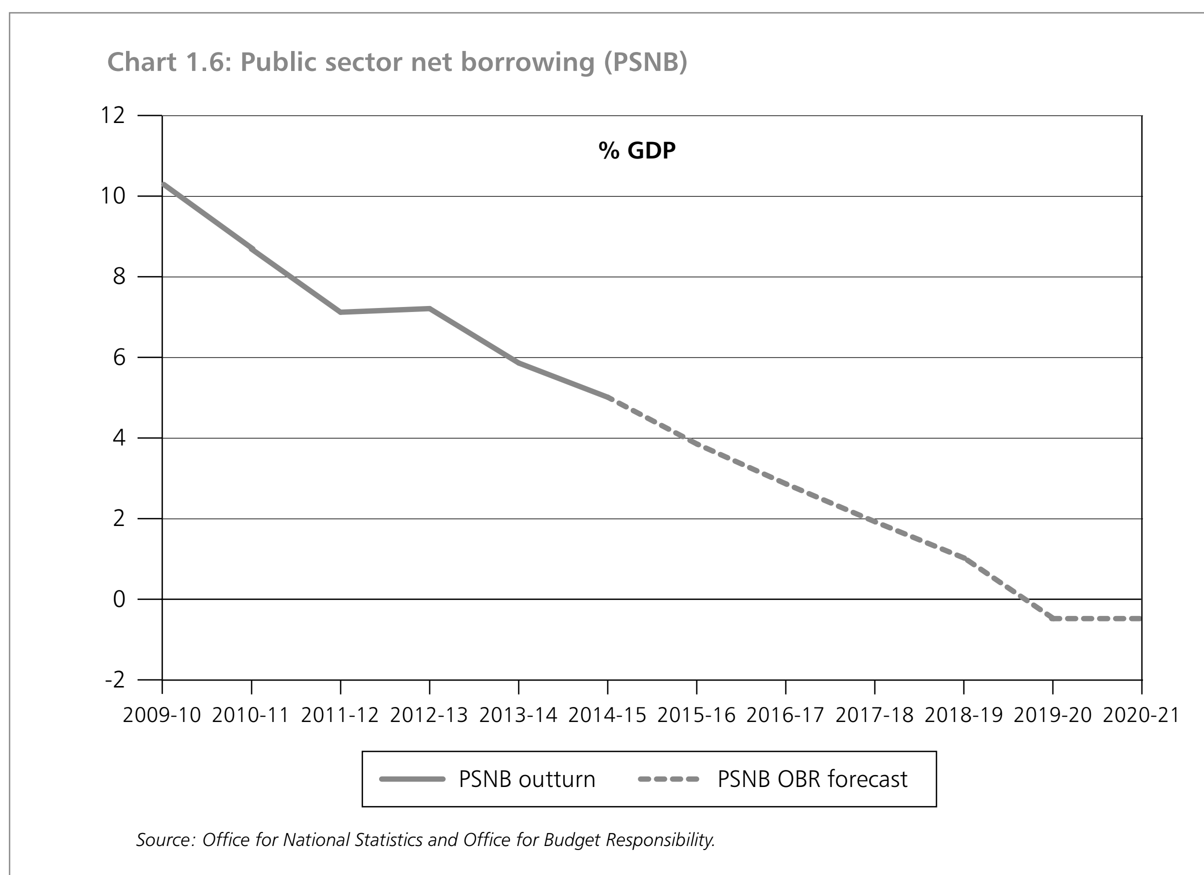
1.63 The Charter for Budget Responsibility was approved by the House of Commons on 14 October 2015.[49] It defines the government's fiscal mandate as a surplus on the headline measure of Public Sector Net Borrowing (PSNB) by 2019-20, maintaining a surplus in normal times thereafter. This is supplemented by a target for debt as a share of GDP to be falling in each year until 2019-20. The simplicity and clarity of the metrics ensure that governments will be held to account for their fiscal policy when the economy is performing well.

[48] 'Private Finance Initiative and Private Finance 2 projects: 2015 summary data', HM Treasury, March 2016.
[49] 'Charter for Budget Responsibility: autumn 2015 update', HM Treasury, October 2015.

1.64 Under the updated Charter, the surplus rule will be suspended if the economy is hit by a significant negative shock (defined as 4 quarter-on-4 quarter GDP growth below 1%). This provides flexibility to allow the automatic stabilisers to operate freely when needed. Following a shock, the government of the day will be required to set a plan to return to surplus, including appropriate fiscal targets. The framework does not prescribe what the targets should be, allowing the government of the day to respond to the circumstances. However, the targets will be voted on by the House of Commons and assessed by the OBR.

1.65 The OBR's March 2016 'Economic and fiscal outlook' provides an assessment of the government's performance against its fiscal targets. It confirms the government is on track to meet its fiscal mandate, achieving a surplus of £10.4 billion on the measure of public sector net borrowing in the target year of 2019-20 and to maintain a surplus in the following year, 2020-21.[50] The OBR's judgement is that the government's policies are more likely than not to achieve the mandate in 2019-20.[51]

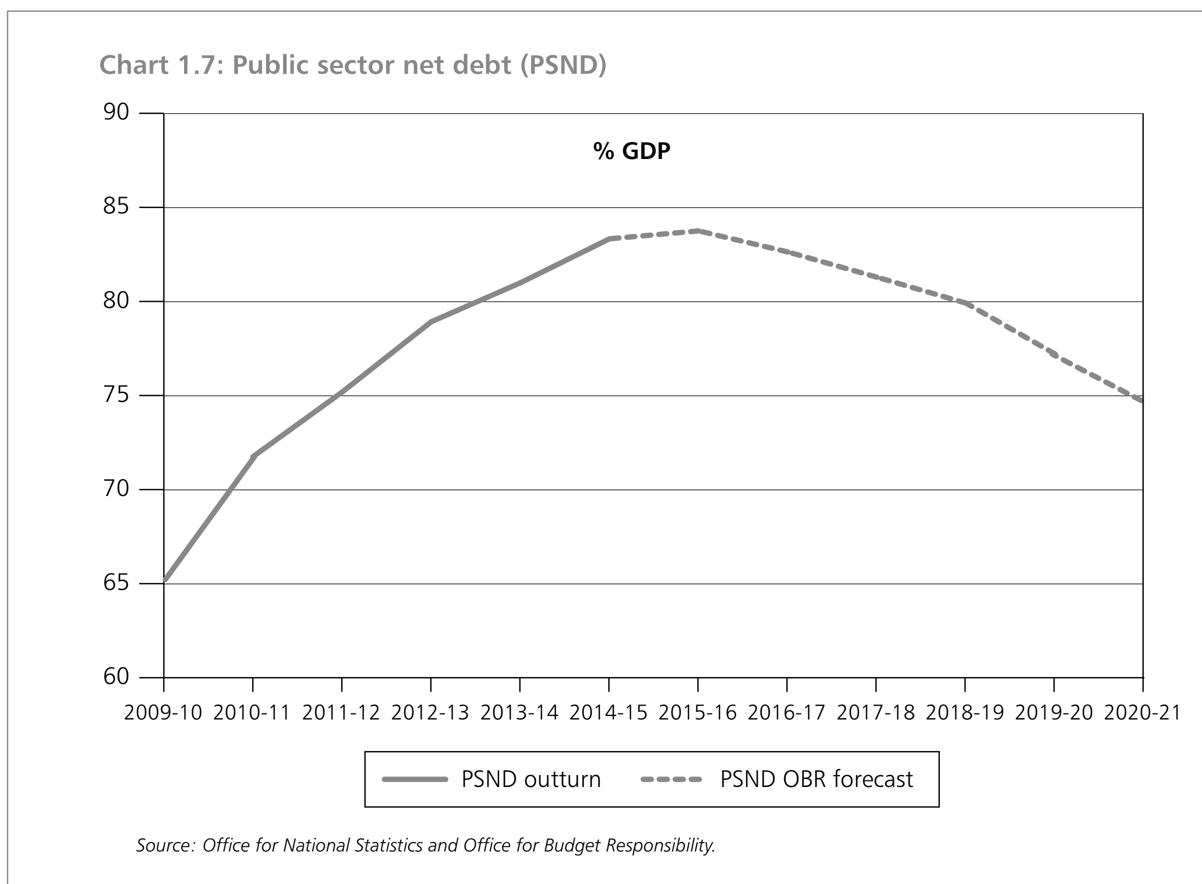
Chart 1.6: Public sector net borrowing (PSNB)



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

1.66 The fiscal mandate is supplemented by a target for public sector net debt to be falling as a share of GDP in each year to 2019-20. Chart 1.7 shows PSND as a percentage of GDP. Public sector net debt is forecast to fall from 2016-17 to the end of the Parliament, reaching 77.2% of GDP by the end of 2019-20.[52] The OBR forecasts that the level of cash debt at the end of 2015-16 will be £1591 billion, down from £1599 billion in its November forecast. Debt as a share of GDP is forecast to rise to 83.7% of GDP at the end of 2015-16 because the economy is smaller in nominal terms in 2015-16 than forecast in November, largely due to lower inflation. The government has also delayed the sale of the remaining shares in Lloyds Banking Group as a result of market conditions.[53]

[50] 'Economic and fiscal outlook', OBR, March 2016.
[51] 'Economic and fiscal outlook', OBR, March 2016.
[52] 'Economic and fiscal outlook', OBR, March 2016.
[53] 'Economic and fiscal outlook', OBR, March 2016.



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

1.67 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. The OBR's forecast indicates that this target will be met in 2016-17.

Welfare Cap

1.68 The government introduced the Welfare Cap at Budget 2014 to strengthen control of welfare spending, support fiscal consolidation and improve Parliamentary accountability for the level of welfare spending. The cap applies to welfare spending in Annually Managed Expenditure (AME) with the exception of the state pension and the automatic stabilisers. It is assessed at Autumn Statements.

1.69 Summer Budget 2015 and Autumn Statement 2015 announced reforms to ensure that the welfare system is both fair and sustainable. The Welfare Reform and Work Bill legislates for the majority of these reforms. As announced by the Secretary of State for Work and Pensions, the Department for Work and Pensions (DWP) will continue to deliver Personal Independence Payments (PIP) in line with their original intention of supporting claimants with the greatest need in helping them meet the extra costs of their disability or long-term health condition. Spending in 2015-16 on PIP and its predecessor, the Disability Living Allowance, is expected to be over £3 billion higher in real terms than in 2009-10.[54] Spending on these benefits is forecast to be higher in real terms in 2019-20 than in 2009-10.

1.70 The government's intention is for the cap to be met by the end of the Parliament when the OBR conducts its next assessment at Autumn Statement 2016.

[54] 'DWP Benefit Expenditure and caseload tables for Autumn Statement 2015, 'Economic and fiscal outlook' OBR, March 2016 and HMT calculations'.

1.71 The Charter for Budget Responsibility requires the Treasury to set out the level of the welfare cap in the Budget Report. This is in Table 1.5. OBR forecasts of the level of welfare spending are set out in the 'Economic and fiscal outlook', March 2016.

Table 1.5: The welfare cap

	£ billion				
	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare cap set at Summer Budget 2015	115.2	114.6	114.0	113.5	114.9
Forecast Margin (2%)	2.3	2.3	2.3	2.3	2.3

Source: HM Treasury

Financial sector and other state-owned asset sales

1.72 The government is committed to returning the financial sector assets acquired in 2008-09 to the private sector. As there is no longer a policy need for the government to hold these assets, it will seek to dispose of them, reducing PSND while maximising value for taxpayers.

1.73 Since 2010, the government has recovered over £75 billion, including further progress in 2015-16 in getting taxpayers' money back.[55] This included:

- £2.1 billion from an initial sale of Royal Bank of Scotland (RBS) shares in August 2015[56]
- approximately £7.5 billion through the continuation of the Lloyds Banking Group trading plan[57]
- receipt of the final payment of £740 million from the Landsbanki estate in Iceland[58] and
- a further £5.1 billion in payments received from our holdings in UK Asset Resolution (UKAR).[59]

1.74 Decisions on disposals will be made taking into account market conditions and value for money.

1.75 **The government is committed to launching a retail sale of Lloyds Banking Group shares and to fully returning its stake to the private sector in 2016-17.** UK taxpayers' money was used to bail out the banks, so it is right to give the public the opportunity to invest in Lloyds Banking Group. The government will shortly receive the final payment from RBS of £1.2 billion for the retirement of the Dividend Access Share (DAS), and it continues to seek further opportunities to dispose of its holding in RBS.[60] From both the DAS and share disposals, the government expects to raise up to £25 billion from RBS by the end of 2019-20.

1.76 Following the recent successful sale of £13 billion of former Northern Rock mortgages, the Treasury, UK Financial Investments (UKFI) and UKAR have been exploring further sales of UKAR mortgages: in particular, a programme of sales designed to raise sufficient proceeds for Bradford & Bingley (B&B) to repay the £15.65 billion debt to the Financial Services Compensation Scheme (FSCS) and, in turn, the corresponding loan from the Treasury.[61] It is expected that this programme of sales will have concluded in full before the end of 2017-18.

[55] 'Economic and fiscal outlook', OBR, March 2016.
[56] 'Government begins sale of its shares in the Royal Bank of Scotland', HM Treasury, 4 August 2015, available on www.gov.uk
[57] 'Chancellor extends Lloyds trading plan', HM Treasury, 4 December 2015, available on www.gov.uk.
[58] 'UK authorities receive final payment from Icesave', HM Treasury, 15 January 2016, available on www.gov.uk.
[59] 'Economic and fiscal outlook', OBR, March 2016.
[60] 'Economic and fiscal outlook', OBR, March 2016.
[61] HMT, UKFI and UKAR have received 'highly confident' letters from a consortium of the main Financial Services Compensation Scheme (FSCS) member banks, setting out the in-principle terms on which they would expect to provide debt funding to support a major sales programme of B&B mortgages. Discussions with the banking consortium will continue. Any sales will be subject to market conditions and ensuring value for money.

1.77 The government is making progress towards achieving a further £5 billion of corporate and financial asset sales by March 2020. The process to transfer the Green Investment Bank to private ownership has begun and the government will shortly consult on options to move the operations of the Land Registry to the private sector. In addition, the government is continuing to pursue the sale of the pre-2012 income contingent repayment student loan book, with a first sale in 2016-17.

Debt and reserves management

1.78 The Official Reserves, which include the government's foreign currency assets, were $134 billion in February 2016, almost 90% larger than in June 2010.[62] This reflects a total of £42 billion of additional financing provided for the reserves since 2010 and changes in the market prices of the assets held. The government will provide £6 billion of sterling financing for the Official Reserves in 2016-17.

1.79 The government's financing plans for 2016-17 are summarised in Annex A. They are set out in full in the 'Debt management report 2016-17', published alongside the Budget.

[62] 'UK official holdings of international reserves', HM Treasury, 3 March 2016, available on www.gov.uk.

Support for working people

1.80 The Budget puts the next generation first, providing security and opportunity from childhood to working age and through to retirement. This means building an economy based on lower taxes, so that people can take home more of what they earn. It also means investing in education to equip the next generation for the future, tackling childhood obesity and investing in school sports. It means building the housing Britain needs and it means providing the next generation with better incentives to save, and more choice and flexibility as they do so. It means delivering on the government's aim to reach full employment, increasing wages so that more people are in work and earning more.

1.81 The Budget continues to reform public services in a way that is fair. The policies of this government mean that the richest are paying an increasing share of taxes, with those lower down the income distribution continuing to pay less. Distributional analysis published today confirms that half of public spending continues to go to the poorest 40% of households, and that the richest 20% will pay over half of taxes in 2019-20.[63] In addition, the richest 1% paid over 28% of all income tax revenue in 2013-14 – a higher proportion than in any year of the last two decades.[64]

Lower tax society: cutting tax for working people

1.82 The government is determined to support those in work by continuing to cut taxes and has committed to **raise the personal allowance to £12,500, and the higher rate threshold to £50,000 by the end of this parliament.**

1.83 The personal allowance will be 70% higher in April of this year than in 2010-11.[65] **At Budget 2016, the government takes another significant step towards this commitment, by increasing the personal allowance from £11,000 in 2016-17 to £11,500 in 2017-18.** This continues to ensure that no-one working 30 hours per week on the National Minimum Wage (NMW) will pay income tax in 2017-18, and will bring the total number of taxpayers taken out of income tax since the start of this parliament to 1.3 million.[66] As a result, a typical basic rate taxpayer will pay over £1,000 less income tax in 2017-18 than in 2010-11.[67]

1.84 The government also wants to ensure that the tax system encourages individuals to progress. At Summer Budget 2015 the government announced that the higher rate threshold would rise from £42,385 in 2015-16, to £43,000 in April this year.

1.85 This Budget goes further. **The government will increase the higher rate threshold by £2,000 to £45,000 in 2017-18**. This will be the biggest above inflation cash increase to this threshold since it was introduced by Lord Lawson in 1989.[68] This delivers the government's ambition to reverse the trend whereby an increasing number of individuals are faced with paying the higher rate. In 2017-18, there will be 585,000 fewer higher rate taxpayers than at the start of the parliament.[69]

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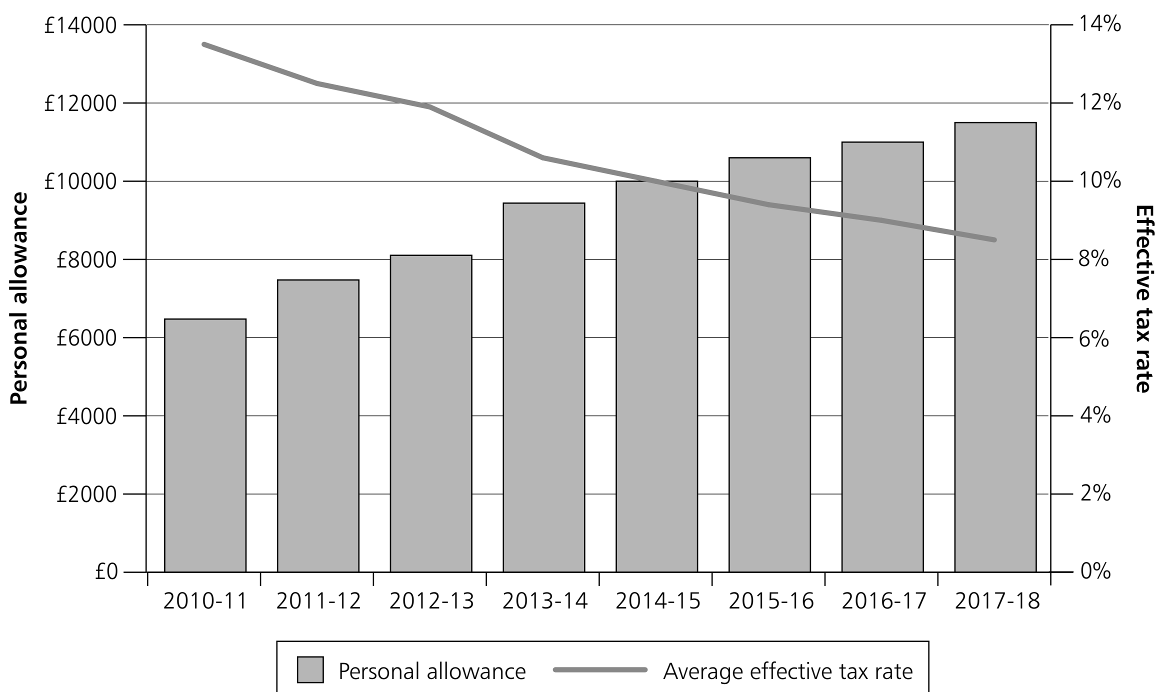
[63] Impact on Households: distributional analysis to accompany Budget 2016, available at gov.uk.
[64] HMRC Personal Income Statistics, 2013-14.
[65] HM Treasury analysis based on personal tax parameters, ONS CPI series, HMRC analysis based on Survey of Personal Incomes (SPI) 2013-14 data and Budget 2016 OBR forecasts.
[66] HM Treasury analysis based on personal tax parameters, ONS CPI series, HMRC analysis based on Survey of Personal Incomes (SPI) 2013-14 data and Budget 2016 OBR forecasts.
[67] HM Treasury analysis based on personal tax parameters, ONS CPI series, HMRC analysis based on Survey of Personal Incomes (SPI) 2013-14 data and Budget 2016 OBR forecasts.
[68] HM Treasury analysis based on personal tax parameters, ONS CPI series, HMRC analysis based on Survey of Personal Incomes (SPI) 2013-14 data and Budget 2016 OBR forecasts.
[69] HM Treasury analysis based on personal tax parameters, ONS CPI series, HMRC analysis based on Survey of Personal Incomes (SPI) 2013-14 data and Budget 2016 OBR forecasts.

Chart 1.8: Personal allowance increases since 2010



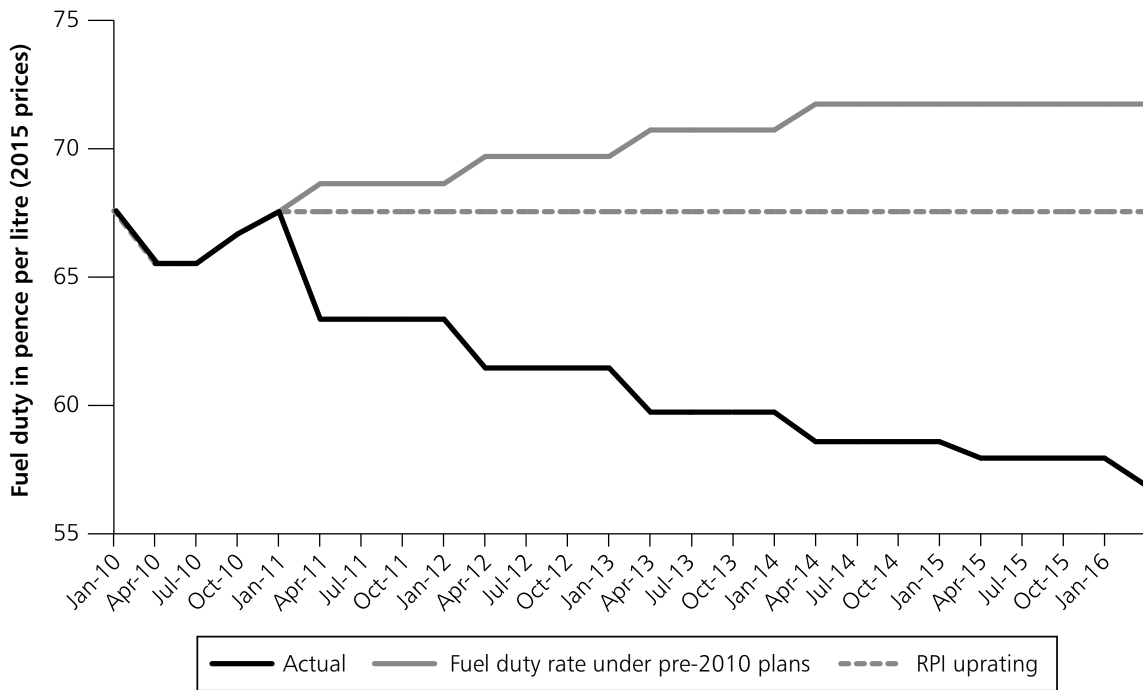
Source: HMT analysis of personal tax parameters.
[1] This is based on an individual with earnings of £20,000 in each year.
[2] The average effective tax rate is for income tax only.

Freezing fuel duty

1.86 Budget 2016 announces that, for the 6th successive year, the government will freeze the main rate of fuel duty at 57.95 pence per litre for 2016-17. This marks the longest fuel duty freeze in over 40 years.[70] Since Budget 2011, fuel duty has been kept at this level, delivering year-on-year real cuts for motorists. The average driver will save around £75 every year in duty compared to pre-2010 fuel duty escalator plans.[71] Pump prices are now 18 pence per litre lower than they would have been if the government had maintained pre-2010 fuel duty escalator plans,[72] and the typical motorist now spends £450 a year less on motor fuel than they did in 2011 when the freeze began.[73]

[70] 'Petrol and diesel prices' (Standard Note SN/SG/4712, p23), House of Commons Library, 28 Jan 2014.
[71] HM Treasury/HMRC calculations, based on DfT and ONS data on distance travelled per car, OBR RPI data and manufacturer's specifications for a Ford Focus 1.6 diesel car.
[72] HM Treasury/HMRC calculations based on RPI.
[73] HM Treasury/HMRC calculations, based on DfT and ONS data on distance travelled per car, DECC data on pump prices and manufacturer's specifications for a Ford Focus 1.6 diesel car.

Chart 1.9: Fuel duty rates in 2015 prices



Source: HM Treasury
Rates uprated to April 2015 prices using RPI.

Freezing alcohol duties

1.87 Pubs play an important role in their local communities. The British Beer and Pub Association report that beer duty rate changes since Budget 2013 have helped support both pubs and over 19,000 jobs.[74] **To continue this support, the duty rates on beer will be frozen in cash terms this year**.

1.88 The Scotch whisky industry is a great British success story. Exports are worth around £4 billion a year making up around a fifth of UK food and drink exports.[75] **To continue to support the Scotch whisky industry, the duty rate on spirits will be frozen this year. The duty rates on most ciders will also be frozen this year** in recognition of the important role cider makers play in rural communities. Other alcohol duty rates will rise by inflation. Beer and wine duties will continue to be broadly similar.

[74] British Beer and Pub Association Budget Submission, 2016.
[75] HMRC analysis based on UK Trade Statistics data and DEFRA's Food Statistics Pocketbook 2015.

Investing in the next generation

Education

1.89 This Budget accelerates the government's schools reforms and takes steps to create a gold standard education throughout England. The government will:

- **drive forward the radical devolution of power to school leaders, expecting all schools to become academies by 2020, or to have an academy order in place to convert by 2022.** The academies programme is transforming education for thousands of pupils, helping to turn around struggling schools while offering our best schools the freedom to excel even further
- **accelerate the move to fairer funding for schools. The arbitrary and unfair system for allocating school funding will be replaced by the first National Funding Formula for schools from 2017-18.** Subject to consultation, the government's aim is for 90% of schools who gain additional funding to receive the full amount they are due by 2020. **To enable this the government will provide around £500 million of additional core funding to schools over the course of this Spending Review, on top of the commitment to maintain per pupil funding in cash terms.** The government will retain a minimum funding guarantee
- **ask Professor Sir Adrian Smith to review the case for how to improve the study of maths from 16 to 18,** to ensure the future workforce is skilled and competitive, including looking at the case and feasibility for more or all students continuing to study maths to 18, in the longer-term. The review will report during 2016
- **invest £20 million a year of new funding in a Northern Powerhouse Schools Strategy.** This new funding will ensure rapid action is taken to tackle the unacceptable divides that have seen educational progress in some parts of the North lag behind the rest of the country. In support of this, **Sir Nick Weller will lead a report into transforming education across the Northern Powerhouse**

Soft drinks industry levy to pay for school sport

1.90 Childhood obesity is a national problem. The UK currently has one of the highest overall obesity rates amongst developed countries.[76] In England 1 in 10 children are obese when they start primary school, and this rises to 2 in 10 by the time they leave.[77]

1.91 The evidence shows that 80% of children who are obese between the ages of 10 and 14 will go on to become obese adults,[78] and this has widespread costs to society, including through lost productivity and the direct costs of treating obesity-related illness. The estimated cost to the UK economy today from obesity is approximately £27 billion,[79] with the NHS currently spending over £5 billion on obesity-related costs.[80]

1.92 Sugar consumption is a major factor in childhood obesity, and sugar-sweetened soft drinks are now the single biggest source of dietary sugar for children and teenagers.[81] A single 330ml can of cola can contain more than a child's daily recommended intake of added sugar.[82] Public

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[76] 'Healthy Weight, Healthy Lives: A toolkit for developing local strategies', Dr Kerry Swanton for the National Heart Forum/Cross Government Obesity Unit/Faculty of Public Health, 2008.
[77] Public Health England (PHE), figures based on 2014/15 data.
[78] 'Foresight', Government Office for Science, 2007.
[79] 'The Economic burden of Obesity', National Obesity Observatory, PHE, October 2010.
[80] 'Sugar Reduction: the Evidence for Action', PHE, October 2015.
[81] 'Sugar Reduction: the Evidence for Action', PHE, October 2015.
[82] Press Release, PHE, January 2016.

health experts have identified sugar-sweetened soft drinks of this kind as a major factor in the prevalence of childhood obesity.[83]

1.93 Budget 2016 announces a new soft drinks industry levy targeted at producers and importers of soft drinks that contain added sugar. The levy will be designed to encourage companies to reformulate by reducing the amount of added sugar in the drinks they sell, moving consumers towards lower sugar alternatives, and reducing portion sizes.

1.94 Under this levy, **if producers change their behaviour, they will pay less tax.** The levy is expected to raise £520 million in the first year. The OBR expect that this number will fall over time as the total consumption of soft drinks in scope of the levy drops, in part as a result of producers changing their behaviour and helping consumers to make healthier choices.[84]

1.95 In England, **revenue from the soft drinks industry levy over the scorecard period will be used to:**

- **double the primary school PE and sport premium from £160 million per year to £320 million per year** from September 2017 to help schools support healthier, more active lifestyles. This funding will enable primary schools to make further improvements to the quality and breadth of PE and sport they offer, such as by introducing new activities and after school clubs and making greater use of coaches
- **provide up to £285 million a year to give 25% of secondary schools increased opportunity to extend their school day** to offer a wider range of activities for pupils, including more sport
- **provide £10 million funding a year to expand breakfast clubs** in up to 1,600 schools starting from September 2017, to ensure more children have a nutritious breakfast as a healthy start to their school day

1.96 The Barnett formula will be applied to spending on these new initiatives in the normal way.

Improving health

1.97 The government is committed to investing in the next generation's health, and will:

- **invest £1.5 million in child prosthetics,** giving hundreds of children with limb deficiency access to sports prosthetics, and creating a fund to incentivise the development of new breakthrough innovative prosthetic products for the NHS
- tackle the health impacts of smoking, by continuing the tobacco duty escalator, ensuring tobacco duties rise by more than inflation each year in this Parliament. Hand-rolling tobacco is currently taxed at a lower rate than cigarettes. **The government will therefore increase the duty on hand-rolling tobacco by an additional 3% above the escalator from 6pm on Budget day**

Apprenticeships

1.98 The government is committed to increasing the quality and quantity of apprenticeships, and will deliver 3 million apprenticeship starts by 2020. As announced at the Autumn Statement 2015, an apprenticeship levy will be introduced in April 2017, and employers that are committed to training will be able to get out more than they put in.

1.99 From April 2017, employers will receive a 10% top-up to their monthly levy contributions in England and this will be available for them to spend on

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[83] Duncan Selbie; Press Release, PHE, July 2015.
[84] 'Economic and fiscal outlook', Office for Budget Responsibility (OBR), March 2016.

apprenticeship training through their digital account. The government will set out further details on the operating model in April and draft funding rates will be published in June.

Lifetime learning, from basic skills to PhDs

1.100 The digital revolution is transforming the world of work. As working lives lengthen and jobs change, adults will need more opportunities to retrain and up-skill. This Budget announces that, for the first time, **direct government support will be available to adults wishing to study at any qualification level, from basic skills right the way up to PhD.** During this parliament, loans will be introduced for level 3 to level 6 training in further education, part-time second degrees in STEM, and postgraduate taught master's courses.

1.101 From 2018-19, loans of up to £25,000 will be available to any English student without a Research Council living allowance who can win a place for doctoral study at a UK university. They will be added to any outstanding master's loan and repaid on the same terms, but with the intention of setting a repayment rate of 9% for doctoral loans and a combined 9% repayment rate if people take out a doctoral and master's loan. The government will launch a technical consultation on the detail. Those who take out only a master's loan will still repay at 6%, as announced at Autumn Statement 2015. **The government will also extend the eligibility of master's loans to include three-year part-time courses with no full-time equivalent.**

1.102 To promote retraining and prepare people for the future labour market, **the government will review the gaps in support for lifetime learning, including for flexible and part-time study. The government will bring together information about the wages of graduates of different courses and the financial support available across further and higher education** to ensure that people can make informed decisions about the right courses for them.

1.103 The government will continue to free up student number controls for alternative providers predominantly offering degree level courses for the 2017-18 academic year. The best providers can also grow their student places further through the performance pool.

Supporting people to save for the long term and buy their own home

1.104 The government has taken significant steps to support savers. It has nearly tripled the amount of cash that people can save in ISAs and made them more flexible, abolished tax on savings for 17 million people through the introduction of the Personal Savings Allowance,[85] and given people the freedom to take their pension savings in a way that best suits their needs without being bound by the straitjacket of having to buy an annuity. To further help savers at a time of unprecedentedly low interest rates, **the ISA allowance will rise from £15,240 to £20,000 in April 2017.**

1.105 Since their launch, the Help to Buy: equity loan and mortgage guarantee schemes have helped over 150,000 people to buy a home.[86] More than 350,000 first time buyers have opened a Help to Buy: ISA with someone signing up every 30 seconds.[87] Over 45,000 people have bought their home under Right to Buy since the scheme was reinvigorated in 2012.[88]

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[85] HMRC calculations using data from the Survey of Personal Incomes.
[86] HM Treasury Help to Buy: mortgage guarantee scheme quarterly statistics and DCLG Help to Buy (equity loan scheme) and Help to Buy NewBuy statistics: Data to 31 December 2015.
[87] Data collected by the Tax Incentivised Savings Association (TISA) from the Help to Buy: ISA providers.
[88] 'Annual Right to Buy sales for England', DCLG, 2015.

1.106 The government consultation 'Strengthening the incentive to save' looked at the way pensions are taxed.[89] The consultation found that while the current system gives everyone an incentive to save into a pension, and people like the 25% tax free lump sum, it is also inflexible and poorly understood. Young people in particular are not saving enough, often because they feel they have to choose between saving for their first home and saving for retirement.[90] Budget 2016 therefore addresses both of these concerns, continuing to prioritise transparency, choice and flexibility for savers.

A brand new flexible saving opportunity for the next generation

1.107 Building on the success of the Help to Buy: ISA, Budget 2016 gives the next generation a brand new opportunity to save in one place for a home and for retirement, and introduces new support for those who find it hardest to save.

The Lifetime ISA

1.108 The government wants to help young people save flexibly for the long term and ensure they do not have to choose between saving for retirement and saving for their first home. **The Budget announces that from 6 April 2017 any adult under 40 will be able to open a new Lifetime ISA. They can save up to £4,000 each year and will receive a 25% bonus from the government on every pound they put in.**

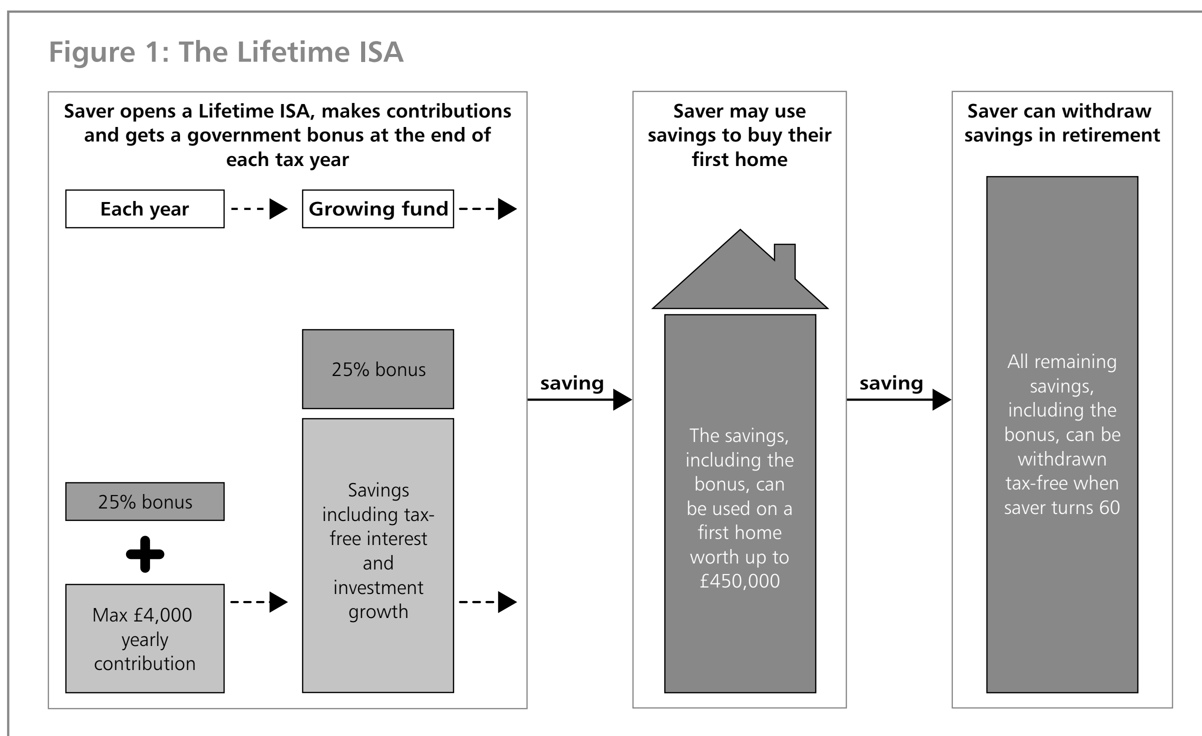
1.109 Contributions can continue to be made with the bonus paid up to the age of 50. **Funds can be used to buy a first home with the government bonus at any time from 12 months after opening the account, and can be withdrawn from the Lifetime ISA with the government bonus from age 60 for use in retirement.**

1.110 The government will set the limit for property purchased using Lifetime ISA funds at £450,000. This limit will apply nationally. People can continue to open a Help to Buy: ISA until November 2019, as planned. They can also choose to open a Lifetime ISA, but will only be able to use the government bonus from one of their accounts to buy their first home. During the 2017-18 tax year, those who already have a Help to Buy: ISA will be able to transfer the savings they have built up into the Lifetime ISA and still save an additional £4,000.

1.111 Whilst this is a product aimed at encouraging saving for the long term, the government understands that circumstances change so wants to ensure that people can access their own money if they need it whilst also keeping an incentive to leave funds invested for the long term. **The government will consider whether Lifetime ISA funds plus the government bonus can be withdrawn in full for other specific life events in addition to buying a first home**.

1.112 The government proposes that savers can make withdrawals at any time for other purposes, but with the bonus element of the fund plus any interest or growth on it returned to the government, and a small 5% charge applied. The government will also explore with the industry whether there should be the flexibility to borrow funds against the Lifetime ISA without incurring a charge if the borrowed funds are fully repaid. In the US some retirement plans allow 50% to be borrowed up to a maximum of $50,000. Further details on the Lifetime ISA are set out in the document published alongside Budget.

[89] 'Strengthening the incentive to save: a consultation on pensions tax relief', HM Treasury, July 2015.
[90] 'Strengthening the incentive to save: summary of responses to the consultation on pensions tax relief', HM Treasury, March 2016.



Help to Save

1.113 To help the people who find it hardest to save, **the government will introduce a new Help to Save scheme for those on low incomes** who wish to regularly set aside some of their income. The scheme will be open to 3.5 million adults in receipt of Universal Credit with minimum weekly household earnings equivalent to 16 hours at the National Living Wage, or those in receipt of Working Tax Credit.[91] It will work by **providing a 50% government bonus on up to £50 of monthly savings into a Help to Save account**. The bonus will be paid after two years with an option to save for a further two years, meaning that people can save up to £2,400 and benefit from government bonuses worth up to £1,200. People will be able to use the funds in any way they wish.

Understanding pension savings

1.114 As people work longer and change jobs more often, pension savings can become confusing. The average person will move employers 11 times over their working life, meaning they could end up with 11 or more private pensions by the time they retire.[92] Research shows that over a third of people approaching retirement find it difficult to keep track of their pension pots.[93] To help the next generation to clearly view their pensions savings, the government will **ensure the industry designs, funds and launches a pensions dashboard by 2019**. This will mean an individual can view all their retirement savings in one place.

Financial advice

1.115 The government welcomes the recommendations of the Financial Advice Market Review (FAMR),[94] which aims to support the provision of affordable and accessible advice for everyone, at all stages of their lives. FAMR was a joint review between the Financial Conduct Authority and Her Majesty's Treasury, and its recommendations were published on 14 March. **The government commits to implement all of the recommendations for which it is responsible, and will:**

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[91] HMRC and DWP forecasts of welfare claimants using data from Family Resources Survey and HMRC tax credit administration data.
[92] 'Making automatic enrolment work', DWP, October 2010.
[93] 'Half of over-50s don't know value of their pension', Which?, March 2016.
[94] 'Financial Advice Market Review: Final report', HM Treasury/ FCA, March 2016.

- **consult on introducing a single clear definition of financial advice** to remove regulatory uncertainty and ensure that firms can offer consumers the help they need
- **increase the existing £150 Income Tax and National Insurance relief for employer-arranged pension advice to £500**
- **consult on introducing a Pensions Advice Allowance. This will allow people before the age of 55 to withdraw up to £500 tax free from their defined contribution pension to redeem against the cost of financial advice.** The exact age at which people can do this will be determined through consultation. This means that a basic rate taxpayer could save £100 on the cost of financial advice

1.116 The government will also **restructure the delivery of public financial guidance to make it more effective.**[95]

Home ownership

1.117 The government supports home ownership and first time buyers. In addition to helping young people to buy their own home through the Lifetime ISA and Help to Buy, the Budget sets out further measures to deliver more housing.

1.118 The Autumn Statement 2015 set out the government's commitment to delivering 400,000 affordable housing starts by 2020-21, including 200,000 Starter Homes and 135,000 Help to Buy Shared Ownership properties. This constitutes the most ambitious affordable housing programme since the 1970s. To deliver on these plans **the Budget announces**:

- **the launch of the Starter Homes Land Fund prospectus**, inviting Local Authorities to access £1.2 billion of funding to remediate brownfield land to be used for housing, to deliver at least 30,000 Starter Homes
- **the delivery of 13,000 affordable homes two years early by bringing forward £250 million of capital spending to 2017-18 and 2018-19**

1.119 Consumers spend £270 million each year on failed housing transactions.[96] The government will shortly publish a call for evidence on how to make the process better value for money and more consumer-friendly.

A more streamlined planning system

1.120 The government has undertaken a series of reforms to streamline and simplify the planning system. Annual housing starts are now at an 8-year high and planning permission was granted for more than 250,000 homes last year alone.[97] Further reform is needed to deliver the government's commitment to deliver 400,000 affordable housing starts by 2020-21, while continuing to protect the Green Belt. **Budget 2016 therefore announces:**

- **the government's intention to move to a more zonal and 'red line' planning approach**, where local authorities use their local plans to signal their development strategy from the outset and make maximum use of permission in principle, to give early certainty and reduce the number of stages developers must go through to get planning permission
- **measures to speed up the planning system**, including minimising the delays caused by planning conditions, and ensuring the delivery of local plans by 2017

[95] 'Public Financial Guidance Review: Proposal for consultation', HM Treasury, March 2016.
[96] Department for Business, Innovation and Skills, research and analysis, to be published alongside the call for evidence.
[97] 'Planning applications in England: October to December 2015', DCLG, 8 March 2016.

- **a consultation on options for increasing transparency in the property market,** including by increasing the visibility of information relating to options to purchase or lease land
- that the government will deliver provisions to provide **greater freedoms and flexibilities for the deployment of mobile infrastructure**, including reducing planning restrictions for existing telecoms infrastructure and allowing taller new ground based masts to be built

Unlocking more land for housing

1.121 The government is committed to bringing more land into the planning system to ensure more families have a chance to own a home. At the Autumn Statement 2015 the government committed to releasing enough public sector land for 160,000 homes, over 50% more than in the last Parliament. **The government will now go even further to release public sector land for housing:**

- **for the first time ever Local Authorities are collaborating with central government on a local government land ambition, working with their partners to release land with the capacity for at least 160,000 homes, helping to support the government's policy on estates regeneration**
- **the Homes and Communities Agency will work in partnership with Network Rail and local authorities to provide land around stations for housing, commercial development and regeneration.** The government will set out shortly which sites will take part in the scheme

1.122 To increase densities on brownfield land, following the consultation on 'building up' in London, the government will consult on providing similar powers through devolution deals.

Garden towns, cities, and villages

1.123 The government supports the construction of a new wave of garden towns and cities across the country, with the potential to deliver over 100,000 homes. The Budget announces that the government will **legislate to make it easier for local authorities to work together to create new garden towns**, as well as **consult on a second wave of Compulsory Purchase Order (CPO) reforms** with the objective of making the CPO process clearer, fairer and quicker.

1.124 For areas that want to establish smaller settlements, **the government will provide technical and financial support to areas that want to establish garden villages and market towns of between 1,500 to 10,000 homes**. The government will shortly announce what planning and financial flexibilities will be offered to local authorities that submit proposals for settlements that deliver a significant number of additional houses.

Additional properties

1.125 As part of the government's commitment to support home ownership and first-time buyers, the Autumn Statement 2015 announced that from 1 April 2016, higher rates of Stamp Duty Land Tax (SDLT) will apply to purchases of additional residential properties, such as second homes and buy-to-let properties. The higher rates will be 3 percentage points above the current SDLT rates and will apply to purchases of additional residential properties in England, Wales and Northern Ireland.

1.126 Following consultation, the government has decided:

- **to help those moving in difficult circumstances, purchasers will have 36 months rather than the originally proposed 18 months to either claim a refund from the higher rates or before the higher rates will apply, in the event that there is a period of overlap or a gap in ownership of a main residence**

- **there will be no exemption from the higher rates for significant investors, and the higher rates will apply equally to purchases by individuals and corporate investors**

1.127 The government will provide £60 million of the additional receipts from higher rates on additional residential properties to enable community-led housing developments, including through Community Land Trusts, in rural and coastal communities where the impact of second homes is particularly acute.

Preventing homelessness

1.128 The Autumn Statement 2015 announced a real terms protection for central funding for homelessness, demonstrating the government's commitment to support the most vulnerable in society. This funding will support wider work to reform and refocus the system on preventing homelessness.

1.129 To further support rough sleepers off the streets and to help those who are recovering from a homelessness crisis, Budget 2016:

- **invests £100 million to deliver low-cost 'second stage' accommodation for rough sleepers leaving hostel accommodation and domestic abuse victims and their families moving on from refuges.** This will provide at least 2,000 places to enable independent living for vulnerable households and individuals, freeing up hostels and refuges for those in most acute need
- **invests £10 million over two years to support and scale up innovative ways to prevent and reduce rough sleeping**, particularly in London, building on the success of the No Second Night Out initiative
- **doubles the funding for the Rough Sleeping Social Impact Bond announced at the Autumn Statement 2015 from £5 million to £10 million**, to drive innovative ways of tackling entrenched rough sleeping, including 'Housing First' approaches
- **takes action to increase the number of rough sleeping EU migrants returning to their home countries.** Building on the success of the Operation Adoze pilot, the government will roll out a new approach in which immigration officials work with Local Authorities and outreach workers to connect rough sleepers to services that can return them home

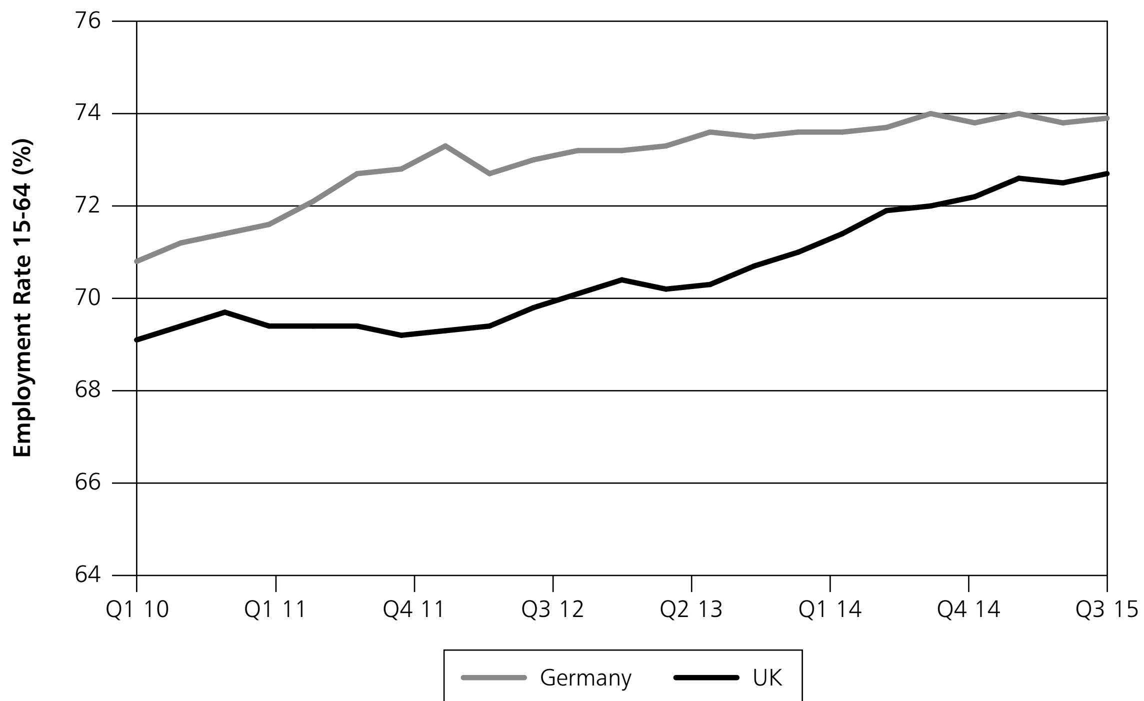
1.130 The government recognises the important work of providers of supported accommodation, including the providers of homelessness shelters and other services for those who may otherwise be sleeping rough. On 1 March 2016 the government confirmed that the date from which Local Housing Allowance caps apply to new tenancies in the supported accommodation sector will be delayed by one year. It will now apply to tenancies in this sector signed after 1 April 2017. The evidence review of the supported accommodation sector, due to report in the spring, will provide a foundation to support further decisions on protections for the supported housing sector in the long term.

Delivering full employment

1.131 A productive, dynamic economy is one that makes full use of its workforce, ensuring that as many people as possible can benefit from a growing economy and higher wages. The government has set out an ambition to achieve the highest employment rate among major economies by the end of the parliament. As Chart 1.10 shows, the difference between the employment rate in the UK and Germany, the country with the highest employment rate in the G7, has more than halved since 2011. On current population levels, an extra 500,000 people would need to move into employment to equal Germany[98] and deliver on the government's full employment ambition.

[98] OECD Labour Force Statistics.

Chart 1.10: UK and German employment rates (15-64)



Source: Organisation for Economic Co-Operation and Development statistics.

1.132 Much of the contribution to the increase in working-age employment seen over the last parliament came from substantial reductions in unemployment. Unemployment is at a 10 year low.[99] It has fallen by 820,000 since 2010, and at the end of last year, the claimant count was the lowest since 1975.[100] In order to meet the government's full employment goal, it is crucial to continue to reduce unemployment but also economic inactivity. In particular, the government wants to remove the barriers to work for key groups – notably women and the disabled, building on the progress made in the last parliament. The government will also introduce measures to support the self-employed, as set out in the business and enterprise section of this document.

Disability employment reform

1.133 The government is delivering on its manifesto pledge to halve the disability employment gap. The number of disabled people in employment has increased by 150,000 to over 3.25 million people over the last year[101] and the government is taking action to increase this further. At Summer Budget 2015, the government allocated funding to provide additional help for those on Employment and Support Allowance to move closer to the labour market.

1.134 This Budget announces that the government is accepting the recommendations of an independent stakeholder group and will offer new peer and specialist support for those suffering from mental health conditions and young disabled people. Later this year, the government will publish a White Paper focusing on the roles that the health, care and welfare sectors can play in supporting disabled people and those with health conditions to get into and stay in work.

[99] 'UK Labour Market', ONS, February 2016.
[100] 'UK Labour Market', ONS, February 2016.
[101] Table A08, 'UK Labour Market', ONS, February 2016.

Support for parents in employment

1.135 Significant progress has been made in achieving greater equality of opportunity for women. Female employment is at a record high and the number of women in full time jobs has increased by over 30% since 1992, when records began.[102] Yet it is still the case that 90% of those who aren't working because they are caring for a family or home are women,[103] and there are over 1 million women who aren't currently able to work who want a job.[104] The OECD have said equalising the roles of men and women in the labour force could raise UK GDP by 10% by 2030.[105]

1.136 To support families in this Budget, government will launch a consultation in May 2016 on how to implement its commitment to extend Shared Parental Leave and Pay to working grandparents. The consultation will also cover options for streamlining the system, including simplifying the eligibility requirements and notification system, and will explore the potential to make better use of digital technology.

1.137 The government **will work with the Behavioural Insights Team to look at new ways to support parents in choosing how and when to return to work.**

1.138 From early 2017, the government is introducing Tax-Free Childcare to help working parents with the cost of childcare, ensuring more parents who want to can go out to work or increase the number of hours they work. **Tax-Free Childcare will be rolled out in such a way that allows the youngest children to enter the scheme first, with all eligible parents brought in by the end of 2017. The existing scheme Employer-Supported Childcare will remain open to new entrants until April 2018 to support the transition between the schemes.** This will sit alongside doubling the free childcare entitlement from 15 hours to 30 hours a week for working families with three and four year olds from September 2017.

1.139 Last year, the Economic Secretary to the Treasury asked Jayne-Anne Gadhia, CEO of Virgin Money, to lead a review into the representation of women in senior managerial roles in the financial services industry. It is the sector with the highest pay in the UK and the widest gender pay gap.[106] **The review will launch its report on the 22 March at the Bank of England** with recommendations on how to improve gender diversity and will complement wider government work to eliminate the gender pay gap.

Higher wage society: the National Living Wage and National Minimum Wage

1.140 The new mandatory National Living Wage (NLW) will come into effect from 1 April 2016, set at £7.20 an hour for workers aged 25 and above. This will represent a £900 cash increase in earnings for a full-time worker on the current National Minimum Wage (NMW) – the largest annual increase in a minimum wage rate across any G7 country since 2009, in cash and real terms.[107] Around 65% of those who will benefit directly from the NLW are women, and the OBR estimate that by 2020 1.9 million women will be earning the NLW.[108]

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[102] 'UK Labour Market', ONS, February 2016.
[103] 'UK Labour Market', ONS, February 2016.
[104] 'UK Labour Market', ONS, February 2016.
[105] 'Effects of Reducing Gender Gaps in Education and Labour Force Participation on Economic Growth in the OECD', Thevenon, Ali, Adema & Salva Del Pero, OECD Social, Employment and Migration Working Papers No. 138, 2012.
[106] 'Trailblazing Transparency: Mending the Gap', Government Equalities Office/Deloitte, February 2016.
[107] HM Treasury calculations using OECD Minimum Wage Statistics, 2016.
[108] 'Number of employees paid the National Living Wage - November 2015 Economic and fiscal outlook', OBR, November 2015.

1.141 The government has asked the Low Pay Commission (LPC) to set out how the new NLW will reach 60% of median earnings by 2020.[109] Based on the OBR's March 2016 earnings forecasts, a NLW of 60% of median earnings would be £9 in 2020,[110] in line with the government's objective.

1.142 The Budget announces that the government will set the main rate of the NMW, which applies for workers aged between 21 and 24, at £6.95 from October 2016, in line with the Low Pay Commission's recommendations.[111] This increase means the main NMW rate will reach its highest ever level in real terms.[112] The government has also accepted the LPC's recommendations for the youth and apprentice rates of the NMW.

Addressing imbalances in the tax system

1.143 The government wants to see lower taxes for all, while continuing to put the public finances on a more sustainable footing. To do this in a fair way, this Budget takes steps to better align the tax treatment of different forms of remuneration and removes some imbalances in the tax system.

Different forms of remuneration

1.144 Long-standing anomalies in the tax system mean that employer-provided benefits are taxed more favourably than cash salaries, and individuals who work through their own company can pay lower taxes. The measures in this Budget aim to treat different forms of income in a similar way, to fund a fairer, more sustainable tax system for everyone.

Tax and NICs rules for pay-offs

1.145 Certain forms of termination payments are exempt from employee and employer National Insurance contributions and the first £30,000 is income tax free. The rules are complex and the exemptions incentivise employers to manipulate the rules, structuring arrangements to include payments that are ordinarily taxable such as notice and bonuses to minimise the tax and National Insurance due.

1.146 From April 2018, the government will tighten the scope of the exemption to prevent manipulation and align the rules so employer National Insurance contributions are due on those payments above £30,000 that are already subject to income tax. The government will continue to support those individuals who lose their job. The first £30,000 of a termination payment will remain exempt from income tax and the full payment will be outside the scope of employee NICs.

Salary sacrifice

1.147 Salary sacrifice arrangements enable employees to give up salary in return for benefits-in-kind that are often subject to more favourable tax treatment than salary. The government wants to encourage employers to offer certain benefits but is concerned about the growth of salary sacrifice schemes: clearance requests for salary sacrifice arrangements from employers to HMRC have increased by over 30% since 2010. **The government is therefore considering limiting the range of benefits that attract income tax and NICs advantages when they are provided as part of salary sacrifice schemes**. However, the government's intention is that pension saving, childcare and health-related benefits such as Cycle to Work should continue to benefit from income tax and NICs relief when provided through salary sacrifice arrangements.

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[109] 'Low Pay Commission Remit 2016', BIS, July 2015.
[110] 'Economic and fiscal outlook', OBR, March 2016.
[111] 'National Minimum Wage Report', Low Pay Commission, March 2016.
[112] HM Treasury calculations using OECD minimum wage statistics.

Off-payroll engagement in the public sector

1.148 Some individuals who work through their own limited company are undertaking jobs that would ordinarily mean they are employees of the business that they are working for. In those circumstances, existing legislation on off-payroll working requires them to pay broadly the same taxes as employees. However, non-compliance with these rules is costing the taxpayer around £440 million a year – and these costs are rising.[113]

1.149 Public sector bodies have a responsibility to taxpayers to ensure that the people working for them are paying the right tax. **From April 2017, where the public sector engages an off-payroll worker through their own limited company, that body (or the recruiting agency if the public sector body engages through one) will become responsible for determining whether the rules should apply, and for paying the right tax.** This strengthens the public sector's role in ensuring that the workers it engages comply with the rules.

1.150 The government also recognises that the current rules are seen as complex and can create uncertainty. It will therefore consult on a simpler set of tests and online tools that will provide a clear answer as to whether and when the rules should apply.

Loans to participators

1.151 The loans to participators rules aim to prevent owners of close companies avoiding Income Tax and National Insurance contributions by remunerating themselves through loans or advances that are not repaid, rather than taking dividends or salary. Budget 2016 announces an increase in the rate of tax payable by close companies under the loans to participators rules so that it continues to mirror the higher rate of dividend tax. **The loans to participators tax rate will be increased from 25% to 32.5% in April 2016, with effect for loans, advances and arrangements made on or after 6 April 2016.**

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[113] HMRC analysis of taxpayer data.

Backing business and enterprise

1.152 Businesses are the lifeblood of the economy, and it is enterprise and innovation by British business which will deliver growth and opportunity for the next generation. In particular, the government recognises the importance of small businesses, responsible in 2015 for almost half of employment and a third of turnover in the private sector.[114]

1.153 Since 2010, the government's economic plan has delivered security for British business. Reducing the deficit and fixing the public finances is continuing to provide the strong and stable environment which businesses need. Reforms to the banking sector have made the UK economy more resilient and ensured that banks lend again. By supporting capital investment – committing over £100 billion to infrastructure over this Parliament and setting up the National Infrastructure Commission – the government is continuing to take the long term steps to make the UK the best place in the world to do business.

Competitive taxes in a global economy

1.154 Since 2010, the government has provided a competitive environment for business by cutting taxes. Budget 2016 builds on this success by setting out a business tax road map for this Parliament with a clear plan to deliver low taxes, but low taxes which must be paid. The road map will implement international best practice and focus on supporting small business. This approach will help to raise productivity, create job opportunities and increase wages for the next generation.

1.155 Reforms to business tax have been a central part of the government's strategy to boost economic growth. Since 2010, these reforms have included:

- cutting the main rate of corporation tax from 28% to 20% – the lowest rate in the G20[115] – with further cuts to 19% in 2017 and 18% in 2020 to come
- introducing the Employment Allowance, reducing the cost of employer National Insurance contributions by up to £2,000 every year for businesses and charities. The allowance will increase to £3,000 from April 2016
- increasing the permanent level of the Annual Investment Allowance to £200,000, meaning 99% of firms will receive 100% first-year relief on all qualifying investment[116]
- extending the doubling of small business rate relief to April 2017, meaning that over 400,000 properties continue to receive 100% business rates relief[117]
- introducing the Diverted Profits Tax to target contrived arrangements so that multinational enterprises pay more tax on their UK profits, forecast to raise £1.3 billion over the next 5 years

Business tax road map

1.156 In 2010, the government set out a corporate tax road map for the first time. This outlined plans to back business through lower corporation tax rates and the modernisation of tax rules and administration. The road map gave businesses the certainty to invest, and a clear and consistent direction for reform. Investment has grown by 30% since 2010, twice as fast

[114] Business population estimates 2015, Department for Business, Innovation and Skills, 14 October 2015
[115] Corporate tax rates table, KPMG, 2015
[116] HMRC analysis of corporation and self-assessment tax return data
[117] Department of Communities and Local Government (DCLG) calculation using DCLG and Valuation Office Agency data

as consumption over the same period.[118] Meanwhile, the UK was the number one recipient for inward investment in the EU in 2014,[119] creating job opportunities across the UK.

1.157 The government is building on its achievements in the last Parliament, with a new plan to focus support on small businesses through ambitious reforms to business rates. The business tax road map will support investment while continuing to crack down on avoidance and aggressive tax planning, making sure rules are fair and taxes paid. In particular, the road map will:

- cut tax rates to drive growth and support small businesses
- modernise the business tax system in line with international best practice
- ensure a level playing field, with large multinationals paying their fair share of tax

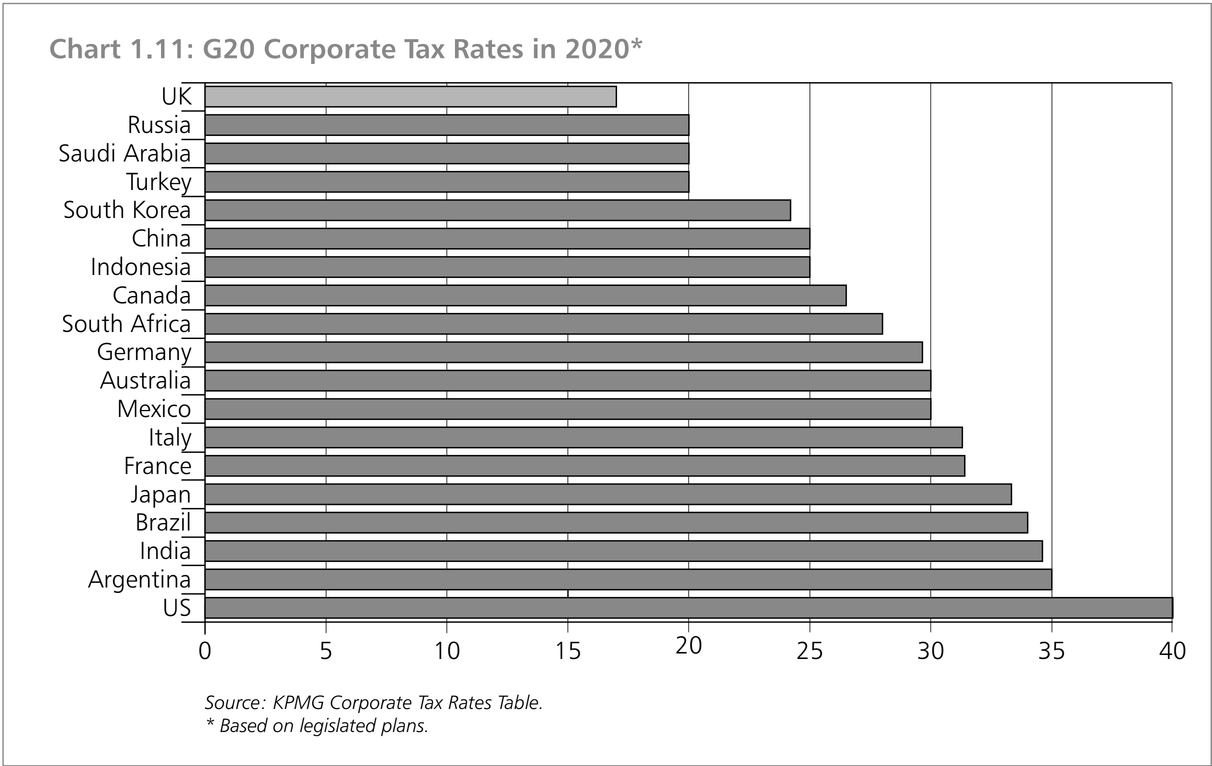
Lower tax rates to drive growth and support small businesses

Lower corporation tax

1.158 In the last Parliament, the government cut the main rate of corporation tax from 28% to 20%. The small profits rate was also cut to 20%, and the two rates were unified, in a major simplification of the tax system. Future reductions in this unified rate have already been announced: to 19% in 2017 and 18% in 2020 to support small and large businesses alike.

1.159 Budget 2016 announces that the government will cut corporation tax further, so the rate will fall to 17% in 2020. This measure will benefit over a million companies, large and small.[120] It will ensure the UK has the lowest tax rate in the G20, as set out in Chart 1.11 below. Overall, the cuts to corporation tax delivered since 2010 will be worth almost **£15 billion a year** to business by 2021.[121]

Chart 1.11: G20 Corporate Tax Rates in 2020*



Source: KPMG Corporate Tax Rates Table.
** Based on legislated plans.*

[118] 'UK Quarterly National Accounts – Q3 2015', ONS, 23 December 2015
[119] 'World Investment Report 2015', United Nations Conference on Trade and Development (UNCTAD), 24 June 2015
[120] HMRC analysis based on taxpayer data
[121] Policy measures database, OBR

Cutting business rates

1.160 The government has concluded the business rates review and has decided to cut the burden on ratepayers in England by £6.7 billion over the next 5 years,[122] cutting business rates for all properties and ensuring that the smallest businesses pay no rates at all, while modernising the tax to make it fit for the 21st century.

1.161 The government recognises that business rates represent a higher fixed cost for small businesses and **this Budget cuts business rates from next year for half of all properties** – 900,000 smaller properties – starting 1 April 2017. The government will:

- **permanently double Small Business Rate Relief (SBRR) from 50% to 100% and increase the thresholds to benefit a greater number of businesses. Businesses with a property with a rateable value of £12,000 and below will receive 100% relief. Businesses with a property with a rateable value between £12,000 and £15,000 will receive tapered relief.** 600,000 small businesses, **occupiers of a third of all properties**, will pay no business rates at all – a saving worth up to £5,900 in 2017-18. An additional 50,000 will benefit from tapered relief[123]
- **increase the threshold for the standard business rates multiplier to a rateable value of £51,000, taking 250,000 smaller properties out of the higher rate.**[124] This will reduce business rates for many small businesses – including some high street shops

1.162 From April 2020, taxes for all businesses paying rates will be cut through a switch in the annual indexation of business rates from RPI to be consistent with the main measure of inflation, currently CPI, in line with the government's previous commitment to consider moving the indexation of indirect taxes from RPI once fiscal consolidation is complete. This represents a business rates cut every year from 2020.[125] In 2020-21 alone it is worth £370 million to businesses and the benefit will grow significantly thereafter.[126]

1.163 The government will also modernise the administration of business rates to revalue properties more frequently and make it easier for businesses to pay the taxes that are due:

- **the government will aim to introduce more frequent business rate revaluations (at least every 3 years) and will publish a discussion paper in March 2016 outlining options on how to achieve this to support both businesses and the stability of local authority funding**
- the government will transform business rates billing and collection. **By 2022, local authority business rate systems will be linked to HMRC digital tax accounts** so that businesses can manage their rates bills in one place alongside other taxes. **As a first step, the government will work with local authorities across England to standardise business rate bills and ensure ratepayers have the option to receive and pay bills online by April 2017**
- once local authority and HMRC systems are linked, **the government will consider the feasibility of replacing SBRR with a business rates allowance for small businesses** – this would be applied to a business's total property portfolio across local authority areas allowing businesses that grow and acquire more property to benefit from relief

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[122] HM Treasury calculations
[123] HM Treasury calculations based on DCLG and Valuation Office Agency data
[124] DCLG calculation
[125] HM Treasury calculations based on OBR forecasts of RPI and CPI
[126] HM Treasury calculations based on OBR forecasts of RPI and CPI

1.164 These measures build on the devolution revolution confirmed at Autumn Statement 2015, which will allow local government to keep the rates they collect from business, give councils the power to cut business rates to boost growth, and give elected city-wide mayors the power to levy a business rates premium for local infrastructure projects – with the support of local business. Local government will be compensated for the loss of income as a result of the business rates measures above, and the impact considered as part of **the government's consultation on the implementation of 100% business rate retention in summer 2016**.

Table 1.6: Impact of business rate measures

Property rateable value £	Type of premises	Ratepayer's bill in 2017-18 after Budget 2016 measures applied £	Total value of Budget 2016 support in 2017-18 £	Total value of Budget 2016 support over the period 2017-21 £
6,000	Guest house	0	1,476	6,162
12,000	Small shop	0	5,904	24,648
14,000	Hairdresser	4,592	2,296	9,641
30,000	Pub	14,760	390	1,740
50,000	High street shop	24,600	650	2,900
1,000,000	Department store	505,000	0	6,000

Source: HMT calculations.

Supporting the self-employed

1.165 Self-employment is a major part of the British economy and this Budget offers new support to the self-employed.

1.166 The government announced its intention to reform self-employed National Insurance contributions (NICs) in the March 2015 and July 2015 Budgets. This Budget delivers on that commitment. **From April 2018, Class 2 NICs will be abolished. This represents an annual tax cut for 3.4 million self-employed people of £134 on average.**[127] This will allow millions of self-employed individuals to keep more of their money and invest it back into growing their business, as well as ending an outdated and complex feature of the NICs system.

1.167 The government will reform Class 4 NICs, so that self-employed individuals continue to build entitlement to the State Pension and other contributory benefits, following the abolition of Class 2 NICs. The government will set out its plans for the contributory benefit tests in its response to the recent consultation on this reform.

1.168 The Lifetime ISA provides a more flexible way for the self-employed to save for their retirement, with greater freedom to withdraw funds if needed. For the self-employed who pay the basic rate of tax it is at least as generous as a private pension, and more so if they expect to pay tax in retirement.

1.169 The government wants to help low-earning self-employed people to grow their businesses. **The Budget provides self-employed Working Tax Credit claimants with access to business support** and will **extend the mentoring support offered on the New Enterprise Allowance scheme to self-employed Universal Credit claimants.** The government will also trial **face-to-face support from Jobcentre advisors for self-employed Working Tax Credit claimants,** with a view to national roll out if successful.

[127] HMRC calculation

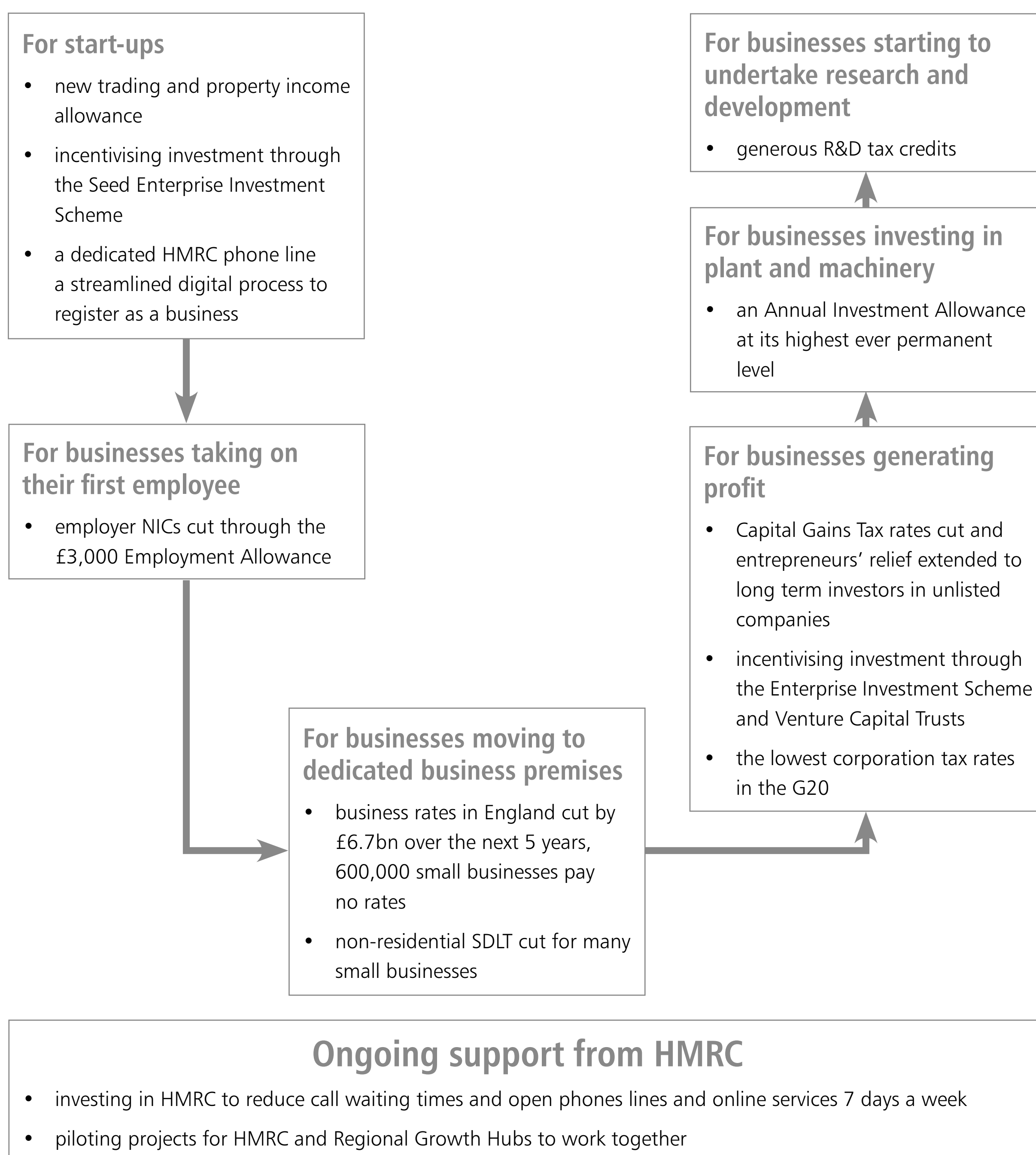
1.170 The rapid growth of the digital and sharing economy means it is becoming easier for more and more people to become 'micro-entrepreneurs'. However, for those making only small amounts of income from trading or property, the current tax rules can seem daunting or complex. To help make the tax position more certain and simple for these individuals, **from April 2017 the Budget introduces two new £1,000 allowances for property and trading income**. Individuals with property income or trading income below the level of allowance will no longer need to declare or pay tax on that income. Those with relevant incomes above £1,000 can benefit by simply deducting the allowance instead of calculating their exact expenses.

Cutting Capital Gains Tax

1.171 The government wants to ensure that companies have the opportunity to access the capital they need to grow and create jobs, and wants the next generation to be backed by a strong investment culture. **Budget 2016 announces that, from 6 April 2016, the higher rate of Capital Gains Tax (CGT) will be reduced from 28% to 20%, and the basic rate will be reduced from 18% to 10%.** There will be an 8 percentage point surcharge on these new rates for carried interest and for gains on residential property. This will ensure that CGT provides an incentive to invest in companies over property. Private Residence Relief will continue to ensure that an individual's main home is not subject to CGT.

1.172 In addition, **entrepreneurs' relief will be extended to long term investors in unlisted companies**. This will provide a 10% rate of CGT for gains on newly issued shares in unlisted companies purchased on or after 17 March 2016, provided they are held for a minimum of three years from 6 April 2016, and subject to a separate lifetime limit of £10 million of gains.

Figure 2: How the government is using the tax system to support businesses as they grow



Simplifying and modernising business tax

1.173 The government will continue to simplify and modernise the tax system to keep pace with a changing world, including implementing international best practice. Businesses that comply with tax rules fairly and consistently should find the tax system easy to understand and navigate. The government also believes in keeping pace with a changing economy, recognising the increasing role of micro-entrepreneurs and the self-employed.

Corporation tax loss relief

1.174 Loss relief is an important part of the corporation tax regime, but the current system is outdated and in need of reform.

1.175 First, under the current system, losses carried forward can only be used by the company that incurred the loss, and not used in other companies in a group. In addition, some losses carried forward can only be set against profits from certain types of income, for example trading losses can only be set against trading profits. This produces unfair outcomes and is out of step with the way businesses now operate. So the Budget makes these rules more flexible, benefiting over 70,000 companies.[128] **For losses incurred on or after 1 April 2017, businesses will be able to use carried forward losses against profits from other income streams or from other companies within a group.**

1.176 Second, the current rules enable companies to offset all of their eligible taxable profits through losses carried forward. This can lead to a situation where a large company pays no tax in a year when it makes substantial profits. To address this, **the Budget applies a restriction of the amount of profit that can be offset through losses carried forward**. The majority of G7 countries already have restrictions of this kind in place.[129] From 1 April 2017 the government will restrict to 50% the amount of profit that can be offset through losses carried forward. **The restriction will only apply to profits in excess of £5 million.** This allowance will ensure that 99% of all companies are unaffected by the restriction.[130]

1.177 This package of reforms will ensure that large companies make a tax contribution when they make significant profits. It will modernise one of the most outdated elements of the tax regime, and bring the UK into line with international best practice. The government will consult on the design of the reforms in 2016, and will legislate in 2017.

1.178 At the same time, **the government will reduce the amount of profit that banks can offset with pre-2015 losses from 50% to 25% from 1 April 2016**. This will rightfully maintain the exceptional treatment of banks' losses relating to the financial crisis and subsequent misconduct scandals. Banks' post-2015 losses, as well as any pre-2015 losses covered by the existing reliefs for new-entrant banks and building societies, will be treated in the same way as other industry groups.

Stamp duty on commercial property

1.179 The government will reform Stamp Duty Land Tax (SDLT) on non-residential property transactions. This will cut the tax for many businesses purchasing property.

1.180 Currently, SDLT rates on freehold and lease premium transactions operate on a slab system, where one tax rate is due on the entire transaction value. This creates distortions in the market and leads to large increases in SDLT as transactions move into higher tax bands. A small business buying a property for £250,000 pays £2,500 in SDLT. If the price is just £1 higher, their tax bill is trebled. **This Budget announces that these rates will be reformed to a slice system, so that SDLT is payable on the portion of the transaction value which falls within each tax band. The new rates will be 0% for the portion of the transaction value between £0 and £150,000; 2% between £150,001 and £250,000; and 5% above £250,000.** This means that all freehold and lease premium transactions below £1.05 million will pay the same or less in SDLT.[131]

1.181 The government will also introduce a new 2% rate for leasehold rent transactions where the net present value is above £5 million. These transactions are already taxed on a slice basis. All leasehold rent transactions up to £5 million will remain unaffected.

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[128] HMRC analysis based on taxpayer data
[129] 'Worldwide tax summaries: Corporate taxes 2015/16', PwC
[130] HMRC analysis based on taxpayer data
[131] HMRC analysis based on taxpayer data

1.182 In combination, these changes ensure that businesses purchasing the highest value freeholds and leases make a larger contribution whilst delivering a tax cut for those purchasers, often smaller businesses, who purchase less expensive properties. Around 42% of commercial property transactions pay no SDLT at all due to the generous nil-rate bands.[132] Of the remainder that do pay SDLT, **around 43% will pay less tax and a further 42% will pay the same.**[133] As a result of these changes, over **90% of non-residential property transactions will pay the same or less in SDLT,**[134] **with only 9% paying more.**

1.183 These changes will take effect on 17 March 2016. For those transactions which have already exchanged contracts but not completed when the changes come into force, transitional rules will ensure taxpayers will not lose out.

Modernising tax collection

1.184 At the March 2015 Budget the government committed to transform the tax system through digital technology and end the need for annual tax returns. Spending Review and Autumn Statement 2015 announced a major investment in HMRC to deliver this. To make further progress towards this transformation, the Budget announces that:

- **from 2018 businesses, self-employed people and landlords who are keeping their records digitally and providing regular digital updates to HMRC will if they wish be able to adopt pay-as-you-go tax payments** – this will enable them on a voluntary basis to choose payment patterns that suit them and better manage their cashflow
- **the government will explore options to simplify the tax rules for businesses, landlords, and the self-employed**, to reduce administrative burdens and ensure that regular digital updates work smoothly

1.185 The government will consult on these measures in 2016, alongside publishing detailed proposals for other elements of the Making Tax Digital programme announced previously.

1.186 Individuals and businesses should be able to get the help and support they need from HMRC, when they need it. By the end of this Parliament, HMRC's digital transformation will have made it quicker and easier for customers to report and pay their taxes online. But the government recognises that more needs to be done now, and is investing £71 million to improve the service it provides taxpayers. This investment will deliver:

- **a 7-day a week service by 2017**, with extended hours and Sunday opening on online services and the tax and tax credits phone lines, so that people and businesses have more opportunity to contact HMRC outside of working hours
- **improved telephone services and reduced call waiting times** by recruiting over 800 new staff into HMRC call centres
- **a dedicated phone line and online forum for new businesses and self-employed individuals** to get help and support about filing and paying their taxes for the first time, and on the transition to using digital services

[132] HMRC analysis based on taxpayer data
[133] HMRC analysis based on taxpayer data
[134] HMRC analysis based on taxpayer data

Simplifying the tax rules

1.187 The government will increase the VAT registration threshold in line with inflation to £83,000 from 1 April 2016. This will save around 2,000 small businesses from having to register for VAT by the end of the 2016-17 financial year.[135]

1.188 The government welcomes the Office of Tax Simplification's (OTS's) reviews of small companies[136] and the closer alignment of income tax and National Insurance contributions (NICs).[137] These reports provide a valuable contribution to the debate on long-term reform and will help the government to make the tax system quicker, simpler and easier for taxpayers. **The government will commission the OTS to review the impacts of moving employee NICs to an annual, cumulative and aggregated basis and moving employer NICs to a payroll basis. It will also commission the OTS to review the options to simplify the computation of corporation tax.** The terms of reference for both reviews will be published shortly.

Bringing forward corporation tax payments

1.189 At Summer Budget 2015, the government announced that corporation tax payment dates for the largest and most profitable companies in the UK – those with profits in excess of £20 million – would be brought forward, so tax is paid closer to the point at which these companies make a profit. These companies will be required to make payments in the third, sixth, ninth and twelfth months of their accounting period. The government will defer the introduction of this measure, to give businesses more time to prepare for the transition to the new payment schedule. The new schedule will apply to accounting periods starting on or after 1 April 2019, and it will have a broadly neutral impact on the public finances over the scorecard period.

Energy taxes

1.190 The government is committed to meeting the UK's ambitious environmental targets in a cost-effective way, ensuring value for money for the taxpayer and retaining protection for the smallest and most energy intensive businesses. **This Budget announces the biggest business energy tax reforms since the taxes were introduced**, in response to the business energy efficiency tax review. To simplify the landscape and drive business energy efficiency the government will:

- **abolish the CRC energy efficiency scheme (CRC) following the 2018-19 compliance year**, ending a complex scheme with bureaucratic and costly administrative requirements. It will significantly streamline the business energy tax landscape by moving to a system where businesses are only charged one energy tax administered by suppliers rather than CRC participants being required to forecast energy use, buy and surrender allowances
- **increase the Climate Change Levy (CCL) from 2019**, to recover the revenue from abolishing the CRC in a fiscally-neutral reform, and incentivise energy efficiency among CCL-paying businesses

[135] HMRC analysis
[136] 'Small company taxation review', OTS, 3 March 2016
[137] 'The closer alignment of income tax and National Insurance contributions', OTS, 7 March 2016

- **rebalance CCL rates for different fuel types to reflect recent data on the fuel mix used in electricity generation**, moving to a ratio of 2.5:1 (electricity:gas) from April 2019. In the longer term, the government intends to rebalance the rates further, reaching a ratio of 1:1 (electricity:gas) rates by 2025. This will more strongly incentivise reductions in the use of gas, in support of the UK's climate change targets
- **keep existing Climate Change Agreement (CCA) scheme eligibility criteria in place until at least 2023**, ensuring energy intensive industries remain protected. From April 2019, the CCL discount available to CCA participants will increase so that they pay no more than an RPI increase. The government will ensure that these agreements deliver on their energy efficiency goals through a DECC-led target review starting in 2016

1.191 At Budget 2014 the government capped Carbon Price Support (CPS) rates at £18 t/CO_2 from 2016-17 to 2019-20 to limit competitive disadvantage to British businesses. Due to the continued low price of the EU Emissions Trading System (EU ETS), **the government is maintaining the cap on CPS rates at £18 t/CO_2, uprating this with inflation in 2020-21, in order to continue protecting businesses**. The government will set out the long-term direction for CPS rates and the Carbon Price Floor at Autumn Statement, taking into account the full range of factors affecting the energy market.

Motoring taxes

1.192 Transport is a major element in the cost base of many businesses, and the government recognises the link between low fuel prices and economic growth. **Budget 2016 announces a further freeze to fuel duty**, meaning the average small business with a van saves £12 each time they fill their tank compared to the fuel escalator plans in place before 2010.[138] Hauliers have on average saved a total of £14,400 over the last six years.[139] The government has also kept the rates of HGV VED and Road User Levy frozen in 2016-17, benefiting HGV operators.

1.193 This Budget also announces measures to support transition in the UK to cleaner zero and ultra-low emission vehicles, which will help improve air quality in the UK's towns and cities and protect the environment for the next generation. The government will:

- **extend the 100% First Year Allowance (FYA) for businesses purchasing low emission cars for a further 3 years to April 2021**
- **reduce the main rate threshold for capital allowances for business cars to 110 grams/kilometre of CO_2 and the FYA threshold to 50 grams/kilometre of CO_2 from April 2018**, to reflect falling vehicle emissions
- **continue to base Company Car Tax on CO_2 emissions of cars, and consult on reforming the lower CO_2 bands for ultra-low emission vehicles to refocus incentives on the cleanest cars beyond 2020-21**

Support for oil and gas

1.194 The government believes in making the most of the UK's oil and gas resources. The oil and gas industry delivers significant economic benefits, supports hundreds of thousands of jobs and supplies a large portion of the nation's primary energy needs.[140]

[138] HM Treasury/HMRC calculations, based on DfT data on distance travelled per van, DECC data on pump prices, OBR RPI data and manufacturer's specifications for a Ford Transit 2.2 diesel van
[139] HM Treasury/HMRC calculations, based on DfT data on distance travelled per heavy goods vehicle and average fuel economy of heavy goods vehicles, DECC data on pump prices and OBR RPI data
[140] 'Economic Report 2015', Oil and Gas UK, 9 September 2015

1.195 Budget 2016 delivers the next stage of the government's plan to ensure the fiscal regime supports the objective of maximising economic recovery while obtaining a fair return on the nation's resources. The government will:

- **effectively abolish Petroleum Revenue Tax by permanently reducing the rate from 35% to 0%**,[141] to simplify the regime for investors and level the playing field between investment opportunities in older fields and infrastructure and new developments. The change will take effect from 1 January 2016
- **reduce the Supplementary Charge from 20% to 10%**, to send a strong signal that the UK is open for business and in recognition of the exceptionally challenging conditions that are currently facing the sector. The change will take effect from 1 January 2016
- **provide a further £20 million of funding for a second round of seismic surveys in 2016-17**, as announced by the Prime Minister in January, to build on the success of the seismic programme in 2015 and encourage exploration in under-explored areas of the UKCS
- **extend the Investment and Cluster Area Allowances to include tariff income**, in order to encourage investment in key infrastructure maintained for the benefit of third parties
- **provide certainty that companies will be able to access tax relief on their costs when they retain decommissioning liabilities for an asset after a sale**, to encourage new entrants for late-life assets and the development of late-life business models
- build on the new decommissioning powers of the Oil and Gas Authority (OGA) by **undertaking further work with the OGA and industry to reduce overall decommissioning costs**, to deliver significant savings for industry and the Exchequer. If significant progress can be made, **the government will explore whether decommissioning tax relief could better encourage transfers of late-life assets**

1.196 This radical package will ensure the UK has one of the most competitive tax regimes for oil and gas in the world, supporting jobs and investment and safeguarding the future of this vital national asset.

1.197 The government is willing to consider proposals for using the UK Guarantees Scheme for infrastructure where it could help secure new investment in assets of strategic importance to maximising economic recovery of oil and gas. Any proposals would also need to meet the existing criteria of the scheme, including in relation to commerciality and financial credibility.

Better financial services

1.198 Access to fairly priced financial services is vital for both households and firms. At this Budget the government reaffirms its commitment to boost competition in UK retail financial services, including by:

- **pursuing more proportionate capital requirements for small banks and building societies in the EU**
- **working with the New Bank Start-up Unit to promote the authorisation of new banks**, building on the three new banks already authorised in this Parliament
- **ensuring action is taken to improve further the Current Account Switch Service following Bacs'** recent report on making improvements to the service

[141] While no company will ever pay Petroleum Revenue Tax again, the tax will not be abolished in legislation. This is to ensure that companies which decommission fields that have paid Petroleum Revenue Tax will be able to benefit from the decommissioning relief to which they are entitled.

1.199 New ways of providing financial services also expand choice for consumers and businesses. **The government is examining recommendations from the recent Fintech benchmarking exercise[142] and will announce further measures to support the sector in the coming months.** These build on actions the government has already taken, including support for alternative lending, to make the UK the global FinTech Capital.

1.200 The government is supporting SME access to finance, setting **out a £1 billion package to support SMEs through the British Business Bank.** It will support the first loans under its Help to Grow programme from spring 2016, supporting at least £200 million of lending. The Enterprise Finance Guarantee programme, which supports firms that lack a sufficient track record or collateral to access the finance that they need, will be extended until at least 2018.

1.201 This Budget also supports competition in the SME credit market. Small firms that are rejected for finance by high-street banks will be able to access new options as **the Budget announces that Bizfitech, Funding Options and Funding Xchange will be designated as finance platforms to help match borrowers and alternative lenders**. And on 1 April 2016 the government will designate the banks and Credit Reference Agencies (CRAs) that are within scope of the SME credit data regulations. This will ensure CRAs will receive SME credit information from high street banks and provide equal access to this information to all finance providers.

1.202 The government is doing more to help exporters access trade finance. Steps that aim to cut UK Export Finance (UKEF) transaction times in half are being trialled. If successful, they will be rolled out across trade finance providers supported by UKEF.

Long term investment

1.203 The government is committed to working in partnership with investors and businesses on the productivity challenge. Short term horizons can undermine the investment the UK needs so the **government welcomes the forthcoming Productivity Action Plan from the Investment Association.** The Investment Association advocates encouraging firms to move away from quarterly reporting, improving the measurement and reporting of firm-level productivity, and ensuring that long term incentives are incorporated into investment mandates.

1.204 In addition, a large group of institutional investors has agreed a 3-year plan to fund the Investor Forum, helping boost long termism by improving dialogue between shareholders and corporates. And the Productivity Leadership Group, led by Sir Charlie Mayfield, continues to make good progress in exploring how businesses can boost productivity and is expected to report in the summer.

Funding further investment in flood defence

1.205 In order to fund increased investment in flood defence and resilience, **the standard rate of Insurance Premium Tax (IPT) will be increased from 9.5% to 10%**. This ensures that the impact of the rate increase is spread broadly across the entire general insurance industry. IPT is a tax on insurers. However, if they do pass the cost of this rate increase on to their business and household customers, the average combined home and contents insurance would only increase by £1, and the average motor insurance premium by £2 per year.[143] All the revenue raised from this increase in IPT will be invested in flood defence and resilience measures.

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[142] 'UK FinTech: On the cutting edge', EY for HM Treasury, 24 February 2016
[143] HM Treasury calculations

Claims management companies

1.206 The government is clamping down on the rogue claims management companies (CMCs) that provide bad service and bombard customers with nuisance calls. Alongside action to cap the amount that CMCs charge, **Budget 2016 announces that the government accepts the recommendations of the independent review into the regulation of CMCs.** The new regime will be tougher and will ensure CMC managers can be held personally accountable for the actions of their businesses. In order to ensure that the new regulatory regime is implemented effectively, the government intends to transfer responsibility for regulating CMCs to the Financial Conduct Authority.

Ensuring companies pay their fair share of tax

1.207 The government has taken significant action to tackle tax avoidance by multinational companies, especially through working with G20 and OECD partners on the Base Erosion and Profit Shifting (BEPS) project to modernise the international tax rules. Following the publication of the OECD BEPS outputs in October 2015, and the endorsement by G20 leaders in November 2015, the government is setting out a comprehensive package to take further action, to modernise the tax rules in the UK and to ensure these rules are applied effectively to multinationals.

1.208 The government is committed to low taxes to support business – but these low taxes must be paid. Tax avoidance and aggressive tax planning by multinationals is unacceptable and the business tax road map sets out a package specifically targeting multinational enterprises that are engaged in these activities.

Interest relief

1.209 The government is leading the way in implementing the G20 and OECD recommendations to ensure that profits are taxed in line with activities in the UK. Where large multinationals are over-leveraging in the UK to fund activities elsewhere in their worldwide group or claiming relief more than once, the government will act to prevent aggressive tax planning and level the playing field, so that multinational businesses can no longer arrange their interest expenses to shelter profits.

1.210 The government will cap the amount of relief for interest to 30% of taxable earnings in the UK or based on the net interest to earnings ratio for the worldwide group. To ensure the rules are targeted where the greatest risk of base erosion and profit shifting lies, **the rule will include a threshold limit of £2 million net UK interest expense and provisions for public benefit infrastructure**. The government will continue to work with the OECD on the appropriate application of these rules to groups in the banking and insurance sectors.

Royalty payments

1.211 The ease with which capital can be moved in the modern economy enables multinationals to avoid tax by using intragroup royalty payments to shift profits from the UK to low or no-tax jurisdictions, either directly or via a second country. The government will change the rules on withholding tax on royalty payments to counter this type of avoidance. There are a number of aspects to this – the government will extend withholding tax rights to cover all intangible assets such as trademarks and brand names, apply this tax to all payments connected with the activities of a business liable for tax in the UK, and introduce a domestic law to prevent our tax treaties being abused by royalty payments being routed through third countries to gain a tax advantage.

Hybrid mismatch arrangements

1.212 At Autumn Statement 2014, the government announced new rules to address hybrid mismatch arrangements, which are used by some multinational companies to avoid tax by exploiting differences between countries' rules to avoid paying tax in either country, or to get excessive tax relief by deducting the same expense in more than one country. To strengthen these proposals, **Budget 2016 announces that the rules will be extended to cover hybrid mismatches arising from permanent establishments, further restricting the opportunities for tax avoidance by multinationals.** These rules will be introduced in Finance Bill 2016, and come into effect from 1 January 2017.

Offshore property developers

1.213 The government believes it is unfair to allow property developers to use offshore structures to avoid UK tax on their trading profits from developing property in the UK. By enforcing the international rules on the taxation of trading profits derived from property, the government will level the playing field between UK and offshore developers. **The government will introduce legislation in Finance Bill 2016 to ensure offshore structures cannot be used to avoid UK tax on profits that are generated from developing UK property.**

1.214 HMRC will also create a task force to focus on offshore property developers. This task force will target offshore structures used to avoid tax on profits and rental income from property development in the UK. The task force aims to achieve a long term improvement in taxpayer compliance.

Tackling tax avoidance and evasion

1.215 Alongside the measures above targeting multinational enterprises, the government is cracking down on all forms of tax evasion and avoidance, and aggressive tax planning and non-compliance. There should be a level playing field for the majority who pay their tax, and everyone should make their contribution. In the last Parliament, HMRC secured £100 billion in additional tax revenue as a result of action take. This Budget goes further, and introduces a comprehensive package of measures – raising £12 billion in total[144] – including those specifically targeting multinational companies.

Disguised remuneration

1.216 At Autumn Statement 2015 the government announced it would ensure that those who have used disguised remuneration tax avoidance schemes pay their fair share of tax and National Insurance contributions. In 2011, the government legislated to clamp down on these schemes. This action successfully protected £3.9 billion, £100 million more than originally estimated.[145] Since then, new schemes have emerged which attempt to sidestep this legislation.

1.217 These schemes often involve individuals being paid in loans through structures such as offshore Employee Benefit Trusts. **The government will raise £2.5 billon[146] by taking action to tackle both the historic and continued use of these schemes, beginning with legislation in Finance Bill 2016 and with further action to follow in future Finance Bills.** This will include a new charge on loans paid through disguised remuneration schemes which have not been taxed and are still outstanding on 5 April 2019.

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[144] HM Treasury calculations
[145] 'Anti-avoidance costings: an evaluation', OBR, January 2016
[146] HM Treasury calculations

Tackling VAT evasion by overseas sellers

1.218 The government is taking firm action to protect the UK market from unfair online competition. Some overseas traders from beyond the EU avoid paying UK VAT, undercutting online and high street retailers and abusing the trust of UK consumers who purchase goods via online marketplaces.

1.219 Budget 2016 announces action that will help to protect consumers and level the playing field for businesses. **HMRC will be able to require non-compliant overseas traders to appoint a tax representative in the UK, and will be able to inform online marketplaces of the traders who have not complied.** If traders continue to evade VAT and no action is taken to prevent the fraud, then online marketplaces can be made liable for the VAT.

1.220 The government will also introduce a due diligence scheme for the fulfilment houses where overseas traders store their goods in the UK. This will make it harder for VAT evading firms to trade. While the government continues to take action domestically, the global nature of the fraud means international action is also required. The UK has already raised this issue with EU and international partners and the EU and OECD's current work programmes include further work to help combat this fraud.

Addressing issues in the waste sector

1.221 The government will increase HMRC compliance activity to tackle tax evasion and non-compliance across the waste supply chain – waste-related crime is a blight on communities and undermines the environmental objectives of landfill tax. This is why HMRC and the Environment Agency are already working together to tackle fraud and tax evasion in the waste sector. The government will provide additional funding for HMRC to increase its compliance activity in this area.

Crackdown on smuggling

1.222 The government is dedicated to cutting the funding sources of organised crime and catching the individuals responsible. Tobacco smuggling undermines legitimate businesses and is dominated by organised criminal groups often involved in other crimes, such as drug smuggling and people trafficking. At this Budget, **the Home Office will receive £31 million of funding to form a dedicated group of border officers and intelligence officials to tighten the government's grip on the most prolific smuggling routes and intercept smugglers as they try to adapt their tactics**. Coordinated enforcement, alongside the additional intelligence and investigative resources provided at Summer Budget 2015, will work to further increase the seizure of illicit shipments and increase prosecutions for tobacco fraud.

The hidden economy

1.223 Tackling the hidden economy is an important part of the government's stance in supporting compliant business – by levelling the playing field so that those playing by the rules do not face unfair competition from those not paying their fair share. **The government will consult over the summer on a range of measures to address the hidden economy**, including introducing tougher sanctions for traders and evaders who have been penalised for deliberate non-compliance but have failed to change their behaviour.

Addressing imbalances in the tax system

Remote gambling

1.224 Remote gaming operators currently benefit from a more generous tax treatment when they offer discounted or free gambling ('freeplays') to customers in Remote Gaming Duty than would be the case for operators offering free bets on things like football and horseracing. **The government will therefore amend the tax treatment of freeplays in Remote Gaming Duty to bring it into line with the tax treatment of free bets in General Betting Duty.**

Asset managers

1.225 Following the draft legislation issued at Autumn Statement 2015, the government has finalised the rules that determine when asset managers can pay capital gains tax rather than income tax on their performance related returns ('carried interest'). **These new rules ensure that carried interest will be taxed as a capital gain only when the fund undertakes long term investment activity (with investment horizons longer than 3 years).**

Employee Shareholder Status

1.226 The government believes that Employee Shareholder Status (ESS) provides vital flexibility for early stage firms, and that it is right that employee shareholders receive tax benefits on shares awarded in exchange for relinquishing certain employment rights. However, the government wants to ensure that the benefits for individuals are proportionate and fair. **Budget 2016 introduces an individual lifetime limit of £100,000 on gains eligible for Capital Gains Tax (CGT) exemption through ESS.** This limit will apply to arrangements entered into on or after 17 March 2016, and will not apply to arrangements already in place. This change will enable employee shareholders to realise a significant growth in the value of their shares without paying any CGT, whilst helping to ensure that the status is not misused.

Boosting productivity for the next generation

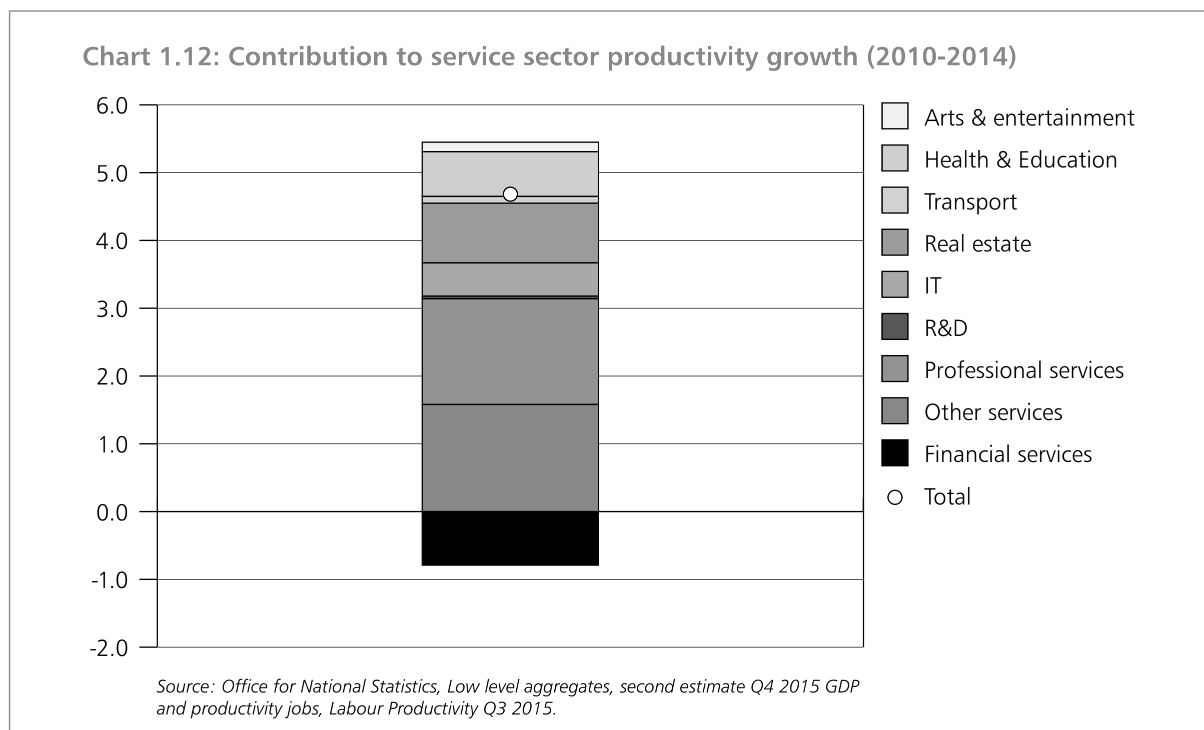
1.227 Productivity growth is the key driver of long-term increases in living standards. This Budget announces further measures to drive productivity across the UK. It continues to deliver on the government's 2015 productivity plan[147], encourages long-term investment, promotes a dynamic and competitive economy, and devolves more power to local leaders.

Encouraging long-term investment

1.228 Investment is an essential part of raising productivity. In today's economy, that applies to increasing the stock of machines, equipment and essential physical infrastructure and also to the development of human and intellectual capital in the next generation. This section sets out further measures to support long-term investment, alongside action to improve education and skills and to back businesses through the tax system set out earlier in the chapter.

1.229 As Chart 1.12 shows, productivity growth varies across the services sector. The financial services sector continues to act as a drag on productivity growth, while other parts of the services sector have grown more strongly since 2010.

Chart 1.12: Contribution to service sector productivity growth (2010-2014)



Source: Office for National Statistics, Low level aggregates, second estimate Q4 2015 GDP and productivity jobs, Labour Productivity Q3 2015.

[147] 'Fixing the foundations: Creating a more prosperous nation', HM Treasury, July 2015

Table 1.7: Action to raise productivity[1]

Policy area and key evidence	Existing policies	Budget 2016 measures
	Encouraging long term investment	
Business investing for the long term • An even more competitive tax system • Rewards for saving and long term investment *OECD research suggests that corporate taxes are the most damaging to growth*	**Cut corporation tax** to 18%, the lowest in the G20 **Annual Investment Allowance** set at £200,000, its highest ever permanent level	A £6.7 billion package of cuts and reforms to **business rates** **Cutting Capital Gains Tax** and expanding **entrepreneur's relief** **Cutting corporation tax to 17%** in 2020
Skills and human capital • A highly skilled workforce • World-leading universities, open to all who can benefit *16-24 year olds in England and NI still ranked in the bottom 4 of 22 countries for literacy and numeracy skills*	An **apprenticeship levy** to fund more high quality apprenticeships Protected the **core schools budget** **Removed HE student numbers cap**	All schools in England **academies** by 2022 Accelerating the **move to fairer funding** for schools **Review of post 16 maths** **Northern Powerhouse Schools Strategy**
Economic infrastructure • A modern transport system • Reliable and low carbon energy • World-class digital infrastructure *UK investment as a share of GDP has been in the lowest 25% of OECD countries for 48 of the last 55 years*	**Over £100bn infrastructure investment** this Parliament **National Infrastructure Commission** to improve long term planning A **Roads Fund** from 2020-21 to provide certain long term investment	Green light to **Crossrail 2, and High Speed 3** between Leeds and Manchester New **National Infrastructure Commission studies** on 5G and the Cambridge-Milton Keynes-Oxford corridor
Ideas and Knowledge • High-quality science and innovation *New ideas are central to long run growth and there is a robust link between R&D spending and productivity*	Protected **science funding** in real terms £6.9bn for **research infrastructure** by 2021	**Funding for doctoral loans** Making the **UK a centre for driverless vehicles**
	Promoting a dynamic economy	
Flexible, fair markets • Planning freedoms, more houses to buy • A higher pay, lower welfare society • More people able to work and progress *A productive economy ensures work always pays and uses land efficiently*	Introduced a new **National Planning Policy Framework** Doubled the **affordable housing** budget at SR2015 A new **National Living Wage**	Launching a £1.2bn **Starter Homes Land Fund** Supporting areas to establish new settlements **Highest ever National Minimum Wage** (for under 25s)
Productive finance • Financial services that lead the world in investing for growth *Financial services generated £58 billion in net exports in 2014 and facilitate investment in the wider economy*	Launched the **British Business Bank** **Boosted competition in the banking market** and encouraged new entrants to ensure a better deal for SMEs	**Over £250m Midlands Engine Investment Fund** **Help to Grow** will support over £200m of finance in the next 2 years, from spring 2016
Openness and competition • Competitive markets with less regulation • A trading nation open to international investment *Improvements in competition in the 80s and 90s accounted for up to 20% of industry productivity growth in the decade to 2005*	Committed to **cut £10 billion of red tape** this Parliament Published **"A Better Deal"** with measures to open up markets Helped make the **UK the number 1 destination in Europe for FDI** projects	Consulting on **improving choice and competition** in legal services and **increasing transparency of local authority procurement** A goal to halve turnaround times for accessing **trade finance**
Resurgent cities • A rebalanced economy and a thriving Northern Powerhouse. *Cities with fragmented governance structures have up to 6% lower levels of productivity than those that do not*	**Signed landmark mayoral devolution deals** with Greater Manchester, Sheffield City Region, the North East, Tees Valley, Liverpool City Region and the West Midlands	**£1.2bn City deal for Cardiff, and deals for East Anglia, West of England and Greater Lincolnshire** **A Thames Estuary 2050 Growth Commission**

[1] *All sources can be found in the accompanying sources document*

National Infrastructure Commission

1.230 The government has set up the new National Infrastructure Commission, chaired by Lord Adonis, to produce a clear picture of the future infrastructure the country needs and provide expert, independent advice on infrastructure priorities.

1.231 The commission has begun work on a National Infrastructure Assessment, which will establish priorities for the decades to come. It will set out an overarching, long-term vision and the government will be obliged to respond formally.

1.232 In the shorter term, the Chancellor asked the commission to report on three high-priority issues by Budget 2016: Northern connectivity, London transport and energy infrastructure. The commission has now published its first three reports and has made innovative proposals to address some of the country's most pressing infrastructure challenges. **This Budget confirms that the government accepts the commission's recommendations, as set out later in this chapter:**

- **the government is providing £300 million of funding to improve northern transport connectivity and is giving the green light to High Speed 3 between Leeds and Manchester to reduce journey times to around 30 minutes**, in response to the commission's report 'High Speed North'
- **the government is giving the green light to Crossrail 2, supported by £80 million to help fund development**, in response to the commission's report 'Transport for a World City'. The government is asking Transport for London to match that contribution, with the aim of depositing a Hybrid Bill within this Parliament
- **the government will lay the foundations for a smart power revolution**, with support for innovation in storage and other smart technologies, and an increased level of ambition on interconnection, which the NIC estimates could unlock benefits to UK consumers of up to £8 billion per year

1.233 Budget 2016 announces that the commission will carry out two new studies on the following infrastructure challenges:

- **an assessment of how the UK can become a world leader in 5G deployment, and how it can take early advantage of the potential benefits of 5G services**. This review will include a case study of the south-west of England
- **proposals for unlocking growth, housing and jobs in the Cambridge-Milton Keynes-Oxford corridor** – the commission will report on the strategic infrastructure priorities needed to generate further growth and maximise the potential of this corridor, which encompasses some of the UK's fastest-growing and most productive cities

1.234 The government is consulting on the structure, governance and operation of the commission, which is currently in interim form, and proposes to introduce legislation to put it on a statutory footing. The public consultation closes on 17 March.

Transport and infrastructure

Roads

1.235 The government is making the biggest investment in transport infrastructure in generations and is increasing capital investment in the transport network by 50% over this Parliament compared to the last, investing £61 billion.[148]

1.236 The first Roads Investment Strategy is the biggest programme of investment in England's strategic road network since the 1970s.[149] The government continues to take a long-term approach to improving England's motorways and major roads and **this Budget marks the launch of the second Roads Investment Strategy, which will determine the investment plans for the period from 2020-21 to 2024-25.**

1.237 The government will also establish the UK as a global centre for excellence in connected and autonomous vehicles. The government will:

- conduct trials of driverless cars on the strategic road network by 2017
- consult this summer on sweeping away regulatory barriers within this Parliament to enable autonomous vehicles on England's major roads
- establish a £15 million 'connected corridor' from London to Dover to enable vehicles to communicate wirelessly with infrastructure and potentially other vehicles
- carry out trials of truck platooning on the strategic road network
- start trials of comparative fuel price signs on the M5 between Bristol and Exeter by spring 2016 to drive fuel price competition and help motorists save money

1.238 The government is allocating £151 million from the Local Majors Fund in the first round of allocation, and is launching the bidding process for the second tranche of funding, designed to fund transformative local transport projects.

1.239 Budget 2016 also announces the allocation of the £50 million Pothole Action Fund for England in 2016-17, enabling local authorities to fill nearly a million potholes.[150] The government will also provide a further £130 million to repair roads and bridges damaged by Storms Desmond and Eva.

Rail

1.240 Nicola Shaw has today published the Shaw Report[151] on the future structure and financing of Network Rail, including recommendations for greater devolution to the routes and the creation of a new, dedicated northern route. **The government welcomes the recommendations of the Shaw Report**, and will respond in full later this year. To ensure an improved service for passengers through greater accountability and more competition, **the government will also work with the Competition and Markets Authority to explore how their recommendations[152] could potentially be implemented as part of the government's wider reforms**.

1.241 As set out above, the government is investing in rail by giving the green light to Crossrail 2, supported by £80 million to help fund development, and to High Speed 3 between Leeds and Manchester to bring journey times to around 30 minutes.

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148 'Spending Review and Autumn Statement 2015' (p50), HM Treasury, November 2015
149 'Road Investment Strategy', Department for Transport, December 2014
150 'Annual Local Authority Road Maintenance (ALARM) Survey 2014', Asphalt Industry Alliance, April 2014
151 'The Shaw Report. The future shape and financing of Network Rail: final report.'
152 'Competition in passenger rail services in Great Britain', CMA, 8 March 2016

Flood defences

1.242 Many communities experienced the devastating impacts of flooding this winter, with homes and businesses destroyed. On top of the government's £2.3 billion capital programme, which will invest in over 1,500 flood defence schemes across the country, **Budget 2016 announces an additional boost to spending on flood defence and resilience of over £700 million by 2020-21**. The government will increase maintenance expenditure in England by £40 million per year, and deliver even more flood defence schemes – including investing over £150 million in Leeds, York, Calder Valley, Carlisle and wider Cumbria. This increase in investment will be funded by a rise in the standard rate of Insurance Premium Tax by 0.5 percentage points.

Smart and low carbon energy

1.243 The government welcomes the National Infrastructure Commission's energy study 'Smart Power' as an opportunity to transform the future of the UK's electricity sector, saving consumers up to £8 billion a year.[153] **The government will implement the commission's recommendations**, and will work with Ofgem to remove regulatory and policy barriers, positioning the UK to become a world leader in flexibility and smart technologies, including electricity storage.

1.244 The government will allocate at least £50 million for innovation in energy storage, demand-side response and other smart technologies over the next five years to help new technologies and business models access the market. **Ofgem will consult later this year on the future of the £100 million Network Innovation Competition** to maximise the delivery of genuinely innovative projects and technologies.

1.245 The government recognises the important contribution interconnection can make to the future energy mix. There is a strong pipeline of projects in development, and **the government supports the market delivery of at least 9 GW of additional interconnection capacity – an 80% increase on previous estimates.**

1.246 The government is committed to driving down the costs of decarbonisation. **Budget 2016 announces that the government will auction Contracts for Difference of up to £730 million this Parliament for up to 4 GigaWatts of offshore wind and other less established renewables**, with a first auction of £290 million. Support for offshore wind will be capped initially at £105/MWh (in 2011-12 prices), falling to £85/MWh for projects commissioning by 2026. The government will continue to control costs on consumer bills – further details will be announced in the autumn.

1.247 The government also welcomes the publication of the Competition and Market Authority's (CMA's) provisional decision on their Energy Market Investigation.[154] The government will act quickly on the CMA's final recommendations and ensure that bill payers get a fair deal from our energy markets.

1.248 At Autumn Statement 2015, the government announced a competition to identify the best value small modular nuclear reactor (SMR) in the UK. This will pave the way to build one of the world's first SMRs**. Budget 2016 announces the launch of the first stage of this competition**, which will generate a list of SMR developers that could deliver on the government's objectives. **The government will also publish an SMR delivery roadmap later this year** and **will allocate at least £30 million for an SMR-enabling advanced manufacturing R&D programme to develop nuclear skills capacity**.

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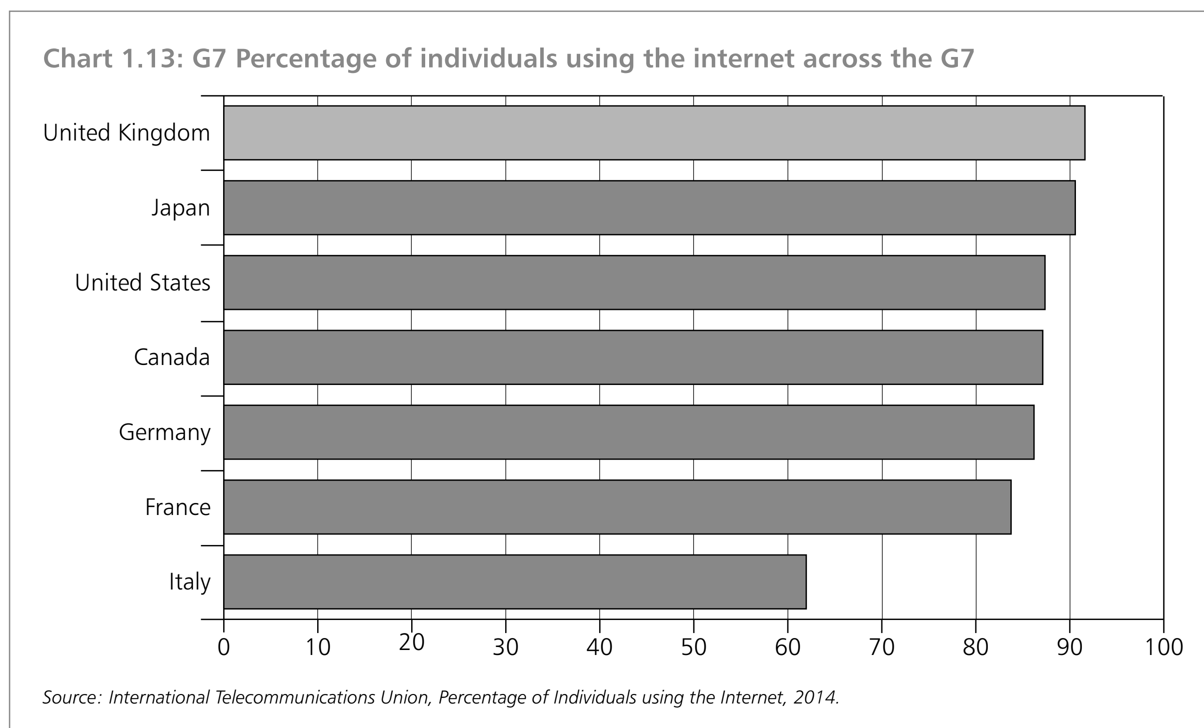
[153] 'Smart power', National Infrastructure Commission, 4 March 2016
[154] 'Energy market investigation: Summary of provisional decision on remedies', CMA, 10 March 2016

1.249 The government will be consulting later this year on the priorities and delivery models for the Shale Wealth Fund, and how it can be deployed in local communities and the North as a whole. The Shale Wealth Fund could be worth up to £1 billion over 25 years[155] and will provide additional funds over and above industry schemes and other sources of government funding.

Supporting the digital economy

1.250 Digital technology is transforming every sector of the UK economy, opening up opportunities for businesses and individuals. The UK has the highest internet usage of any G7 economy, as shown in Chart 1.13 and in 2014, the UK's digital sector contributed around £120 billion to the economy.[156]

Chart 1.13: G7 Percentage of individuals using the internet across the G7



Source: International Telecommunications Union, Percentage of Individuals using the Internet, 2014.

1.251 This Budget sets out steps to ensure the benefits of digital technology are felt by all businesses and individuals. The government will:

- **establish a new Broadband Investment Fund, in partnership with private sector investors**, to support the growth of alternative broadband networks by providing greater access to finance
- **deliver a 5G strategy in 2017, based on an assessment by the National Infrastructure Commission of how the UK can become a world leader in 5G**
- **establish a panel of leading experts, chaired by Kathryn Parsons, to shape the £20 million Institute for Coding competition**
- **provide up to £5 million to develop options for an authoritative address register that is open and freely available** – making wider use of more precise address data and ensuring it is frequently updated will unlock opportunities for innovation

[155] HM Treasury calculations
[156] Digital Sector Economic Estimates Statistical Release, Department for Culture, Media and Sport, January 2016.

1.252 Affordable broadband is essential for a connected household sector but pricing in this market can be opaque. The government expects quick action to ensure the price of broadband provision is as clear as possible. New proposals from the Advertising Standards Authority (ASA) will ensure broadband adverts do not mislead. A new cost comparison measure for telecoms services will be developed by Ofcom this year.

1.253 Electromagnetic spectrum is a valuable and scarce resource. **Budget 2016 announces a new government commitment that 750MHz of valuable public sector spectrum in bands under 10GHz will be made available by 2022, of which 500MHz will be made available by 2020**. This builds on government's previous 2010 commitment, and will deliver wider economic benefits by generating capital receipts and by supporting innovation in digital communications services and the development of new technologies.

Response to the Independent Review of Economic Statistics

In 'Fixing the Foundations: Creating a more prosperous nation', the Chancellor of the Exchequer and the Minister for the Cabinet Office commissioned Professor Sir Charles Bean to conduct a review of economic statistics assessing the UK's future statistics needs, the capability of Office for National Statistics in delivering those statistics and the most appropriate governance framework to support production of those statistics. **The government welcomes the review and accepts all its recommendations**.

To enable the Office for National Statistics to develop world-leading analytical and digital capabilities in economic measurement, **the government will invest over £10m in a new hub for data science and a centre for excellence in economic measurement in line with Professor Sir Charles Bean's recommendations**. The new hub for data science will maximise the public value of existing and new data sets – so called 'big data' from public and private sources – using cutting-edge techniques to allow the Office for National Statistics to produce more innovative, accurate and timely statistics. The centre for excellence will improve the Office for National Statistics' capability to measure the changes in the UK's digital economy and to push the frontiers of economic measurement.

Investing in creative industries

1.254 The government's creative sector tax reliefs have been highly successful at supporting growth, investment and innovation in industries that employ 1.8 million people.[157] **To encourage museums and galleries to develop creative new exhibitions and display their collections across the country, the government will introduce a new tax relief from 1 April 2017.** This will be available for the costs of developing temporary or touring exhibitions and will follow a consultation on its design over summer 2016.

1.255 The government will also broaden the eligibility criteria for the VAT refund scheme for museums and galleries, with new guidance to allow a wider range of free museums to access the support.

[157] 'Creative industries: Focus on employment', DCMS, 30 June 2015

Competitive markets

1.256 Competitive and efficient markets lie at the core of a productive economy, promoting innovation and efficiency. At Autumn Statement 2015, the government published a comprehensive plan to boost competition[158]. Since its publication, there has been concrete progress in a number of markets:

- mobile – even when a handset has been paid off, some operators still charge customers to unlock it. At Autumn Statement 2015, the government challenged the industry to do better; since then operators have committed to unlocking many more of their customers' handsets for free. Unlocking handsets currently costs consumers an estimated £48 million a year[159]
- government procurement – the public sector can drive competition via open procurement practices. The government wants to ensure the £60 billion local authorities spend to procure services[160] is done in an efficient and competitive way. **The government will consult on new rules requiring local authorities to be transparent about the cost of the in-house services they provide,** and whether there could be savings from using competitive external providers
- legal services – where competitive pricing can make some of the biggest decisions in life, from buying a house to setting up a business, easier. **The government will launch a consultation shortly on how to reduce regulatory barriers so that new providers can provide legal advice**

Stronger and more focused economic regulators

1.257 The government is committed to robust but focused economic regulation. The UK's system of independent economic regulation is widely regarded as one of the best in the world. Building on this, Budget 2016 announces that the government will:

- streamline regulators. **E-Serve will be split off from Ofgem to ensure Ofgem can focus on its core functions of economic regulation and promoting competition.** DECC are committed to consolidating their delivery providers and will set out the future of consumer-facing functions, including those currently undertaken by E-Serve, at Autumn Statement 2016. The government will continue to consider whether economic regulators' functions can be further streamlined
- strengthen competition and innovation, including by **legislating to give Ofgem more power to make sure the system of industry codes supports competition and by enhancing the role of the Competition and Markets Authority** in the regulated sectors. The government will continue to look at further changes
- drive efficiency, **by working with economic regulators to review the business case for co-locating and sharing back office functions across regulators**, reporting by summer 2016

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[158] 'A better deal: Boosting competition to bring down bills for families and firms', HM Treasury and BIS, 30 November 2015
[159] 'Brits spend over £48 million unlocking mobile phones every year', uSwitch Press Release, 10 June 2015
[160] Department for Communities and Local Government analysis based on 'Local Authority Revenue Expenditure and Financing England 2014-15 Final Outturn' (ONS)

A devolution revolution

1.258 This government is fundamentally changing the way the country is run, rebalancing the economy for the next generation through a devolution revolution. Local leaders are taking on radical new powers and responsibility for driving local growth through historic devolution deals, retention of business rates and further targeted investment in response to local priorities.

1.259 Strong progress has been made. **Budget 2016 announces new devolution deals with the West of England, East Anglia, and Greater Lincolnshire. Building on existing devolution deals with Greater Manchester, Liverpool City Region, Sheffield City Region, the North East and Tees Valley, this means that 57% of the population of the North of England will be covered by an elected mayor.**[161] The government also continues to devolve unprecedented powers to Scotland, Wales and Northern Ireland.

Devolution across the UK

1.260 The UK's economic recovery is benefiting families and businesses across Scotland, Wales and Northern Ireland. There are now more people in work in Scotland and Wales than ever before and in Northern Ireland employment grew by 15,000 in 2015.[162] This government is delivering on its commitments to transfer powers to each of the devolved administrations. It also looks to the governments of the devolved administrations to continue to devolve powers within Scotland, Wales and Northern Ireland, so that they empower local areas and ensure that their great cities and regions are not left behind.

1.261 **The government will legislate in order to meet its manifesto commitment to apply 'English Votes for English Laws' to Income Tax.** This will allow MPs representing constituencies in England, Wales and Northern Ireland to have a decisive say on the main rates of income tax, when those rates are devolved to the Scottish Parliament.

Northern Ireland

1.262 In 2015 the government legislated to make a lower Northern Ireland Corporation Tax rate a real possibility. There is now broad support within Northern Ireland for a rate of 12.5%, to be introduced in 2018. The additional financial support and flexibility provided through the Stormont House and Fresh Start Agreements has delivered immediate improvements in the Executive's stability. Now Northern Ireland's own political leaders must press on with the reforms necessary to put the Executive's finances on the sustainable footing required to complete Corporation Tax devolution.

1.263 Where the Northern Ireland Executive intends to top-up UK-wide benefits from within its block grant as it implements welfare reform, **the government will exempt from tax the top-up payments to non-taxable benefits.**

1.264 The Northern Ireland Executive has set the boundaries of a pilot Enterprise Zone near Coleraine. The government will legislate to ensure that Enhanced Capital Allowances can be offered within the Enterprise Zone, with the first investors expected on site later in 2016.

1.265 The Budget **allocates £4.5 million from banking fines to help establish a Helicopter Emergency Medical Service for Northern Ireland.**

[161] The North of England is defined as the North East, North West, and Yorkshire and Humber regions. 'Annual mid-year population estimates: 2014', ONS June 2015.
[162] 'Regional Labour Market Statistics', ONS, February 2016.

Scotland

1.266 The Scotland Bill delivers the legislative elements of the Smith Commission, while the new Fiscal Framework for the Scottish Government was agreed in February 2016. The powers in the Bill, covering tax, welfare and borrowing, will see the Scottish Parliament become one of the most powerful and accountable devolved Parliaments in the world.

1.267 The government demonstrated its ongoing investment in Scotland through a £125 million commitment to an Aberdeen City Deal earlier this year. Good progress has been made towards an Inverness City Deal. **This Budget announces that the government will also work with local partners and the Scottish Government towards a deal for Edinburgh and South East Scotland.**

1.268 Edinburgh and the Lothians will also benefit from a science and innovation audit, to map the area's research strengths in data-driven innovation and identify areas of potential global competitive advantage.

1.269 Nearly half of UK jobs supported by the oil and gas industry are in Scotland, particularly around Aberdeen.[163] The Budget announces a major package of measures, including **zero rating Petroleum Revenue Tax and cutting the Supplementary Charge from 20% to 10%** to help support the industry through the challenging commercial conditions facing the sector.

1.270 The duty on Scotch whisky will also be frozen this year, continuing the government's support for this great British success story.

1.271 To support Scotland's cultural heritage, creative industries and communities, the government will contribute **£5 million to the V&A Dundee and £150,000 towards local regeneration projects in New Cumnock.**

1.272 The government will also allocate £5 million from banking fines for a new leisure facility in Helensburgh, which will benefit both local residents and Royal Navy personnel and their families stationed nearby at Faslane.

Wales

1.273 The government is taking forward the St David's Day agreement for Wales and is committed to delivering the Welsh Rates of Income Tax, alongside devolution of further powers, including on energy and transport. A funding floor for the Welsh Government was announced at the Spending Review.

1.274 To reduce costs for businesses and families in Wales and the South West of England **the government will halve tolls on the Severn River Crossings,** once the Crossings are in public ownership, subject to public consultation. Alongside this, **the government will review the case for free-flow tolling on the Crossings.**

1.275 The government has agreed a £1.2 billion city deal for the Cardiff Capital Region with the Welsh Government and local partners. The government's £500 million contribution to the deal will provide an investment fund for the region and support electrification of the Valley Lines railways, a central part of the ambitious Metro project. As announced in January, £50m will also be invested up to 2020-21 to create a new Compound Semiconductor Catapult in Wales. **The government will open negotiations with local partners and the Welsh Government towards a deal for the Swansea Bay City Region,** extending from Pembrokeshire to Neath-Port Talbot.

[163] Oil and Gas UK, Economic Report 2014, October 2014.

1.276 This Budget opens the door to a growth deal for North Wales to help strengthen its economy and to make the most of its connection to the Northern Powerhouse. This government will look to the next Welsh Government to devolve powers down and invest into the region as part of any future deal.

1.277 South East Wales and South West England will benefit from a science and innovation audit to map the area's research strengths and identify areas of potential global competitive advantage.

1.278 The government will allocate £500,000 in banking fines to CAIS Wales, Change Step Veteran Services. This will deliver a new referral pathway for peer support and tailored specialist intervention for 800 veterans in Wales.

English Devolution

Devolution deals

1.279 The government is transferring significant budgets and responsibilities to the local level, building upon the historic mayoral devolution agreements with Greater Manchester, Sheffield City Region, the North East, Tees Valley, Liverpool City Region and the West Midlands. **The government has now agreed new mayoral devolution deals with English counties and southern cities too, reaching agreements with the West of England, East Anglia and Greater Lincolnshire. The government has also agreed a further devolution deal with Greater Manchester, including a commitment to work towards the devolution of criminal justice powers, and a second devolution deal with Liverpool City Region.**

1.280 Previously agreed mayoral devolution deals will also each receive un-ringfenced single pots of funding to spend on local priorities, worth £2.86 billion in total. This flexibility will allow areas to take more control over strategic investment. The single pots will initially include a five-year settlement rolling together existing transport funding, gainshare investment funds and Local Growth Fund allocations. This will be supplemented in the future with further flexibility over central government funding. The Bus Service Operators Grant will also be devolved to areas that adopt bus franchising, and the Adult Education Budget will be included in the single pot from 2018-19 for those areas with devolved adult skills arrangements.

1.281 The government will pilot the approach to 100% business rates retention in Greater Manchester and Liverpool City Region and will increase the share of business rates retained in London. This will help to develop the mechanisms that will be needed to manage risk and reward under 100% rates retention and will help authorities to build financial capacity to reform core services and invest in long term economic growth from 2017 – three years ahead of schedule. The offer is open to any area that has ratified its devolution deal.

Local growth

1.282 The government believes local areas must be empowered to reach their potential in order to boost national productivity and growth. The Local Growth Fund gives Local Enterprise Partnerships control over £12 billion of central government funding, ensuring that this money is spent in line with local priorities. The initial two rounds of Growth Deals have given local areas nearly £8 billion to drive growth through investing in the infrastructure their areas need. **The government is now announcing further steps in the allocation of the Local Growth Fund, including:**

- **up to £1.8 billion will be allocated through a further round of Growth Deals with Local Enterprise Partnerships later this year.** The government will announce further detail on the process for the next round of Growth Deals soon
- **a further £2 billion of the Local Growth Fund is being allocated through the Home Building Fund.** This programme provides finance to developers to unlock large housing sites and bring forward the necessary infrastructure that large house building projects require

1.283 To date, Enterprise Zones have supported over 560 businesses and secured over £2.3 billion of private sector investment to build world-class business facilities and transport links, attracting over 20,000 jobs.[164] **The government will create a new MarineHub Enterprise Zone in Cornwall following the transfer of Wave Hub to Cornwall Council.** Subject to the necessary business case approvals and local agreements, **the government will also create new Enterprise Zones in Brierley Hill in Dudley, and Loughborough and Leicester, as well as extending the Sheffield City Region Enterprise Zone.** The government will also ensure that all zones are able to offer Enhanced Capital Allowances for eight years following the establishment of the ECA site.

1.284 The government has received ambitious proposals from Local Government Pension Scheme administering authorities **to establish a small number of British Wealth Funds across the country by combining their assets into much larger investment pools.** These pools will deliver annual savings of at least £200-300 million, and we will work with administering authorities to establish a new Local Government Pension Scheme infrastructure investment platform, in line with their proposals, to boost infrastructure investment.

1.285 The next round of the Coastal Communities Fund, for projects starting in 2017-18, will open for applications this summer. The CCF funds projects across the UK which support sustainable economic growth and jobs in coastal communities.

1.286 Greater Manchester and East Cheshire, Sheffield City Region and Lancashire LEP, and the Midlands will each benefit from a science and innovation audit. These will help each of these regions to map their research and innovation strengths and to identify areas of potential global competitive advantage. Future audits in other areas will be announced later this year.

1.287 The government is working on an ambitious strategy to move civil servants out of expensive Whitehall accommodation and into the suburbs of London, delivering substantial savings for the taxpayer. Over the next few years the numbers working in central London will reduce significantly. In addition, **by the middle of this Parliament the Ministry of Justice will have a major programme to create substantial centres of expertise outside the capital.** This will reduce costs, access highly skilled labour markets in the regions and contribute to the Northern Powerhouse.

[164] DCLG data, based on outputs of the Enterprise Zones programme as self-reported by local areas on a quarterly basis.

Figure 3: New investment across the United Kingdom

NORTHERN IRELAND

- Stormont House Agreement funding now delivering infrastructure investment
- £4.5m for an air ambulance service in Northern Ireland
- Pilot Enterprise Zone near Coleraine offering Enhanced Capital Allowance

MIDLANDS

- Over £250m Midlands Engine Investment Fund for smaller businesses
- Put Midlands Connect on a statutory footing, and develop its priority roads schemes, including M1 upgrades, and improvements on the A45, A46, M42 and M5
- New Enterprise Zones for Loughborough and Leicester, and for Brierley Hill, Dudley
- £14m for STEAMhouse, a new innovation centre in Birmingham's Creative Quarter, Digbeth
- £16m grants to aerospace industry including £7m for Rolls-Royce in Derby
- Greater Lincolnshire Devolution Deal, including £450m gainshare pot, devolved transport budget and more joined-up adult skills and criminal justice

WALES

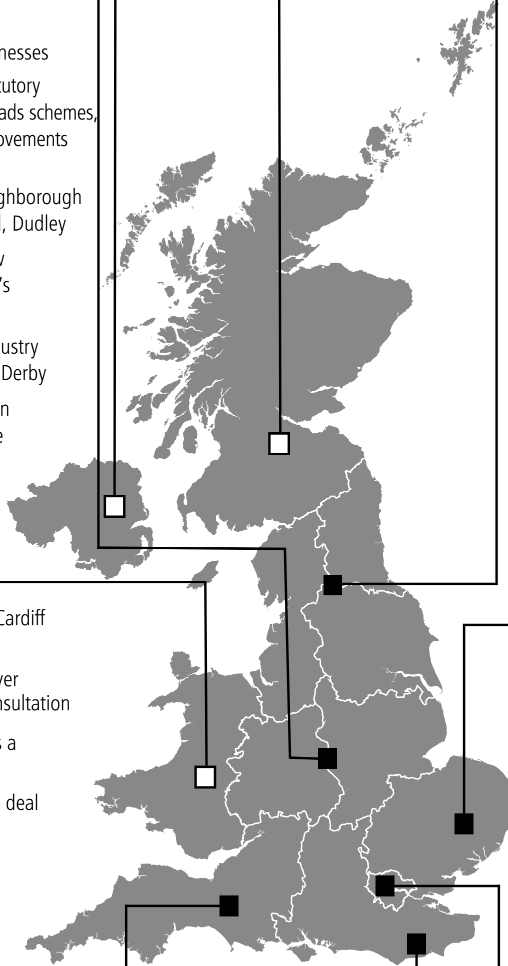
- £500m over 20 years for the Cardiff Capital Region City Deal
- Halving tolls on the Severn River Crossings in 2018, subject to consultation
- Opening negotiations towards a Swansea Bay City Region deal
- Opening the door to a growth deal for North Wales

SOUTH WEST

- West of England Devolution agreement, including £900m gainshare pot, devolved transport budget and powers over adult skills
- £19m from Stamp Duty receipts to community-led housing schemes in areas where the impact of holiday homes is most acute
- £5m additional development funding to improve resilience on the Dawlish rail line
- Increasing grant funding to £14.5m for ultrafast broadband
- New Enterprise Zone for Cornwall
- £3m to improve rail station facilities
- £2m to refurbish the Hall for Cornwall in Truro

SCOTLAND

- A £1bn package of measures to support the oil and gas industry in Scotland
- £5m for the City of Dundee's V&A development
- Opening negotiations on a city deal for Edinburgh and South East Scotland
- Freezing duty on Scotch whisky



SOUTH EAST

- Thames Estuary 2050 Growth Commission, chaired by Lord Heseltine to report in 2017
- National Infrastructure Commission to make proposals on developing the Cambridge-Milton Keynes-Oxford corridor
- Piloting a £15m Connected Corridor on the A2-M2 from London to Dover
- £7m to improve rail station facilities at Redhill, Newbury and High Wycombe

NORTHERN POWERHOUSE

- £300m further investment in transport including:
- £60m to green light HS3 between Leeds and Manchester and for other major city rail links
- £161m to accelerate transformation of the M62 into a smart motorway, reducing congestion
- £75m to fast-track development of major new road schemes including on the M60, A66 and A69 and Trans-Pennine tunnel
- Over £150m investment in flood defence schemes in Leeds, Cumbria, Calder Valley and York
- £20m per year Northern Powerhouse Schools Strategy to improve schools
- £15m for National Institute for Smart Data Innovation, Newcastle
- Extension of Sheffield City Region Enterprise Zone, subject to agreement
- Working with Greater Manchester to devolve powers over criminal justice services, and a new Life Chances Investment Fund
- Additional £130m to repair roads and bridges in Cumbria, West Yorkshire, Northumberland, Greater Manchester, Durham and North Yorkshire
- £13m for Hull UK City of Culture 2017

EAST

- Devolution deal with East Anglia, including £900m gainshare pot, £175m ring-fenced housing fund and devolved transport and adult skills budgets
- £151m towards building new river crossings at Lowestoft and Ipswich
- £50m for a new world-leading centre for food and health research at Norwich
- £5m to redevelop St Albans City rail station

LONDON

- The green light for Crossrail 2 with £80m development funding
- Moving towards 100% business rates retention with the Greater London Authority
- Supporting the expansion of the Royal College of Art's Battersea Campus
- Supporting the British Library to develop its Central London site

Northern Powerhouse

1.288 As set out by the Chancellor in 2014, the Northern Powerhouse is the government's vision for the North of England. It is built on the solid economic theory that while the individual cities and towns of the North are strong, if they are enabled to pool their strengths, they could be stronger than the sum of their parts. It means investing in better transport to connect up the North; backing strengths in science and innovation; investing in culture, housing and the quality of life to make the North a magnet for new businesses and talented people; and devolving powers and budgets and creating powerful new elected mayors who will give people in northern cities and towns a strong voice.

1.289 Strong progress has been made. Since 2010, unemployment in the North of England has fallen by a third and the median earnings of full-time employees grew faster in all regions of the North than they did in London.[165] In 2015, employment grew faster in the North than the South and by the end of the year, the employment rate in the northern regions was at its highest on record, at 72.2%.[166] In 2015, unemployment fell faster in the North West than in any other region.[167]

1.290 Alongside the Budget, the government has agreed a joint statement of intent with the largest cities in the North to drive forward the Northern Powerhouse.

Transport

1.291 The government supports the vision set out by Transport for the North (TfN) in their Northern Transport Strategy[168] and accepts the recommendations from the National Infrastructure Commission on northern connectivity.[169] **The government will take forward these proposals with a total of £300 million of funding, including:**

- **giving the green light to High Speed 3 between Leeds and Manchester, committing to reduce journey times to around 30 minutes,** in line with the recommendation by the National Infrastructure Commission. £60 million will be provided to develop plans for both the Leeds-Manchester route by 2017 and to improve transport connections between cities of the North
- **accelerating the upgrade of the M62 to a four-lane smart motorway.** The government will provide an extra £161 million on top of the existing road programme to bring forward by 2 years the upgrade between junction 10-12 Warrington to Eccles, and to accelerate work on junction 20-25 Rochdale to Brighouse
- **developing the future transformation of east-west road connections,** including a new Trans-Pennine tunnel under the Peak District between Sheffield and Manchester, as well as options to enhance the A66, A69 and the north-west quadrant of the M60. The government will allocate £75 million, including to develop a business case for these schemes by the end of the year
- **accelerating the development of other critical road projects in the North,** including Lofthouse and Simister Island junctions, capacity enhancements to the M1 at junctions 35a-39 Rotherham to Wakefield, and delivering on the commitment to begin upgrades to the M56 at junctions 6-8 south of Manchester in this Parliament

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[165] The north is defined as the North East, North West, and Yorkshire and the Humber regions. The south is defined as London, the South East and South West regions.
'Regional Labour Market Statistics', ONS, February 2016. 'Annual Survey of Hours and Earnings: 2015 Provisional Results', ONS, November 2015.
[166] 'Regional Labour Market Statistics', ONS, February 2016.
[167] 'Regional Labour Market Statistics', ONS, February 2016.
[168] 'The Northern Transport Strategy: Spring 2016 Report', Transport for the North, March 2016.
[169] 'High Speed North', National Infrastructure Commission, March 2016.

- **improving the North's major rail stations.** To take forward the commission's recommendations, the government will allocate a further £4 million to support the development of High Speed 2 Growth Strategies for Manchester Piccadilly, Manchester Airport and Leeds stations

1.292 The Budget announces funding to improve local roads in the North. **£15 million will be allocated from the Pothole Action Fund to repair around 277,000 potholes during 2016-17, and the government is giving the go ahead to £24 million from the Local Growth Fund** to improve roads across North Yorkshire.

Devolution

1.293 The first round of mayoral devolution deals with northern cities were not the end of a process but the beginning of one. Since agreeing a mayoral deal in November 2014, Greater Manchester has been a trailblazer for devolution in England. **The government will work with Greater Manchester on the devolution of powers over criminal justice services, as well as supporting the establishment of a Life Chances Investment Fund.** The radical devolution of justice responsibilities will enable Greater Manchester to offer seamless interventions for offenders as they transition between prisons and the community, and to join up public services to tackle the causes of crime and prevent reoffending.

1.294 The government has agreed another mayoral devolution deal with Liverpool City Region. This builds upon Liverpool's mayoral deal on 17 November 2015, and gives Liverpool additional new powers over transport, pilots the approach to 100% business rate retention across the city region, and commits the city region and government to work together on children's services, health, housing and justice.

Northern Powerhouse Schools Strategy

1.295 The government will invest £20 million a year of new funding in a Northern Powerhouse Schools Strategy. This new funding will ensure that rapid action is taken to tackle the unacceptable divides that have seen educational attainment and progress in some parts of the North lag behind the rest of the country. Ensuring access to an excellent education for all pupils is a critical step in ensuring the long term success and competitiveness of the Northern Powerhouse. The government will:

- **boost investment to turn round performance in the toughest areas:** bringing in support from the best leaders and schools into these areas, empowering the best local heads and schools to become leaders of school improvement and increasing funding available for turnaround activities in coasting and vulnerable schools
- **invest more funding to see the best academy chains expand and to develop new sponsors in the North; the creation of a new Northern centre of the New Schools Network** will encourage more, innovative, free schools in the region
- look at further ways to get and retain the best teachers in these areas
- **ask Sir Nick Weller to lead an in-depth report into transforming education across the Northern Powerhouse**

Business, innovation and science

1.296 To support local business growth, the government will extend the Sheffield City Region Enterprise Zone, subject to local agreement. This will support the area to build

on its expertise in advanced manufacturing across a range of sectors including automotive industries.

1.297 The government will invest £15 million in the National Institute for Smart Data Innovation in Newcastle, subject to approved business case. This new facility will bring together industry, the public sector and universities to create the skills, ideas and resources needed to exploit the opportunities offered by Smart Data.

1.298 Alongside the launch of a **competition to identify the best value small modular reactor for the UK, government will allocate at least £30 million for a 21st century nuclear manufacturing programme.** This will create opportunities for the North's centres of excellence in nuclear research, such as the Nuclear Advanced Manufacturing Research Centre and the Sir Henry Royce Institute.

1.299 The government will **consult on the priorities and delivery models for the Shale Wealth Fund and how it can be deployed in local communities and the North as a whole.** The Shale Wealth Fund could be worth up to £1 billion over 25 years and will provide additional funds over and above industry schemes and other sources of Government funding.[170]

1.300 Greater Manchester and East Cheshire, and Sheffield City Region will benefit from a science and innovation audit.

Flooding

1.301 Many communities in the North were badly affected by flooding this winter. As part of the government's £700 million boost to flood defence and resilience spending, **£150 million will be invested in flood defence schemes in Leeds, Cumbria, Calder Valley and York, which will better protect 7,400 properties.**[171] The government will also invest up to £25 million in flood defences in Carlisle once the Environment Agency has concluded a review of its needs, and will provide funding to support delivery of the final phase of the Leeds Flood Alleviation Scheme in later years subject to business case approval.

1.302 On top of the £49 million already committed to repair transport infrastructure damaged by Storms Desmond and Eva, **a further £130 million will be spent repairing roads and bridges in Cumbria, West Yorkshire, Northumberland, Greater Manchester, Durham and North Yorkshire.** This funding will enable repairs to the Ovingham Bridge in Northumberland, the Linton Bridge in Leeds, Scout Road in Calderdale and the A646 near Mytholmroyd.

Arts and culture

1.303 The North West had the fastest growing arts, entertainment and recreation sector in the country in the year to 2014.[172] To support the North's vibrant creative and cultural offering, the Budget:

- **commits a further £13 million to Hull UK City of Culture 2017.** This includes £5 million towards the refurbishment of Hull New Theatre and £8 million to ensure there is a lasting cultural legacy in Hull
- **provides £5 million support to the Shakespeare North project to establish a new theatre in Knowsley,** subject to business case approval and planning permission being granted

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[170] HM Treasury calculations.
[171] Based on analysis by the Environment Agency.
[172] 'Regional Gross Value Added (Income Approach)', ONS, December 2015.

- **provides £500,000 to Welcome To Yorkshire for an international marketing campaign for the Tour de Yorkshire 2016. The government also supports plans to bid to host the Rugby League World Cup in the Northern Powerhouse**
- **provides £1 million support to S1 Artspace to create an arts complex** subject to planning permission being granted
- **invites bids from northern cities and towns to host the Great Exhibition of the North in 2018**
- **considers the case to support the creation of 'International Screen School Manchester',** to increase the skilled workforce for the screen-based media sector in the Northern Powerhouse

LIBOR

1.304 The government will allocate £1.1 million to Central Manchester University Hospitals NHS Foundation Trust and £700,000 to Sheffield Children's Hospital Charity from banking fines. This will contribute to a dedicated helicopter landing pad in central Manchester and a fully digitally intraoperative 3T MRI scanner in Sheffield.

Figure 4: Northern Powerhouse Timeline

2015-16 Key Project Starts:

- £220m upgrade to M6 J16-19 between Crewe and Knutsford
- Construction of the £230m A6 to Manchester Airport relief road
- Phase one of the Leeds Flood Alleviation Scheme

Key Project Completions

- Electrification of railway between Manchester and Liverpool
- £120m M1 J39-42 Smart Motorway between Wakefield and Leeds
- Construction of the £300m Liverpool2 deep water terminal at Seaforth

2016-17 Key Project Starts:

- Construction of £200m New Polar Research Vessel, Birkenhead
- New rail franchises for TransPennine Express and Northern start 1 April 2016
- £100m improvement to A19/A1058 Coast Road Junction in Newcastle
- £75m development of improvements to M60, Northern TransPennine links (A66 and A69) and TransPennine tunnel between Manchester and Sheffield

Key Project Completions:

- £192m upgrade to A556 Knutsford to Bowdon
- Carrington Power Station enters operation, after a £620m construction

2017-18 Key Project Starts:

- ESIOS – Energy Subsurface Test Centre, Chester
- National Centre for Ageing Science and Innovation, Newcastle
- Smart Motorway on the M62 J10-12 (Manchester – Warrington)
- £13m Hull UK City of Culture 2017

Key Project Completions:

- £380m of improvement works on the A1 Leeming to Barton
- £210m Smart Motorway on M60 J8 – M62 J20
- Graphene Engineering and Innovation Centre, Manchester
- Cognitive Computing Research Centre, Cheshire (Hartree Phase III)
- Plans produced for High Speed 3 between Leeds and Manchester to reduce journey times to around 30 minutes
- National College of High Speed Rail, Doncaster

2018-19 Key Project Starts:

- Ouse and Foss flood defence schemes in York, and phase two of the Leeds Flood Alleviation Scheme
- Publish 2nd Roads Investment Strategy (2020-25), which could include TransPennine tunnel and upgrades to northern TransPennine roads and M60
- Comprehensive upgrades to the TransPennine rail route, paving the way for High Speed 3

Key Project Completions:

- Tees Renewable Energy Plant and £190-200m Energy Works in Hull
- Great Exhibition of the North 2018

2019-20 Key Project Starts:

- Upgrades to the A5036 Princess Way and M56 J6-8 Smart Motorway (Manchester Airport – A556)
- Smart Motorway on the M62 J20-25 (Leeds – Manchester)
- Upgrades to the A1 north of Ellingham
- M62/M606 Chain Bar in Bradford

Key Project Completions:

- M62 J10-12, M60 J24-27 & J1-4 South of Manchester Smart Motorway
- Sir Henry Royce Institute for Advanced Materials, Manchester
- National Institute for Smart Data Innovation, Newcastle

Midlands Engine for Growth

1.305 This Budget pushes forward the government's vision for the Midlands Engine for Growth. There are almost 96,000 more businesses in the Midlands than in 2010 – equal to 52 new business created every day.[173] In 2015, median earnings of full-time employees grew faster in the West Midlands than in any other English region.[174] The East Midlands also had the strongest productivity growth between 2010 and 2014 of any region.[175] This Budget contains measures to support industry and growth in the Midlands, with a focus on supporting the development of Midlands Connect's long-term transport strategy and the region's traditional strengths in manufacturing and engineering.

1.306 The government has agreed with LEPs in the Midlands and the British Business Bank to create a Midlands Engine Investment Fund of over £250 million to invest in smaller businesses in the Midlands, subject to final funding arrangements.

1.307 The government has agreed a new mayoral devolution deal with Greater Lincolnshire. This will give Greater Lincolnshire significant new powers over transport, planning, and skills. Greater Lincolnshire will also receive control of a £450 million investment fund over 30 years to boost economic growth.

1.308 To boost transport and connectivity in the Midlands, the government will:

- **put Midlands Connect on a statutory footing by the end of 2018 to create a sub-national transport body for the Midlands.** This will support Midlands Connect in developing and implementing a long-term Midlands Transport Strategy following the £5 million of funding the government committed at Summer Budget 2015
- develop Midlands Connect's priority strategic roads schemes in this Parliament. The government will carry out development work on four major roads in the Midlands: upgrades to the M1 to provide a continuous smart motorway from London to Yorkshire, improvements to the A46 Newark bypass and its junction with the A1, upgrading the single carriageway link on the A45 Stanwick to Thrapston, and upgrading the M42 and M5 around Birmingham to a four lane smart motorway
- **launch the Local Majors Fund.** This competitive fund will offer the opportunity for local areas to bid for funding for large local transport projects such as the Carrington Bridge
- **allocate £11 million during 2016-2017 to fill around 214,000 potholes**
- **allocate £1 million to expand car parking facilities at Market Harborough rail station**

1.309 To support local businesses and build on the area's strengths in space science and research, a **new Enterprise Zone will be created across Loughborough and Leicester**, subject to business case approval. The government can also announce **the creation of an Enterprise Zone at Brierley Hill in Dudley**, subject to business case approval.

1.310 Budget announces £16 million in R&D funding, matched by industry, to support aerospace firms in the East Midlands. This includes £7 million to help Rolls-Royce develop new high-temperature alloys in Derby. **The Midlands will also receive over £15 million funding to support R&D into lowering vehicle emissions.**

1.311 The Midlands will benefit from a science and innovation audit, to identify the region's strengths in research and innovation.

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[173] 'Business Population Estimate for the UK and Regions', BIS, October 2015.
[174] 'Annual Survey of Hours and Earnings: 2015 Provisional Results', ONS, November 2015.
[175] 'Regional Productivity, Levels (£)', ONS, January 2016.

1.312 This Budget allocates £2 million to develop a regeneration masterplan for Birmingham's Snow Hill district. This will help to maximise the potential of Snow Hill Station and the surrounding business district. **The government will also support Greater Birmingham and Solihull LEP to develop a proposal for a new Knowledge Quarter in the area around the Curzon Street HS2 station.**

1.313 The government will invest £14 million in STEAMhouse, subject to business case. This is a creative innovation centre in Digbeth, Birmingham, bringing together arts and culture with science, technology, engineering and maths to drive innovation.

1.314 This Budget announces the extension of additional work coaches in Birmingham for the next financial year. These additional work coaches work with businesses to match individuals with apprenticeships, training opportunities and skilled jobs.

1.315 The government will allocate £700,000 in banking fines to Birmingham Children's Hospital Charity. This will complete fundraising for the 'Eye Believe' appeal to transform the hospital's Eye Department, and also support the 'Star Appeal', to create the UK's first centre for children with rare diseases and undiagnosed medical conditions.

1.316 The government will also contribute **£1 million towards the transformation of the historic Drapers' Hall in Coventry into a multi-purpose music venue.**

East of England

1.317 The East of England had the highest employment rate of any region at the end of 2015, and was the joint second fastest growing region in the year to 2014.[176] This Budget announces measures to devolve power down, to strengthen the East of England's specialisms in science and research, and to improve transport and connectivity.

1.318 The government has agreed a mayoral devolution deal with East Anglia, covering Norfolk, Suffolk, Cambridgeshire and Peterborough, giving the local area new powers over transport, planning, skills, a £900 million investment fund over 30 years to grow the local economy, and access to £175 million ringfenced funding to deliver new homes.

1.319 The Budget confirms £151 million for the Lowestoft 3rd Crossing and the Ipswich Wet Dock Crossing from the Local Majors Fund. The government will also look at the case for other projects, such as the Canvey Island Third Road, to be taken forward.

1.320 Building upon East Anglia's world-leading status in science and research, the government will contribute £50 million to the Quadram Institute. The Institute will develop solutions to a range of global challenges in human health, food and disease.

1.321 To develop transport facilities and connectivity in the East of England, the government will **allocate £5 million to fund the redevelopment of St Albans City station.**

1.322 This Budget also allocates £7 million during 2016-2017 to fill around 136,000 potholes.

South West

1.323 In 2015, employment grew faster in the South West than in any other region.[177] At the end of 2015 the South West had the lowest unemployment rate of any region, and has seen the

[176] 'Regional Labour Market Statistics', ONS, February 2016. 'Regional Gross Value Added (Income Approach)', ONS, December 2015.
[177] 'Regional Labour Market Statistics', ONS, February 2016.

fastest business growth since 2010 outside London.[178] To drive productivity and support growth, the government is announcing a package of measures to devolve further powers to the West of England, improve transport and connectivity, and support tourism in the region.

1.324 The government has agreed a new mayoral devolution deal with the West of England. This will give the West of England significant new powers over improved transport, planning, skills and employment. The West of England will also receive control of a £900 million investment fund over 30 years to boost economic growth.

1.325 Budget announces **£19 million funding for community-led housing schemes in areas most impacted by holiday homes, using Stamp Duty Land Tax revenue raised from the higher rates for purchases of additional properties.**

1.326 The government will support the interim report of the Peninsula Rail Task Force by investing an additional £5 million in developing options to improve the resilience of the rail line between Newton Abbot and Exeter via Dawlish. The government will fully consider the recommendations in the Peninsula Rail Task Force's final report when it is published in June.

1.327 To strengthen transport and connectivity in the South West, this Budget also:

- **launches the Local Majors Fund,** so that local areas in the South West can bid for funding for large local transport schemes, including the A391 St Austell to A30 improvements and the North Devon Link Road
- **allocates £3 million to improve rail stations across the South West**
- **allocates £8 million during 2016-17 to fill around 159,000 potholes**
- **provides £500,000 to fund a study into a new junction 18a on the M4 to link with the Avon ring road A4174**

1.328 The government will create a new MarineHub Enterprise Zone for Cornwall, following the transfer of Wave Hub to Cornwall Council.

1.329 The government is providing a grant of up to £16 million to Dyson to support research and development for battery technology at their site in Malmesbury.

1.330 The government will distribute **£14.5 million in grants to extend ultrafast broadband coverage in the South West – £4.5 million more than the £10 million allocated at the Spending Review. As part of its assessment of how the UK can become a world leader in 5G, the National Infrastructure Commission will use the South West as a case study.**

1.331 To support tourism and cultural activity in the South West, the government will:

- **contribute £2 million towards the refurbishment of the Hall for Cornwall in Truro,** subject to planning permission being granted
- **contribute £620,000 to Being Brunel: the National Brunel Project in Bristol**

[178] 'Regional Labour Market Statistics, ONS, February 2016'. 'Business Population Estimate for the UK and Regions', BIS, October 2015.

London

1.332 London contributes £364 billion to the UK economy.[179] In London since 2010, Gross Value Added per head has grown 17.1%, there are over 250,000 more businesses, and over 560,000 more people in work.[180] The government is committed to building on this success, so that London continues to thrive as a global city for the next generation.

1.333 London's continued growth requires strategic, long-term investment in infrastructure. The National Infrastructure Commission has recommended that Crossrail 2 is the priority transport investment required to meet the needs of the capital over the decades to come and that DfT and TfL should urgently undertake the work necessary to update the business case.[181] This includes identifying options to improve the affordability and value for money of the scheme by reducing costs. It advises the project will simultaneously relieve the worst congestion on the London transport network and unlock the potential for hundreds of thousands of new homes.

1.334 The government accepts the National Infrastructure Commission's recommendations and is giving the green light for Crossrail 2 to proceed to the next stage. The government will therefore provide a contribution of £80 million to fund the development of Crossrail 2, and asks Transport for London to match that contribution to ensure that the project can be fully developed with the aim of depositing a Hybrid Bill within this Parliament. The National Infrastructure Commission has recommended that clear proposals are identified to significantly reduce and phase costs and that a funding package is developed that involves London funding more than half of the cost of the project. The government will work closely with Transport for London to ensure that both of these recommendations are met.

1.335 Old Oak Common has the potential to be one of the most significant regeneration sites in the country over the next decade. **The government has therefore agreed a Memorandum of Understanding with the Old Oak and Park Royal Development Corporation on transferring government and Network Rail land into the Development Corporation's ownership,** on the condition that the Development Corporation develops a plan for funding, financing and delivering the regeneration.

1.336 The government will increase the share of London's business rates retained by the Greater London Authority and transfer responsibility for funding TfL's capital projects. This will give the Mayor of London control over almost £1 billion more of locally raised taxes. The government will also explore with London options for moving to 100% business rates retention ahead of the full roll-out of the business rates reforms.

1.337 The government has approved the full business case for a new Thameslink station at Brent Cross Cricklewood, unlocking 7,500 new homes.[182]

1.338 The government invites TfL to bring forward proposals for financing infrastructure projects from land value increases, which could support schemes like the proposal for 'flyunder' tunnels to replace busy main roads and support redevelopment in Barking, Hammersmith or other town centres. The government is also **supporting TfL to generate revenue from its property assets** including by consulting on reforms to compulsory purchase orders.

1.339 The government will provide £5 million to establish a fund to support smaller local infrastructure projects in outer London boroughs.

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[179] 'Regional Gross Value Added (Income Approach)', ONS, December 2015.
[180] 'Business Population Estimate for the UK and Regions', BIS, October 2015. 'Regional labour market statistics', ONS, February 2016.
[181] 'Transport for a world city', National Infrastructure Commission, March 2016.
[182] Business case from London Borough of Barnet and Greater London Authority.

1.340 To build upon London's world-class cultural and educational offering, the government will:

- **help to fund the expansion of the Royal College of Art's Battersea Campus**
- **support the British Library's ambition to develop land to the north of its St Pancras site, subject to business case approval**

South East

1.341 The South East contributes £240 billion in Gross Value Added to the national economy.[183] This Budget announces measures to promote growth and infrastructure development in areas of the South East, and to improve transport and connectivity.

1.342 The government has asked Lord Heseltine to lead the Thames Estuary 2050 Growth Commission. The Commission will develop an ambitious vision and delivery plan for North Kent, South Essex and East London up to 2050. This will focus on supporting the development of high productivity clusters in specific locations. It will examine how the area can develop, attract and retain skilled workers. It will also look at how to make the most of opportunities from planned infrastructure such as the Lower Thames Crossing. It will report back at Autumn Statement 2017 with a clear and affordable delivery plan for achieving this vision.

1.343 The government has asked the **National Infrastructure Commission to develop proposals for unlocking growth, housing and jobs in the Cambridge – Milton Keynes – Oxford corridor.** Its report will set out opportunities to maximise the potential for future growth in this corridor.

1.344 This Budget launches the Local Majors Fund, so that local areas in the South East can bid for funding for large local transport schemes including the Chickenhall Link Road. **The government will allocate £8 million during 2016-2017 to fill around 157,000 potholes, and £7 million to improve rail stations in the South East.**

1.345 The government will allocate £2 million in banking fines to University Hospital Southampton NHS Foundation Trust. This commitment of matched funding will facilitate the building of a dedicated Paediatric Emergency and Trauma Department, bringing units which treat sick children into one location.

[183] 'Regional Gross Value Added (Income Approach)', ONS, December 2015.

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 setting a target to correct its excessive deficit. In June 2015, the Council made new recommendations to the UK, including setting a revised target to correct its excessive deficit.

3.2 Significant progress has been made since 2010 in fixing the public finances. In 2009-10, the government borrowed around £1 in every £4 it spent. The deficit as a share of GDP is forecast to be cut by almost two thirds from its 2009-10 post-war peak and will reach 3.8% (public sector net borrowing) of GDP in 2015-16. The government has addressed the rapid rise in public sector net debt (PSND) which more than doubled as a share of GDP between 2007-08 and 2011-12. Net debt as a share of GDP is forecast to fall over this Parliament, reaching 77.2% of GDP by the end of 2019-20.

3.3 However more work needs to be done – the deficit and debt levels are still too high. The government remains committed to continuing the job of returning the public finances to surplus by 2019-20 and running a surplus thereafter in normal times so Britain bears down on its debt and is better placed to withstand future economic shocks. In a low inflationary environment, with the risk of economic shocks, the only reliable way to bring debt down as a share of GDP is to run a surplus.

3.4 The global economic outlook has deteriorated since the Spending Review and Autumn Statement 2015. The UK is one of the most open trading economies in the world and is not immune to the weaker global outlook. And as in other major advanced economies, the UK's productivity growth has been slower since the financial crisis. Combined, this means that the challenge of delivering a sustained rise in living standards following the financial crisis of 2008 and 2009 is greater here in the UK than the OBR previously forecast.

3.5 Budget 2016 sets out the action the government is taking to meet the fiscal mandate, achieving an overall surplus of £10.4 billion on the headline measure of public sector net borrowing in 2019-20 and a surplus of £11.0 billion in 2020-21. The government is maintaining a balanced pace of deficit reduction, with public sector net borrowing forecast to fall as a share of GDP at the same average annual rate over 2015-16 to 2019-20 as was achieved over 2010-11 to 2014-15.

3.6 The government will build on the measures set out at Spending Review 2015 to deliver a surplus and ensure the sustainability of the public finances. Spending Review 2015 set out savings of £21.5 billion, of which £9.5 billion was reinvested in the government's priorities. Budget 2016 sets out that the government is adjusting those plans and will find a further £3.5 billion of savings from public spending in 2019-20, in line with continuing action to ensure maximum efficiency from every pound of public spending.

3.7 Spending Review 2015 prioritised long-term investment over day-to-day spending. Budget 2016 accelerates its commitment to invest £100 billion in infrastructure by 2020-21. The government is now accelerating its investment plans in priority areas to deliver around £1.5 billion investment in areas such as housing, schools and transport over the next 3 years that would otherwise have taken place at the end of the decade.

3.8 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. As Table 3.A shows, the OBR's forecast indicates

that this target will be met in 2016-17, and the deficit is forecast to remain below 3% over the forecast horizon.

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

	% GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Deficit							
Treaty deficit[a]	5.0	3.9	2.9	2.0	1.1	-0.3	-0.4
Debt							
Treaty debt[b]	87.4	88.9	88.3	87.1	85.6	83.0	80.3

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

Source: Office for Budget Responsibility

4 Quality of public finances

Public spending

Total managed expenditure

4.1 Table 4.A sets out the path for Total Managed Expenditure (TME), Public Sector Current Expenditure (PSCE), and Public Sector Gross Investment (PSGI) to 2020-21.

4.2 The government has decided to take action in response to global economic uncertainty. Budget 2016 sets out that the government will find a further £3.5 billion of savings from public spending in 2019-20, building on the plans set out at Spending Review 2015. To inform future spending decisions and the delivery of these savings, the government is launching an efficiency review. After the public finances move into surplus in 2019-20, total departmental resource spending will grow in line with inflation from 2019-20 to 2020-21. Specific departmental budgets for 2020-21 will be set out at the next Spending Review.

4.3 The government prioritises capital investment, and has set out plans to surpass its commitment to invest £100 billion in the UK's infrastructure by 2020-21. As part of this, the government is accelerating around £1.5 billion of capital investment in its priorities, where faster delivery is possible. This includes funding for housing, transport and flood defence schemes, and will allow the government to make quicker progress.

Table 4.A: Total Managed Expenditure[1]

	£ billion					
	2015-16	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
CURRENT EXPENDITURE						
Resource AME	345.6	356.2	358.9	373.1	382.4	394.3
Resource DEL, excluding depreciation[2]	315.1	316.1	325.2	327.6	327.0	333.6
Ring-fenced depreciation	20.6	21.9	21.9	21.9	21.9	21.9
Public Sector Current Expenditure	**681.2**	**694.2**	**706.0**	**722.6**	**731.4**	**749.8**
CAPITAL EXPENDITURE						
Capital AME	33.3	33.5	32.7	31.9	32.5	35.1
Capital DEL	39.4	44.2	45.9	46.5	46.6	56.2
Public Sector Gross Investment	**72.7**	**77.8**	**78.6**	**78.4**	**79.1**	**91.3**
TOTAL MANAGED EXPENDITURE	**753.9**	**771.9**	**784.6**	**801.0**	**810.4**	**841.1**
Total Managed Expenditure (% GDP)	*40.2%*	*39.7%*	*38.8%*	*38.0%*	*37.0%*	*36.9%*

[1] *Budgeting totals are shown including the Office for Budget Responsibility (OBR) forecast allowance for shortfall. Resource DEL excluding ring-fenced depreciation is the Treasury's primary control total within resource budgets and is the basis on which departmental Spending Review settlements are agreed. The OBR publishes Public Sector Current Expenditure (PSCE) in DEL and AME, and Public Sector Gross Investment (PSGI) in DEL and AME. A reconciliation is published by the OBR.*

[2] *In 2016-17 the Scottish government's block grant has been adjusted by £5.5 billion to reflect the devolution of SDLT and Landfill tax with effect from 1 April 2015 and the creation of the Scottish Rate of Income Tax from 1 April 2016. Adjustments to the block grant from 2017-18 onwards will be reflected once the Fiscal Framework recently agreed with the Scottish government has been implemented.*

Source: Budget 2016

Departmental Expenditure Limits

4.4 Spending Review 2015 announced departmental spending allocations for 2016-17 to 2019-20. Capital budgets were also allocated for 2020-21 but resource budgets were only set for some departments in that year, with the rest to be set at the next Spending Review. Tables 4.B and 4.C show the departmental totals set at Spending Review 2015 with adjustments to reflect policy announcements at Budget 2016.

Devolved administrations

4.5 The devolved administrations' budgets will be adjusted in line with the Barnett formula, as set out in the Statement of Funding Policy. The Northern Ireland Executive, Scottish government and Welsh government will each see increases in their budgets, to be allocated according to their own priorities, as a result of spending decisions taken by the UK government at this Budget.

Other information

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

- paragraphs 2.45 to 2.71 deal with the government's fiscal plan
- paragraphs 2.82 to 2.88 and 2.154 to 2.195 deal with taxes for individuals and business
- paragraphs 2.207 to 2.223 cover ensuring a fair contribution through the tax system

Table 4.B: Departmental Resource Budgets (Resource DEL excluding depreciation)

	£ billion				
	Estimate	Plans			
	2015-16	2016-17	2017-18	2018-19	2019-20
Resource DEL excluding depreciation[1]					
Defence	27.6	27.7	28.5	29.1	30.0
Single Intelligence Account	1.9	1.8	2.0	2.1	2.2
Home Office	10.6	10.7	10.6	10.6	10.6
Foreign and Commonwealth Office	1.7	1.0	1.0	1.0	1.0
International Development	7.2	9.1	9.3	10.7	10.4
Health (inc. NHS)	113.1	115.6	118.7	121.3	124.1
Work and Pensions	6.2	6.1	6.3	5.9	5.4
Education	53.3	54.6	55.9	57.0	57.7
Business, Innovation and Skills	13.1	13.4	12.3	11.7	11.5
Transport	2.0	2.0	2.1	2.2	1.8
Energy and Climate Change	1.4	0.9	1.0	1.0	0.9
Culture, Media and Sport	1.2	1.2	1.2	1.2	1.1
DCLG Communities	2.5	1.5	1.4	1.3	1.2
DCLG Local Government	10.8	9.6	8.2	6.9	6.2
Scotland[2]	25.7	20.6	26.5	26.6	26.7
Wales	12.8	13.0	13.3	13.3	13.4
Northern Ireland	10.0	9.8	9.9	9.9	10.0
Justice	6.8	6.6	6.3	5.8	5.7
Law Officers Departments	0.6	0.5	0.5	0.5	0.5
Environment, Food and Rural Affairs	1.6	1.7	1.6	1.5	1.4
HM Revenue and Customs	3.3	3.6	3.4	3.2	2.9
HM Treasury	0.1	0.2	0.2	0.1	0.1
Cabinet Office	0.6	0.6	0.6	0.5	0.6
Small and Independent Bodies	1.6	1.5	1.5	1.5	1.5
Reserves	0.0	3.6	3.6	3.7	4.2
Adjustment for Budget Exchange[3]	0.0	-0.1	0.0	0.0	0.0
Adjustment for planned efficiency savings	0.0	0.0	0.0	0.0	-3.5
Total Resource DEL excluding depreciation	**315.8**	**316.6**	**325.7**	**328.6**	**327.5**
OBR allowance for shortfall	-0.7	-0.5	-0.5	-1.0	-0.5
OBR resource DEL excluding depreciation forecast	**315.1**	**316.1**	**325.2**	**327.6**	**327.0**

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

2. *The Scottish Government's block grant has been adjusted by £5.5bn to reflect the devolution of SDLT and Landfill tax with effect from 1st April 2015 and the creation of the Scottish Rate of Income Tax from 1st April 2016. Adjustments to the block grant from 2017-18 onwards will be reflected once the Fiscal Framework recently agreed with the Scottish Government has been implemented.*

3. *Departmental budgets in 2016-17 include amounts carried forward from 2015-16 through Budget Exchange, which will be voted at Main Estimates. It is assumed that these increases will be offset at Supplementary Estimates in future years so are excluded from spending totals.*

Source: Budget 2016

Table 4.C: Departmental Capital Budgets (Capital DEL)

	£ billion					
	Estimate	Plans				
	2015-16	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
Capital DEL						
Defence	7.6	7.3	7.5	7.8	8.1	8.7
Single Intelligence Account	0.4	0.4	0.4	0.4	0.5	0.5
Home Office	0.4	0.5	0.5	0.4	0.4	0.4
Foreign and Commonwealth Office	0.1	0.1	0.1	0.1	0.1	0.1
International Development	2.2	2.7	3.2	2.8	3.1	3.6
Health (inc. NHS)	3.7	4.8	4.8	4.8	4.8	4.8
Work and Pensions	0.2	0.3	0.4	0.3	0.2	0.2
Education	4.9	5.2	4.7	4.9	3.8	4.6
Business, Innovation and Skills	2.6	3.2	2.3	1.8	1.6	1.6
Transport	6.0	6.3	7.8	9.1	11.3	12.4
Energy and Climate Change	2.3	2.4	2.5	2.4	2.3	2.8
Culture, Media and Sport	0.3	0.4	0.4	0.4	0.3	0.2
DCLG Communities	3.9	4.5	4.4	4.7	3.6	4.8
DCLG Local Government	0.0	0.0	0.0	0.0	0.0	0.0
Scotland	2.9	3.2	3.2	3.2	3.4	3.5
Wales	1.5	1.5	1.5	1.6	1.7	1.7
Northern Ireland	0.8	1.1	1.1	1.2	1.2	1.2
Justice	0.3	0.7	0.7	0.7	0.4	0.1
Law Officers Departments	0.0	0.0	0.0	0.0	0.0	0.0
Environment, Food and Rural Affairs	0.5	0.6	0.7	0.6	0.5	0.5
HM Revenue and Customs	0.2	0.2	0.2	0.2	0.2	0.2
HM Treasury	-0.7	0.1	0.1	0.1	0.1	0.0
Cabinet Office	0.0	0.0	0.0	0.0	0.0	0.0
Small and Independent Bodies	0.1	0.1	0.1	0.1	0.1	0.1
Reserves	0.0	1.0	1.3	1.3	1.2	1.1
Capital spending not in budgets[1]	0.0	0.0	0.0	0.0	0.0	3.0
Adjustment for Budget Exchange[2]	0.0	-0.3	0.0	0.0	0.0	0.0
Total Capital DEL	**40.3**	**46.2**	**48.1**	**49.0**	**48.9**	**56.2**
Remove CDEL not in PSGI[3]	-3.8	-5.0	-4.9	-3.6	-3.6	-3.6
Allowance for shortfall	-0.9	-2.0	-2.2	-2.5	-2.3	-
Public Sector Gross Investment in CDEL	**35.6**	**39.2**	**40.9**	**42.9**	**43.0**	**52.6**

[1] The uplift in Capital DEL in 2020-21 represents funding not allocated to departments. It is presented net of the OBR's allowance for shortfall in that year.

[2] Departmental budgets in 2016-17 include amounts carried forward from 2015-16 through Budget Exchange, which will be voted at Main Estimates. It is assumed that these increases will be offset at Supplementary Estimates in future years so are excluded from spending totals.

[3] Capital DEL that does not form part of public sector gross investment, including financial transactions in Capital DEL

Source: Budget 2016

5 Institutional features of public finances

The fiscal policy framework

5.1 In recent years, many governments internationally have used fiscal targets as a tool to demonstrate political commitment to fiscal policy goals. Increasingly they have established independent fiscal institutions (IFIs) to assess compliance with these targets, and to increase trust in the forecasts and analysis on which such assessments are usually based.

5.2 In the case of the UK, the Office for Budget Responsibility (OBR) was established in 2010 to "ensure that policy is made on an unbiased view of future prospects, improving confidence in the fiscal forecasts".[1] The government also announced a set of clear fiscal targets to deliver the government's fiscal and debt management objectives, and guide fiscal policy decisions over the medium term.

Office for Budget Responsibility

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 two non-executive members. It is supported by a civil service staff.

5.5 The three 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. The Chancellor re-appointed for a second term of office Steve Nickell in October 2013, Graham Parker in October 2014 and Robert Chote, Chair of the OBR in September 2015.

5.6 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 and in June 2015, Lord Burns was also re-appointed to serve his second term.

Remit of the OBR

5.7 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.

5.8 The Act sets out the main duty of the OBR; 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.

5.9 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 and the main risks and assumptions

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210667/press_01_10.pdf

- an assessment of the extent to which the fiscal and debt management objectives have been, and are likely to be, achieved alongside these forecasts
- an assessment on the accuracy of the previous fiscal and economic forecasts
- an analysis of the sustainability of the public finances

Operating framework

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 This guidance 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.

5.12 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. 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.

5.13 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.

5.14 The Charter requires the government to set out before Parliament its fiscal policy objectives, and the means by which these objectives will be attained ("the fiscal mandate").

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

- ensure sustainable public finances that support confidence in the economy, promote inter-generational 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

5.16 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.

5.17 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 welfare cap). The Charter was modified in March 2014 to include the OBR's responsibilities to assess the government's performance against the welfare cap, which it does once a year alongside the 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.

5.18 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.

5.19 In autumn 2015, a further update to the Charter was made to reflect the fiscal rules of the new government. The fiscal rules approved by Parliament on 14 October 2015 are:

- In normal times, once a headline surplus has been achieved, the Treasury's mandate for fiscal policy is: **a target for a surplus on public sector net borrowing in each subsequent year**
- For the period outside normal times from 2015-16, the Treasury's mandate for fiscal policy is: **a target for a surplus on public sector net borrowing by the end of 2019-20**
- For the period until 2019-20, the Treasury's mandate for fiscal policy is supplemented by: **a target for public sector net debt as a percentage of GDP to be falling in each year**
- If the OBR assess/forecast that a significant negative shock to the UK economy has occurred is occurring or will occur:
    - the normal times surplus target will be suspended, providing greater freedom for the automatic stabilisers to operate. If the shock occurs when we are already outside normal times, the government will revisit its targets to return to surplus
    - the government will be required to set out a plan, with targets, to return to surplus and have those targets approved by Parliament
    - a significant negative shock is defined as real GDP growth of less than 1% on a rolling 4 quarter-on-4 quarter basis

5.20 The updated Charter also sets out that the OBR will produce a fiscal risks statement setting out the main risks to the public finances, including macroeconomic risks and specific fiscal risks. This will be produced at least once every 2 years.

Accounting and statistics

5.21 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.

5.22 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'.

5.23 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 three pieces of analysis included are Chapters 3, 4 and 5 of the OBR's March 2016 '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 2015 '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 and the world economy (from paragraph 3.25);
- sets out our short- and medium-term real GDP **growth forecasts** (from paragraph 3.49) and the associated outlook for inflation (from paragraph 3.56) and nominal GDP (from paragraph 3.70);
- discusses recent developments and prospects for the household, corporate, government and external **sectors of the economy** (from paragraph 3.73); and
- outlines **risks and uncertainties** (from paragraph 3.118) and compares our central forecast to those of selected external organisations (from paragraph 3.120).

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 of our forecast. Together they determine the scope for growth in GDP in the next five years as activity returns to a level consistent with maintaining stable inflation in the long term. GDP growth is an important driver of trends in the overall budget deficit and the path of public sector debt, the measures on which the Government's new fiscal targets are based.

3.3 Estimating the size of the output gap also 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. This was particularly pertinent to the previous Government's fiscal target, which was based on a cyclically adjusted measure of borrowing.

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

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

of potential output and the output gap are based on estimates of national output excluding the small and volatile oil and gas sector. We then add on a forecast for oil and gas production to complete our GDP forecast.

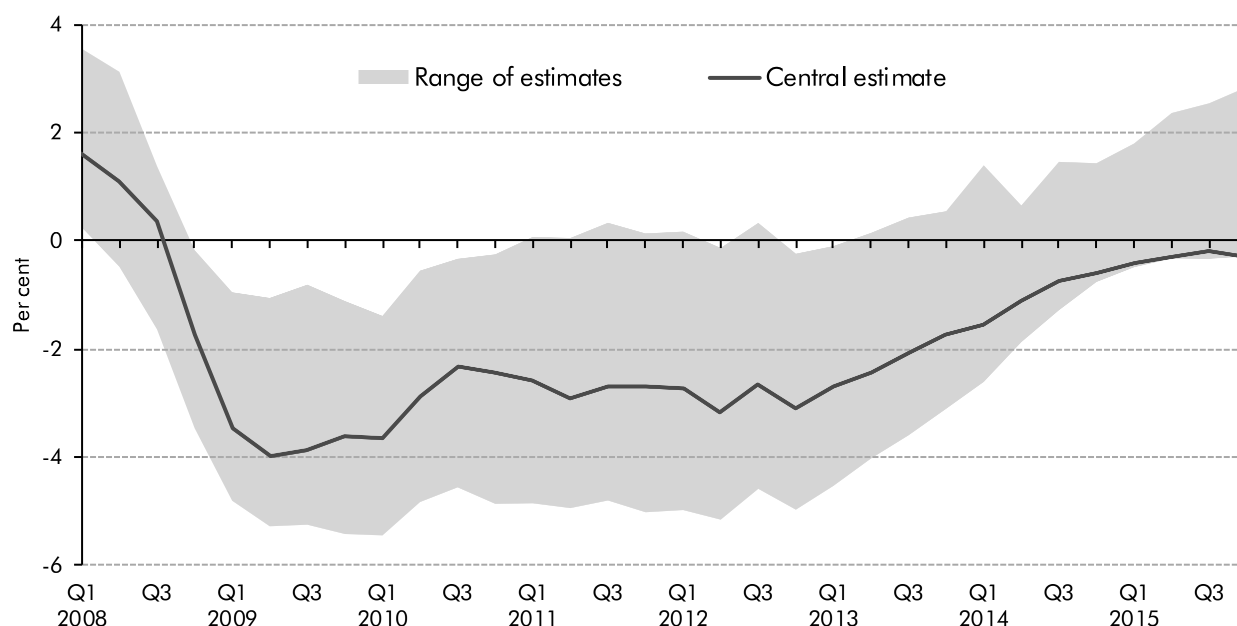
The latest estimates of the output gap

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 avoids the application of judgement. We therefore consider a broad range of evidence when reaching a judgement on spare capacity and the level of potential output that implies.

3.6 Since our December 2014 forecast, we have used estimates of the output gap implied by nine different techniques to inform our judgement. These produce a range, as shown in Chart 3.1 along with our own latest central estimate.[2] Our central estimate is currently close to the bottom of the range, as it has been for the past year. We explain the rationale for this judgement in paragraph 3.13. All these model estimates showed spare capacity increasing during the course of the late 2000s recession, and their dispersion increased. The swathe remained relatively stable, but widely dispersed, until early 2013 when actual growth picked up. Most estimates subsequently tightened and the range narrowed. But it has widened again recently, with estimates varying from -0.3 to +2.8 per cent in the fourth quarter of 2015. Even this may understate the true degree of uncertainty, as such estimates are likely to change as new data become available and past data are revised.

[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*.

Chart 3.1: Range of output gap model estimates



Source: OBR

3.7 The cyclical indicator approaches on which we initially placed greatest weight implied that the output gap began to narrow in 2012, even though growth remained relatively weak – although less weak according to recent data than was reported at the time:

- **'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 2013; and

- **'Principal components analysis' (PCA)** estimates also suggest a significant narrowing of the gap through 2013, but it then remained stable through 2014 before turning positive and rising through 2015.[3]

3.8 The two statistical filters we use that consider output data alone imply that the economy is currently operating close to its potential level, where both had implied a small positive output gap a year ago, as shown in Chart 3.2.

3.9 Chart 3.3 augments the output data with other information. In the latest quarter, these four measures tell an unusually consistent story of the economy operating close to, but just below, its potential level. Taking each in turn:

- **capacity utilisation** indicators suggest firms are operating at levels slightly below their potential level, having been operating above that level for the previous two years;

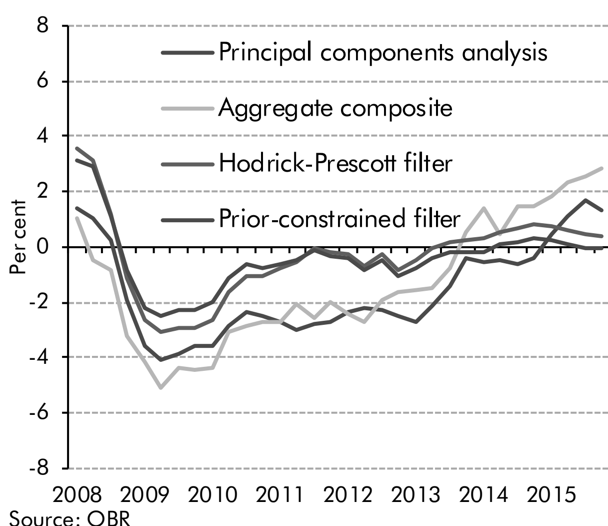
[3] More details on these methodologies are set out in our *Briefing Paper No.2: Estimating the output gap* and in Pybus (2011): *Working Paper No.1: Estimating the UK's historical output gap*.

- **CPI inflation** remains low, which in principle could suggest more slack in the economy. We do not consider that likely, since the weakness in recent months largely reflects lower food and petrol prices, and the lagged effects of past sterling appreciation. The inflation measure that underpins our filters is adjusted for the direct influence of food and oil costs, but in reality only partially so, as changes in these costs also have indirect effects on other prices. This may explain why this measure gives a slightly more negative measure of the output gap;

- the **unemployment** rate has fallen further in the fourth quarter of 2015. Complementing output data with a filter-based structural unemployment estimate (informed by changes in real wages and productivity) would suggest that the output gap has been closing since the end of 2012 and has been very close to zero in the second half of 2015. In recent forecasts, we have placed more weight on measures that capture labour market slack; and

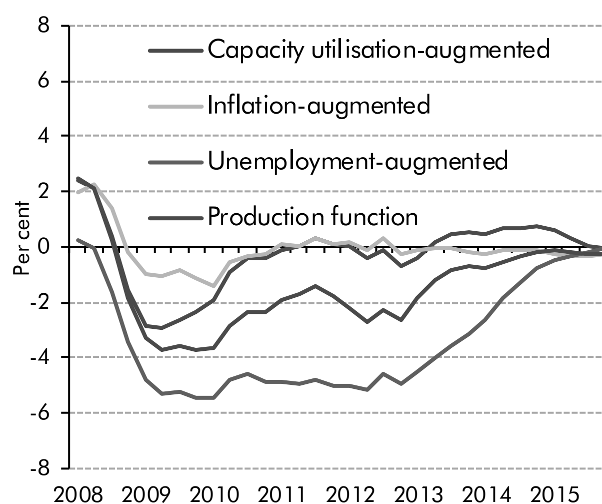
- a **production function** approach, which applies filters to the individual components of production, suggests that output was very close to potential at the end of 2014 but since then the economy has been operating slightly below its potential level. This model suggests the small amount of slack at the end of 2015 was concentrated within total factor productivity in particular.

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



Source: OBR

Chart 3.3: Multivariate filter-based estimates of the output gap



3.10 Output growth (on a non-oil basis) was slightly weaker than we expected in the fourth quarter, at 0.5 per cent compared to the previous quarter and 1.8 per cent compared to the same quarter a year earlier. By contrast, employment growth has remained strong (with the employment level up 0.7 per cent on the quarter and 1.5 per cent over the year). Unemployment and inactivity rates both fell further in the fourth quarter, and average hours worked increased. As a result, hourly productivity – output produced per hour worked in the economy – fell by 1.2 per cent in the fourth quarter, having risen by 0.7 and 0.5 per cent in the second and third quarters. Growth in hourly productivity was therefore close to zero in

the year to the fourth quarter, falling far short of the healthy 1.4 per cent rise assumed in our November forecast.

3.11 Whole-economy productivity growth is influenced by different productivity growth rates in individual sectors and the weight of those sectors in the economy. Table 3.1 shows: a breakdown of the hours worked in different industries; how productivity per hour in those industries related to the whole economy at the beginning of 2008; and how annual productivity growth since then compares with the pre-crisis period. Annual rates of productivity growth have been lower in most industries since 2008 than previously, with the most pronounced falls in financial services and the supply of gas and electricity – both industries with relatively high levels of productivity but a relatively low weight in total hours worked in the economy. Whole economy productivity growth has been affected more by the smaller falls seen in bigger sectors, including manufacturing. In total, productivity has risen at an average annual rate of just 0.1 per cent between 2008Q1 and 2015Q3. Of that 0.9 per cent cumulative rise, almost all is explained by 'within industry' effects, with very little explained by 'between industry' effects as the composition of the economy has changed.[4] The table updates analysis carried out by the Institute for Fiscal Studies (IFS) in its 2013 *Green budget*, with similar results.[5]

Table 3.1: Productivity growth by industry

	Per cent				
	Hours		Productivity (Output per hour)		
	Hours share in 2008Q1	Percentage change: 2008Q1 to 2015Q3	2008Q1 relative to whole economy	Annual change: 1994Q1 to 2008Q1	Annual change: 2008Q1 to 2015Q3
Whole economy excl. real estate	**100.0**	**4.1**	**100.0**	**1.9**	**0.1**
Government services	22.7	1.9	89.2	0.2	-0.2
Wholesale and retail trade; repair of motor vehicles and motor cycles	15.3	-0.2	81.6	1.6	1.6
Manufacturing	10.9	-1.0	112.2	3.1	0.4
Construction	8.6	-0.1	87.2	0.5	-0.4
Administrative and support service activities	7.6	0.9	61.3	1.3	2.5
Professional, scientific and technical activities	7.8	1.4	98.9	3.5	0.5
Transportation and storage	5.5	-0.3	99.1	2.8	0.3
Accommodation and food service activities	5.4	0.7	55.2	1.0	-0.8
Arts, entertainment, recreation and other services	4.8	0.3	97.5	0.5	0.3
Information and communication	4.5	0.5	138.3	4.3	1.3
Financial and insurance activities	4.2	-0.1	217.1	4.0	-1.0
Agriculture, forestry and fishing	1.6	0.0	51.2	3.6	0.7
Water supply, sewage etc.	0.5	0.1	253.5	1.7	-1.8
Electricity supply, gas supply etc.	0.4	0.1	412.1	5.0	-5.2
Mining and quarrying	0.3	0.0	1201.1	-2.4	-5.9

[4] The within-industry contribution (0.8 percentage points) is calculated using the 2008Q1 hours share and the change in productivity between the two periods, whereas the between-industry contribution (0.1 percentage points) is calculated using the change in hours share between the two periods and the 2008Q1 level of productivity.
[5] Institute for Fiscal Studies, *Green budget*, February 2013.

3.12 The latest evidence provides a mixed picture for the output gap. Strong employment growth and falling unemployment implies little remaining spare capacity in the labour market. By contrast, the sharp drop in hourly productivity in the final quarter of 2015 suggests some spare capacity opening up within firms, although it is hard to explain why firms would be hiring at such a rapid pace if that hiring was generating spare capacity.

3.13 Considering the balance of evidence, we have judged that the output gap was -0.3 per cent of potential output in the fourth quarter of last year, narrower than the -0.7 per cent we expected in November. This is towards the lower end of the broad range of estimates illustrated in Chart 3.1, but closer to those to which we attach more weight. We do not believe it would be central to assume the output gap is currently positive since – despite the working-age employment rate having risen to its highest level since at least 1971 – broader inflationary pressures remain subdued. We have attributed most of the -0.3 per cent gap to productivity lying below its potential and some to average hours lying below potential, with offsetting effects from the employment rate being above its assumed sustainable rate.

3.14 A smaller estimate of the output gap – coupled with weaker actual growth – implies that potential output has grown slightly more slowly over recent quarters than we thought in November. But actual output – and therefore also potential output – is subject to revision. If actual output growth is revised up, as has been the case on average over the recovery to date, then potential output would be correspondingly higher, and vice versa.

3.15 Charts 3.4 and 3.5 compare our central output gap estimates for 2015 and 2016 to those produced by other forecasters, as set out in the Treasury's March *Comparison of independent forecasts*. The average estimate is -0.5 per cent in 2015 and -0.3 per cent in 2016, slightly wider than our estimates of -0.3 and -0.2 per cent for those years.

Chart 3.4: Estimates of the output gap in 2015

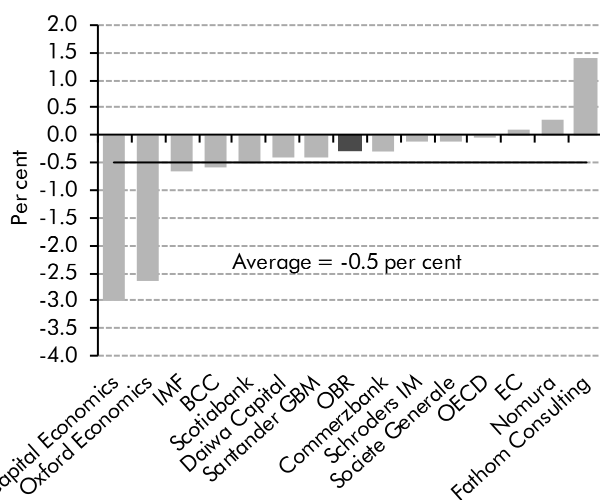
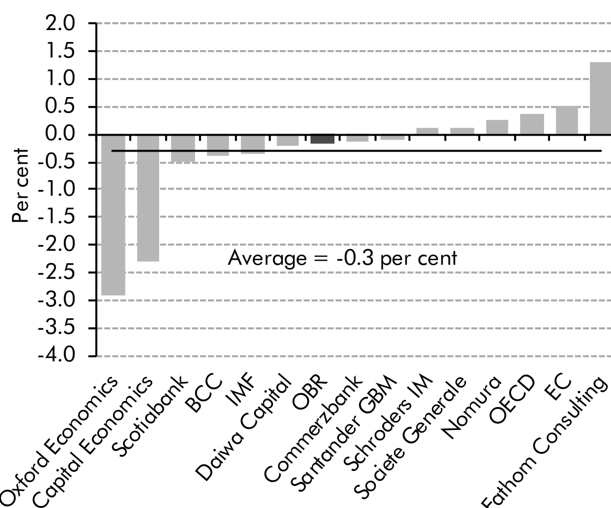


Chart 3.5: Estimates of the output gap in 2016

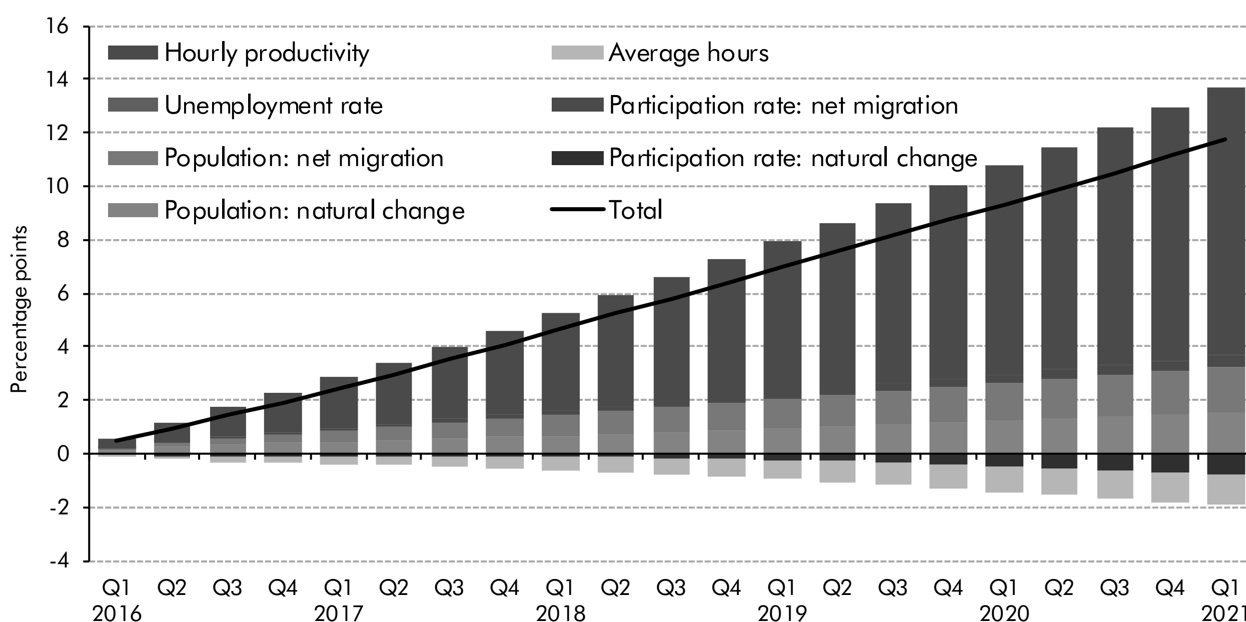


Source: HM Treasury, plus updates where known

The path of potential output

3.16 A small negative output gap implies that actual output can grow slightly faster than potential output over the coming quarters without generating inflationary pressure. But of far greater importance is the path of potential output itself. In November, we forecast a gradual strengthening of potential output growth over the forecast period and that remains our central judgement. But as Chart 3.6 shows, 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, where the latest evidence on actual productivity growth has again been disappointing, particularly in contrast to the buoyant productivity growth seen in the middle of last year. We also expect smaller positive contributions to potential output growth over the next five years from population growth, while average hours worked are expected to trend down over time.

Chart 3.6: Contributions to potential output growth from 2015Q4



Note: We implicitly assume that, conditioned on age and gender, migrants are as likely to be employed as the broader population.
Source: OBR

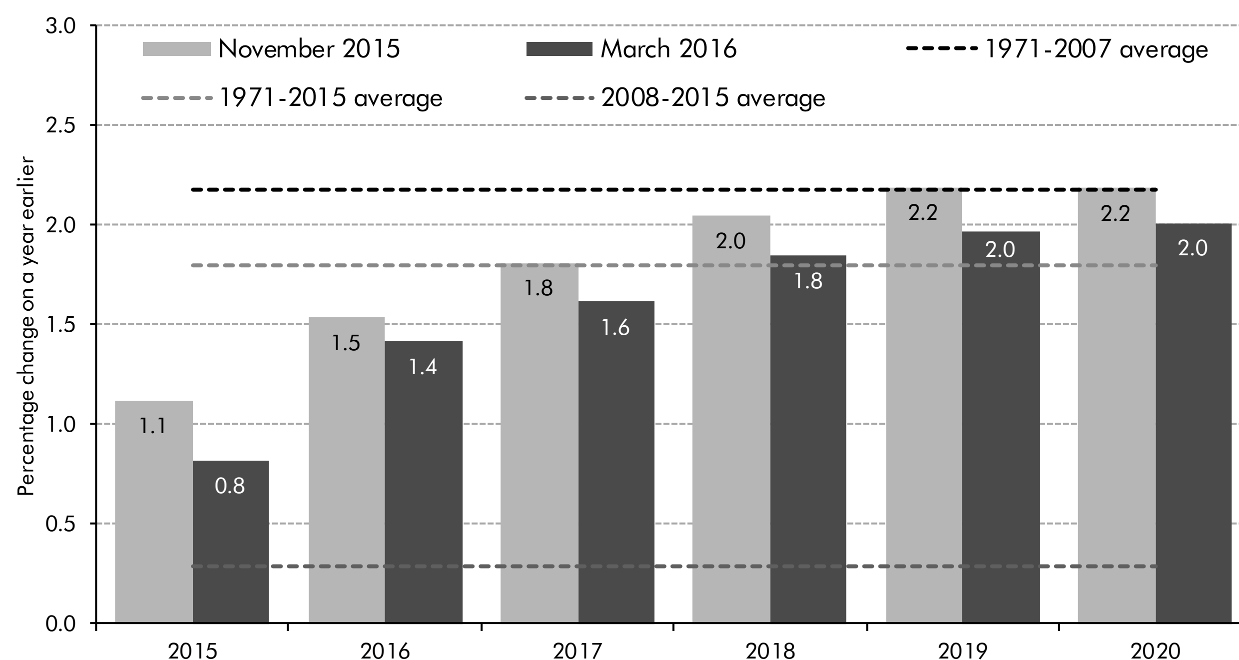
3.17 Following two quarters of productivity growth picking up, the previously familiar pattern of the labour market outperforming and productivity underperforming our forecast has strongly reasserted itself. With the mid-2015 pick-up in productivity growth having faltered, the most significant change to our forecast for potential output growth since November has been to revise down our assumption for trend hourly productivity growth – the rate at which output per hour worked could grow sustainably – over the coming five years by an average of 0.2 percentage points a year. Cumulated over five years, that represents a material downward revision to the level of potential output by 2020, but it is relatively small in the context of the downward revisions that we and most forecasters have felt it necessary to make during the post-crisis period. As Box 3.1 describes, the downward revisions we have made to our estimates of trend productivity growth in the UK over the last five years are very similar to those made by the Congressional Budget Office for the US over the same period.

3.18 Chart 3.7 presents our assumptions for trend hourly productivity growth from November and this forecast. In November, as in all our recent forecasts, we based our assumption on trend productivity growth rising from current rates back to the pre-crisis historical average of 2.2 per cent by the end of the forecast period. This judgement was consistent with assuming that whatever has been holding back productivity growth in the post-crisis period – particularly the slow healing of the financial system – will fade over the coming five years. As it has proved difficult to quantify the sources of recent weakness in trend productivity, it has been equally difficult to judge when and by how much productivity growth will pick up.

3.19 Given the latest disappointment in productivity growth, we now assume that trend productivity growth rises steadily to 2.0 per cent by 2020 rather than to 2.2 per cent. In doing so, we are no longer assuming that the pre-crisis historical norms will fully reassert themselves within the forecast horizon. That said, at 1.8 per cent a year on average from 2016 to 2020, this is still well above the 0.8 per cent a year average we estimate for trend productivity over the past three years in which the recovery has taken hold.

3.20 In reaching a view on the outlook for productivity growth over the medium and longer term, all forecasters – whatever methodology they use – in effect have to decide how much weight to place on the recent period of weak productivity performance and how much on the earlier period of stronger performance. As the period of weak performance lengthens, it seems sensible to put slightly more weight on that as a guide to the future, although this judgement is of course highly uncertain and has to be revisited in each forecast we make.

Chart 3.7: Trend productivity growth forecasts and historic averages for actual productivity growth

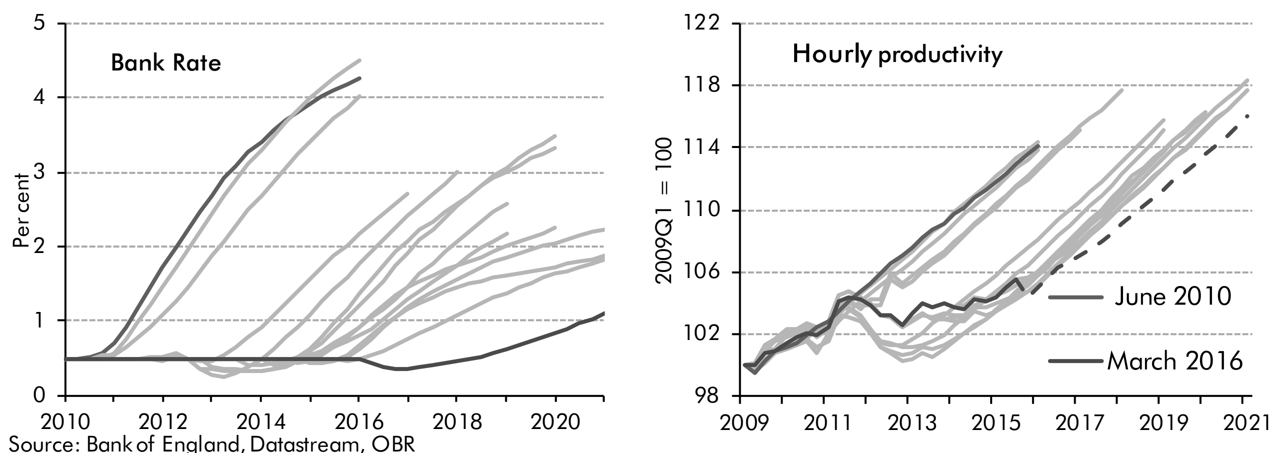


Source: OBR

3.21 Chart 3.8 illustrates how the successive downward revisions to our productivity growth forecasts have been mirrored by successive outward shifts in market expectations for Bank

Rate rises. While there will have been many factors influencing each of these trends, to some extent both will have been driven by repeated disappointment in actual productivity growth and the consequent downward revisions to growth expectations.

Chart 3.8: Successive market expectations for Bank Rate and OBR forecasts for hourly productivity growth



Source: Bank of England, Datastream, OBR

3.22 Turning to other components of potential output, we expect that the long-term decline in average hours will reassert itself as productivity recovers. We also assume that population growth will slow in line with the ONS's current principal population projections.

3.23 In November, we refined our methodology for modelling the trend participation rate to include the implications of an ageing population and state pension age increases from year to year using the cohort model that informs our long-term projections.[6] This change in methodology and updated outturn data implies that the participation is stable until 2019 before declining in the final year of the forecast as the proportion of older people with lower-than-average participation rates increases.

[6] Annex A of our July 2014 *Fiscal sustainability report* discusses our longer-term approach to labour market modelling in more detail.

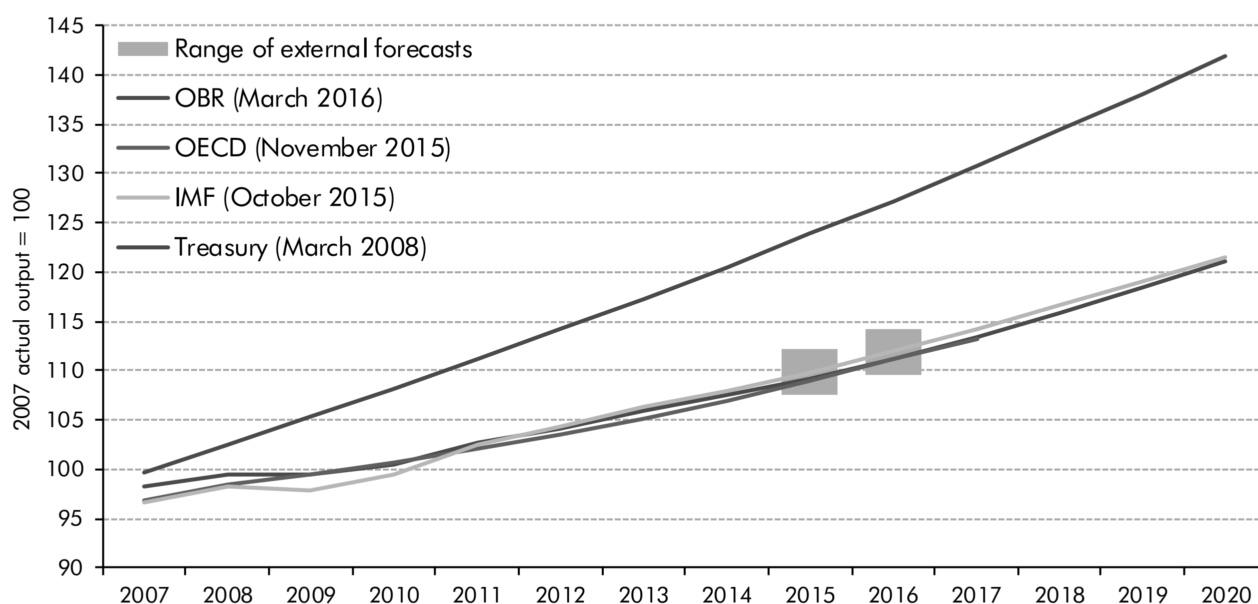
Table 3.2: Potential output growth forecast

	Percentage change on a year earlier, unless otherwise stated				
	Potential productivity[1]	Potential average hours	Potential employment rate[2]	Potential population[2]	**Potential output[3]**
2015	0.8	0.0	0.0	0.6	1.5
2016	1.4	-0.1	-0.1	0.7	1.9
2017	1.6	-0.2	0.0	0.6	2.0
2018	1.8	-0.2	0.0	0.6	2.2
2019	2.0	-0.2	-0.1	0.6	2.2
2020	2.0	-0.2	-0.2	0.6	2.2
Cumulative growth (per cent) from 2014 to 2020					
November forecast	11.4	-1.0	-0.1	3.7	14.2
March forecast	10.1	-1.0	-0.4	3.8	12.6
Change	**-1.3**	**0.0**	**-0.2**	**0.0**	**-1.6**
of which: 2015	-0.3	0.0	0.0	0.0	-0.3
of which: 2016 to 2020	-1.0	0.0	-0.2	0.0	-1.3

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

3.24 Our latest forecast assumes that potential output in 2015 was around 11.9 per cent lower than an extrapolation of the Budget 2008 forecast and that it will be 14.6 per cent below that extrapolation by 2020. Even the most optimistic external assessments of potential output continue to lie well below the pre-crisis trend implied by Budget 2008.

Chart 3.9: Potential output forecasts



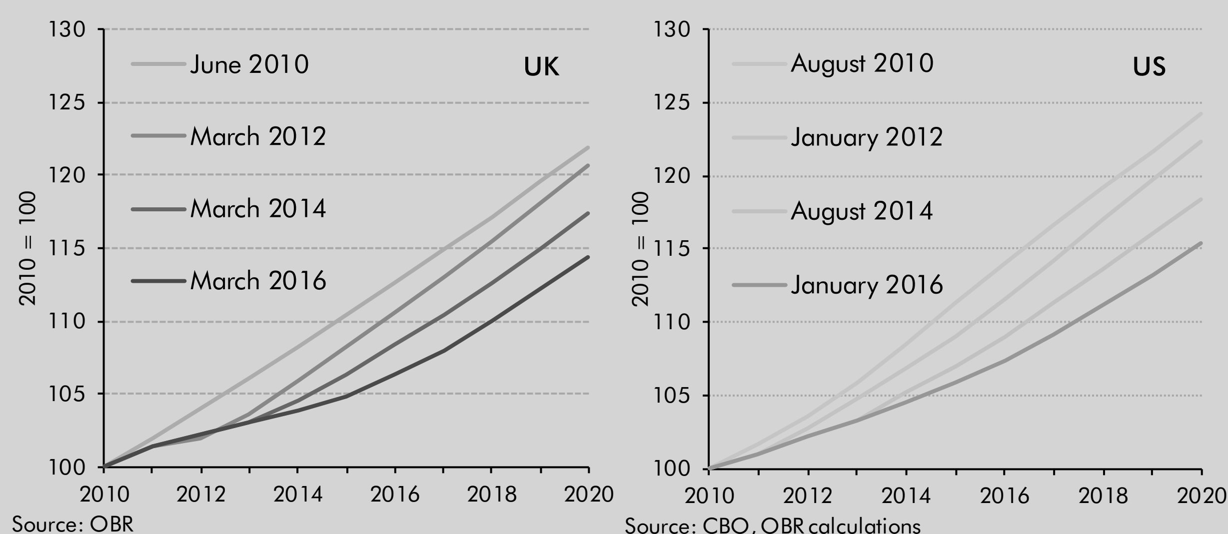
Note: IMF forecasts for potential output are inferred by combining GDP and output gap forecasts.
Source: HM Treasury, IMF, OECD, OBR

Box 3.1: Post-crisis revisions to potential output and productivity in the UK and US

Over the long run the vast majority of output growth is driven by productivity growth, and so the judgement we take on productivity is critical in assessing the likely path of output. That judgement is subject to considerable uncertainty. As discussed in paragraphs 3.17 to 3.19, we have revised down our forecast for trend or potential productivity – the amount of output that the economy could produce sustainably per hour worked – materially since November, just as we did in November 2011. But productivity has also disappointed in many other major advanced economies in recent years, leading other forecasters to revise down their expectations.

Chart A compares different vintages of our five-year forecasts for trend productivity in the UK (extrapolated for the earlier forecasts) to the Congressional Budget Office's (CBO) 10-year forecasts for the US. Since our first forecast in June 2010 – and taking into account the judgement we have made in this forecast – we have revised down our forecast for cumulative trend productivity growth between 2010 and 2020 by 7½ percentage points, from 22 to 14½ per cent. Much the same has happened in the US, where the CBO has reduced its forecast over the same period by 9 percentage points, from 24½ to 15½ per cent.

Chart A: Vintages of UK and US trend hourly productivity forecasts



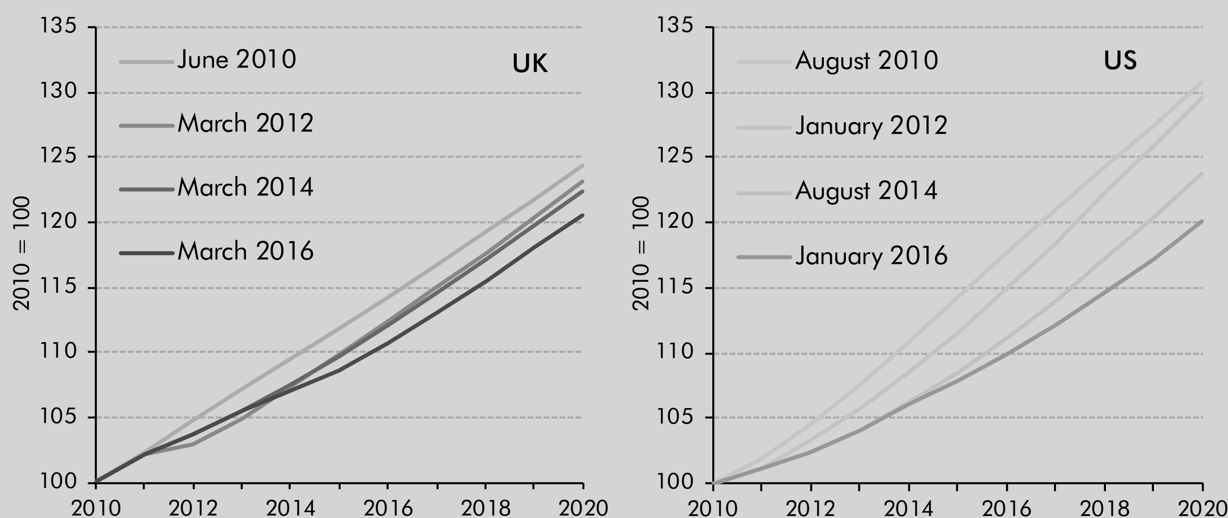
Source: OBR

Source: CBO, OBR calculations

Note: UK trend productivity is defined as potential non-oil GVA divided by potential hours worked, while US trend productivity is defined as potential non-farm business output divided by potential hours worked in the non-farm business sector.

As productivity is the key driver of output growth, these downward revisions feed through to lower forecasts for potential output growth. Recent vintages of these forecasts are shown in Chart B. Our potential output growth forecasts for the UK have been revised down by 4 percentage points, rather less than the revision to trend productivity. The CBO's potential output forecasts for the US have been revised down by 11 percentage points, slightly more than the revision to trend productivity. Looking at the output data in per capita terms (per adult, aged 16+) tells a similar story, with the UK and US having seen downward revisions over the period of 5 and 11 percentage points respectively.

Chart B: Vintages of UK and US potential output forecasts



Source: OBR

Source: CBO, OBR calculations

Note: UK trend output is defined as potential non-oil GVA, while US trend output is defined as potential non-farm business output.

Table A decomposes the changes in our and the CBO's potential output assumptions over the decade to 2020. It shows that the reason for potential output growth being revised down less than trend productivity in the UK but more than trend productivity in the US is largely due to developments in the labour market. In particular, we estimate the trend participation rate will have been flat across the decade, despite an ageing population. In the US, the CBO expects it to have fallen significantly. Population growth has boosted potential output by more than expected in both countries, with net migration being the main factor in the UK.

Table A: Contributions to potential output growth between 2010 and 2020

	Percentage growth between 2010 and 2020, unless otherwise stated					
	Potential productivity[1]	Potential average hours	Potential participation rate[2]	Structural unemployment rate[2,3]	Potential population[2]	Potential output growth[4]
OBR estimates for the UK						
June 2010	21.9	-2.0	-1.8	0.0	5.8	24.1
March 2016	14.4	-1.0	0.0	-0.2	6.7	20.6
Change	**-7.5**	**0.9**	**1.8**	**-0.2**	**0.9**	**-3.5**
OBR calculations based on CBO estimates for the US						
August 2010	24.3	-0.8	-3.0	0.0	9.5	30.8
January 2016	15.4	-0.6	-5.6	0.3	10.6	20.0
Change	**-8.9**	**0.2**	**-2.6**	**0.3**	**1.1**	**-10.8**

[1] Output per hour.
[2] Corresponding to those aged 16 and over.
[3] Percentage point growth between 2010 and 2020.
[4] Changes may not sum due to rounding and interaction effects.
Note: UK and US trend output is defined as in Chart B. Non-farm business employment forecasts are not available for the US, and so we have assumed that non-farm business employment grows at the same rate as whole economy employment.

Key economy forecast assumptions

3.25 Our economic forecasts are conditioned on a number of assumptions. Among them, we assume that domestic and international interest rates, the exchange rate, equity prices and oil prices move in line with market expectations, taking the 10-day average to 25 February 2016. We also base our forecasts on the Government's current stated policies for taxes, public spending and financial transactions, as Parliament requires of us. This is in contrast to some external forecasts, in which the forecasters may assume that these policies will change. The risks to our forecasts are discussed later in the chapter.

Monetary policy and credit conditions

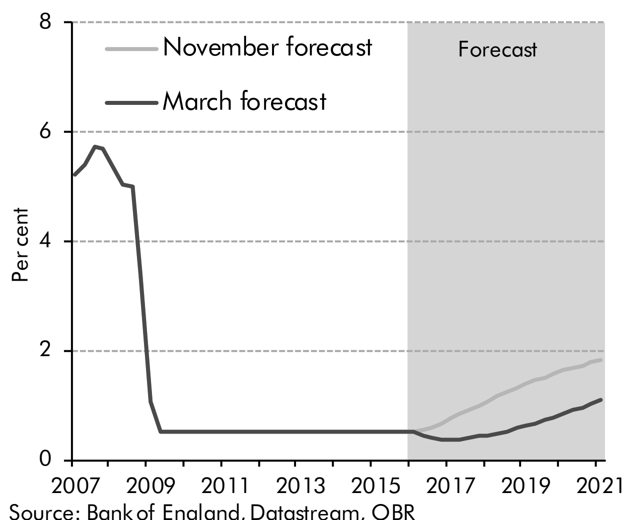
3.26 Our forecast assumes that the Bank of England will try to bring inflation back to target over its forecast horizon, consistent with the remit the Chancellor has set the Monetary Policy Committee (MPC). In its February 2016 *Inflation Report*, the MPC forecast – on the basis of market interest rate expectations at the time – that CPI inflation would reach 2.05 per cent by the beginning of 2018 and 2.25 per cent by early 2019. In its latest *Monetary Policy Summary* the Bank of England has said that "*the MPC judges it more likely than not that Bank Rate will need to increase over the forecast period to ensure inflation remains likely to return to the target in a sustainable fashion*".

3.27 Market expectations of Bank Rate have fallen significantly since November. They are below the current rate of 0.5 per cent for the next two years, do not reach 0.75 per cent until 2019 (a full decade after Bank Rate was initially cut to 0.5 per cent) and only reach 1.1 per cent by the end of our 5-year forecast period. As we have used market expectations throughout the forecast period, our forecast is consistent with Bank Rate being reduced below 0.5 per cent for some of the next two years. We consider that to be consistent with the Bank of England's published guidance on the possibility of Bank Rate cuts if the Monetary Policy Committee considered that necessary in setting policy to meet its inflation target.[7] (Chart 3.8 above shows a number of previous occasions when Bank Rate expectations fell materially below 0.5 per cent for a period, but all preceded the guidance on which we have based our latest assumption.)

3.28 Gilt rate expectations have also fallen and global bond yields are lower (Chart 3.11). These developments are all consistent with market participants downgrading their expectations of future growth prospects.

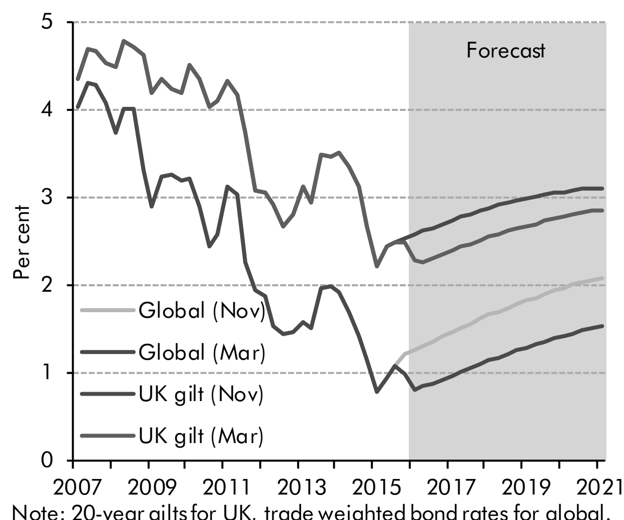
[7] For example, the February 2015 *Inflation Report* stated that "*…there are risks to the inflation outlook in both directions. Were downside risks to materialise, market expectations of the future path of interest rates could adjust to reflect an even more gradual and limited path for Bank Rate increases than is currently priced. The Committee could also decide to expand the Asset Purchase Facility or to cut Bank Rate further towards zero from its current level of 0.5%. The scope for prospective downward adjustments in Bank Rate reflects, in part, the fact that the United Kingdom's banking sector is operating with substantially more capital now than it did in the immediate aftermath of the crisis. Reductions in Bank Rate are therefore less likely to have undesirable effects on the supply of credit to the UK economy than previously judged by the MPC. Were upside risks to materialise, it would be appropriate for Bank Rate to increase more quickly than embodied in current market yields but the likelihood is that those increases would still be more gradual and limited than in previous tightening cycles. The MPC stands ready to take whatever action is needed, as events unfold, to ensure inflation remains likely to return to target in a timely fashion.*"

Chart 3.10: Bank Rate



Source: Bank of England, Datastream, OBR

Chart 3.11: Global bond yields



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

Macroprudential policy

3.29 Since 2013, the Bank of England's Financial Policy Committee (FPC) has held responsibility for "*the identification of, monitoring of, and taking of action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system*". In its latest *Financial Stability Report*, the FPC judged that the risks to financial stability had increased since July, but did not believe the risk level to be 'elevated'.

3.30 Buy-to-let lending has been driving the growth in the UK mortgage market, having risen more strongly than owner-occupier lending since 2008. The FPC has said it will remain vigilant to competition pressures leading to a fall in underwriting standards in the buy-to-let market and has recommended that it be granted powers of direction over loan-to-value and interest coverage ratio limits. The consultation period on these tools closed on 11 March 2016. The Government has recently announced some policies that are likely to affect the buy-to-let market. For example, in November's Autumn Statement, it announced a 3 per cent stamp duty land tax surcharge on purchases of second properties worth over £40,000, which we assume will reduce the incentive to purchase second homes, including buy-to-let.

3.31 The FPC has previously implemented recommendations including that mortgage lenders should not extend more than 15 per cent of new owner-occupier mortgages at loan-to-income multiples at or greater than 4.5, and that lenders should apply an interest rate stress test of 3 percentage points above the rate at origination. The FPC has also introduced a framework that assigns a minimum leverage ratio of 3 per cent for UK financial institutions, supplemented by an additional component that is set in relation to the economic and financial climate at the time and a further buffer for firms that are considered to be of systemic importance. At its most recent meetings, the FPC made no new recommendations with regard to macroprudential policy.

Credit conditions

3.32 Having narrowed steadily up to the end of 2014, bank funding spreads widened over the course of 2015, although they remain much narrower than between 2010 and 2013. Despite this, average mortgage rates fell steadily through the course of 2015, largely reflecting falls in average fixed rates as maturing contracts moved on to lower rates. We expect the effective mortgage rate to continue falling in the near term as maturing contracts are re-set. Mortgage rates are expected to begin rising from the end of 2017, as the gradual increase in Bank Rate offsets a narrowing in margins. Our assumptions about the evolution of margins and funding spreads are little changed from November, so a lower expected path for Bank Rate means that effective mortgage rates are also expected to be lower than we assumed in November.

3.33 Net mortgage lending to households picked up steadily through 2015 and we expect mortgage debt to continue to rise over the forecast period as house prices grow more quickly than incomes and the share of cash transactions falls back towards its historical level. Unsecured lending grew strongly in 2013 and 2014 – supported by lending for car purchases – and recent Bank of England data suggest that consumer credit continued to grow strongly through 2015 and at the start of 2016, with unsecured net lending to individuals increasing by 9.1 per cent in the year to January. We expect the ratio of unsecured debt to income to continue to rise steadily over the forecast period as consumption growth outpaces the growth of household disposable income. Further discussion of our household debt forecast can be found in paragraphs 3.88 to 3.90.

3.34 Bank lending to both large businesses and small and medium-sized enterprises (SMEs) has generally contracted, on an annual basis, over the past few years. The effect of restricted credit availability has been more severe for SMEs, as they are unable to raise funding though non-bank sources, such as the issuance of bonds or equity. While net lending to large businesses continued to contract on an annual basis in 2015, there was some evidence of an easing in credit conditions for SMEs towards the end of the year, with annual net lending growth turning positive from September.

Fiscal policy and Budget measures

3.35 The uneven path of Budget giveaways and takeaways over the next five years has meant that the overall pace of fiscal tightening – which in November was relatively smooth and diminishing over time – is set to pick up slightly over the next three years, then dramatically in 2019-20 before slowing abruptly in 2020-21. The fiscal multiplier framework that we use to estimate the overall effect of changes in fiscal policy on the economy was explained in Box 3.2 of our July *EFO*. In Box 3.2 below, we describe how our current forecast has been affected by the fiscal and other policy changes announced in this Budget that we consider sufficiently material to warrant an explicit adjustment to our economy forecast.

3.36 The Government has announced that a referendum will be held on 23 June to determine whether the UK should remain a member of the European Union (EU) – and the Government is arguing that it should. Parliament has told us to prepare our forecasts on the

basis of the current policy of the current Government and not to consider alternatives, so our central forecast is conditioned on that assumption. Box 3.4 discusses external views of some of the risks and uncertainties associated with the referendum and possible outcomes.

Box 3.2: The economic effects of policy measures

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

The Government has loosened **fiscal policy** in the short term, reflecting net tax reductions and increases in Departmental Expenditure Limits (DELs), both current and capital. The Government has then increased the pace of fiscal tightening significantly in 2019-20, accounted for by net tax increases and lower spending on welfare, public services and capital investment. To reflect these changes in our economy forecast we have applied the same 'multipliers' we have used in previous forecasts. These are larger the shorter the period between a policy being announced and implemented. They imply a 0.1 percentage point boost to real GDP growth in 2017-18 and 0.1 percentage point reductions in both 2018-19 and 2019-20. These effects are sufficient to push the economy slightly above its potential level in 2017 and 2018 and slightly below in 2019, with the output gap closing by the end of 2020. The Government adjusted its plans for capital investment in 2020-21 after we closed our economic forecast. At this horizon we would assume that the multiplier has tapered to zero, so incorporating this adjustment would have no effect on our forecast for real GDP, although it would have had a small effect on the composition of expenditure.

The Budget includes two measures that are expected to affect the cost of capital faced by firms and therefore **business investment** – a reduction in the corporation tax rate to 17 per cent in 2020-21 and restrictions on corporate interest deductibility. We also adjusted our forecast to reflect one additional measure, but the Government informed us that it would not be going ahead after our final economy forecast had been closed. As a result, our business investment forecast is around 0.5 per cent higher in 2020-21 than would be consistent with the final policy package announced in the Budget. The net effect of the other two measures was small.

The Government has announced that **termination payments** over £30,000 will be subject to employer National Insurance Contributions. In the near term we expect the additional cost to employers to be reflected in lower wages and profit margins, with the majority of the cost passed through to wages by the end of the forecast period. This implies a reduction in total wages and salaries of 0.1 per cent by 2020-21.

The Budget includes a number of policies that are likely to affect **housing associations'** finances. They include changes to 'pay to stay' (which is to be made voluntary rather than mandatory for housing associations, while rents above income thresholds are to be subject to a taper rather than a cliff edge); a one-year deferral of the capping of social sector rents in line with local housing allowance eligible rents; and a one-year deferral of the 1 per cent reduction in social rents for supported housing. We expect these measures to affect housing associations' future housebuilding decisions, reducing total residential investment by 0.7 per cent by 2020-21.

The Government has announced the introduction of a **'lifetime ISA'** for the under-40s. Contributions into the lifetime ISA will be made out of taxed income, then matched and not subject to tax when accessed, with an annual contribution limit of £4,000. Holders of lifetime ISAs will be allowed to make 100 per cent withdrawals for first-time house purchases up to £450,000. We think this is more likely than not to lead to higher demand for the relatively fixed supply of housing in the UK, and so to higher prices. We have therefore added 0.3 per cent to the level of house prices by the end of the forecast, although the effect of this policy is highly uncertain.

The Government has announced a number of policies that we expect to have an impact on **inflation**. The implementation of a soft drinks industry levy has the largest effect, and is expected to add around a quarter of a percentage point to CPI growth in 2018-19. We have also made small adjustments for several other policies announced in this Budget. The effects of these measures are small and broadly offsetting, and taken together imply almost no change to our CPI forecast. Measures which are expected to slightly increase CPI inflation across the forecast period include increases in tobacco duty and insurance premium tax, and measures to combat VAT fraud. Other policies are expected to reduce CPI inflation slightly, including the freezes to fuel and most alcohol duties. The replacement of the carbon reduction commitment with a higher climate change levy is also expected to lower inflation: while the net effect of these energy policies is to increase costs for medium sized companies, they reduce costs for large companies that make up a higher proportion of turnover. We expect this fall in costs to be passed through to consumers.

World economy

3.37 Global financial markets have been volatile over the past few months, with stock markets and commodity prices falling sharply and market expectations of future monetary tightening pushed back considerably. Market indicators of volatility also increased at the start of 2016. Real economy indicators have not been as weak as financial markets, but there have been downward revisions since our November forecast.

3.38 World GDP is estimated to have increased by 3.1 per cent in 2015, in line with our November forecast. We now expect world GDP to grow by 3.3 per cent in 2016, down from 3.5 per cent expected in November. We have also revised down our forecast for world GDP growth in 2017 and 2018. Thereafter, it is unchanged from November.

3.39 In the fourth quarter of 2015, euro area GDP was up 1.6 per cent on a year earlier, the same rate as the previous two quarters. It was up 1.3 per cent in Germany, 1.4 per cent in France and 1.0 per cent in Italy, while Spain saw much stronger growth of 3.5 per cent. Euro area GDP is estimated to have increased by 1.6 per cent in 2015 as a whole, slightly higher than our November forecast. The latest data were released after we had closed our forecast for the global economy. From 2016 onwards, our forecast for GDP growth in the euro area is little changed since November.

3.40 Deflation in the euro area remains a risk to the global and UK outlook. Euro area inflation fell to -0.2 per cent in February, having been just above zero since September. Core inflation was also lower in February, falling to 0.7 per cent. Unemployment fell to 10.3 per cent in January, continuing a path of steady decline from a high level. The European Central Bank announced a loosening of monetary policy after we closed the forecast, in order to support the euro area economy in a manner that it deems consistent with its inflation target. This included interest rate cuts, taking the interest rate on the deposit facility to -0.4 per cent, as well as an expansion to its quantitative easing programme, increasing the quantity and types of bonds that can be bought.

3.41 US GDP is estimated to have increased by 2.4 per cent in 2015 as a whole, the same rate as estimated for 2014. US GDP grew by 1.0 per cent in the second quarter of 2015, then by 0.5 per cent in the third quarter and 0.3 per cent in the final quarter. The slowing GDP growth in the final quarter was a result of lower contributions from private consumption and government spending. Private investment, private inventories and net trade also acted as a drag on GDP growth in the final quarter. Unusually adverse weather conditions at the start of 2016 may also reduce GDP growth in the first quarter of 2016, as in 2015.

3.42 China's GDP is estimated to have grown by 6.9 per cent in 2015 as a whole, down from 7.3 per cent in 2014. Real economy indicators and external forecasts suggest that real GDP growth will slow further in 2016 and 2017. In its January 2016 *WEO Update*, the IMF identified a "*sharper-than-expected slowdown along China's needed transition to more balanced growth*" as a potential downside risk to global growth.

World trade and UK export market growth

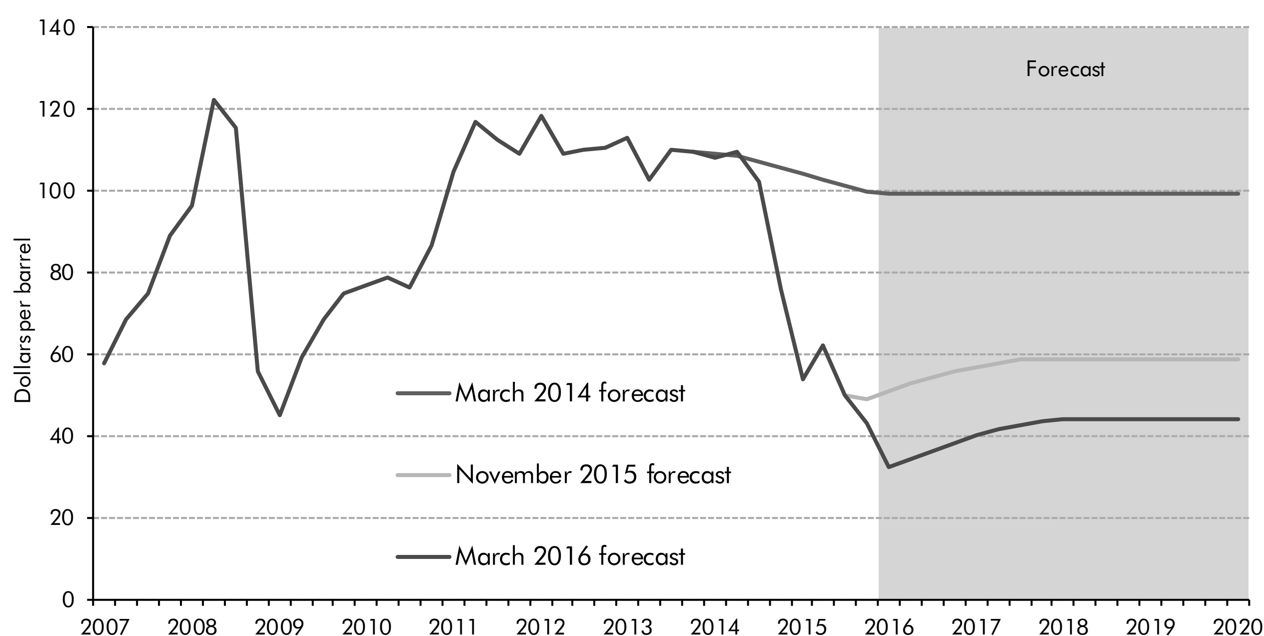
3.43 The latest global trade data have been weaker than we expected in November. We now estimate that world trade in goods and services grew by 2.4 per cent in 2015, lower than we forecast in November. In our November *EFO*, we forecast that trade growth would be lower over the forecast period than the latest IMF forecast available at the time. That was based on a judgement that the trade intensity of world GDP growth (i.e. the ratio of world trade growth to world GDP growth) would increase at a slower rate than was implied by the IMF forecast. We have not altered that judgement, which means that lower expected world GDP growth between 2016 and 2018 has led to a downward revision to world trade growth in those years. Since November, the IMF has revised down its forecast for world trade growth in 2016 and 2017. These changes were driven by downward revisions to trade in emerging markets, with a smaller downward revision to trade in advanced economies.

3.44 UK export markets are estimated to have grown by 4.1 per cent in 2015, in line with our November forecast. We have revised down UK export markets growth between 2016 and 2018, reflecting the downward revision to world trade. The downward revision to world trade growth in our forecast – informed by the IMF's revisions – is concentrated in emerging markets, which have a lower weight in UK export markets. That means that while UK export markets growth has been revised down since November, the cumulative change is smaller than the downward revision to world trade. We expect UK export markets to grow by 4.5 per cent a year in 2019 and 2020, unchanged from November.

Oil prices

3.45 One of the biggest changes to the market-derived assumptions we use in our forecasts since November relates to oil prices. In the 10 days to 25 February, oil prices averaged $33.7 per barrel, 29 per cent lower than in our November forecast (Chart 3.12). The fall since we closed our March 2014 forecast has been 69 per cent. By the beginning of 2020, the differences are slightly smaller at 25 per cent lower than the November assumption and 56 per cent lower than the March 2014 assumption. This reflects the change from a downward sloping futures curve in March 2014 to moderately upward sloping curves in November and now. We use the first two years of the curve in our forecast, holding prices flat thereafter.

Chart 3.12: Oil price assumption



Source: Datastream, IMF, OBR

Other conditioning assumptions

3.46 We also 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: so that the exchange rate will move to reflect the differential between UK and overseas interest rates so as to equalise the expected return to investing at home and abroad. In the first quarter of 2016 we expect the sterling effective exchange rate to be 5.5 per cent lower than our November assumption. That reflects the recent depreciation of sterling against both the US dollar and the euro. 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 (Chart 3.13). We assume equity prices rise in line with nominal GDP from their current level. The FTSE all-share index has fallen almost 8 per cent since November (Chart 3.14).

Chart 3.13: Sterling effective exchange rate assumption

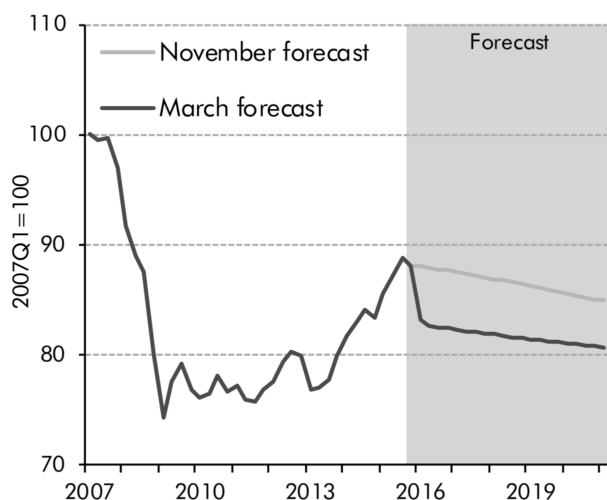
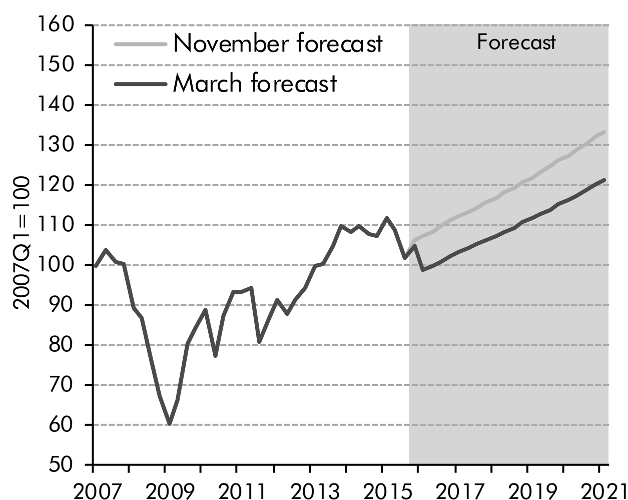


Chart 3.14: Equity prices assumption



Source: Bank of England, Bloomberg, Datastream, OBR

Summary

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

- **monetary policy** remains very loose – even more so than assumed in November. It does not begin to tighten until the final quarter of 2019;
- **fiscal consolidation** continues to depress the level of GDP. The effects of the Government's decisions in this Budget are uneven across the forecast period. The pace of fiscal tightening has eased next year, but it is now set to intensify in 2019-20 as the Government tightens policy significantly to meet its surplus target;
- the **UK remains a member of the European Union**, in line with current Government policy;
- **credit conditions and the financial system** continue to normalise gradually; and
- **global activity and demand for UK exports** pick up steadily over the forecast period, albeit slightly more slowly than expected in November.

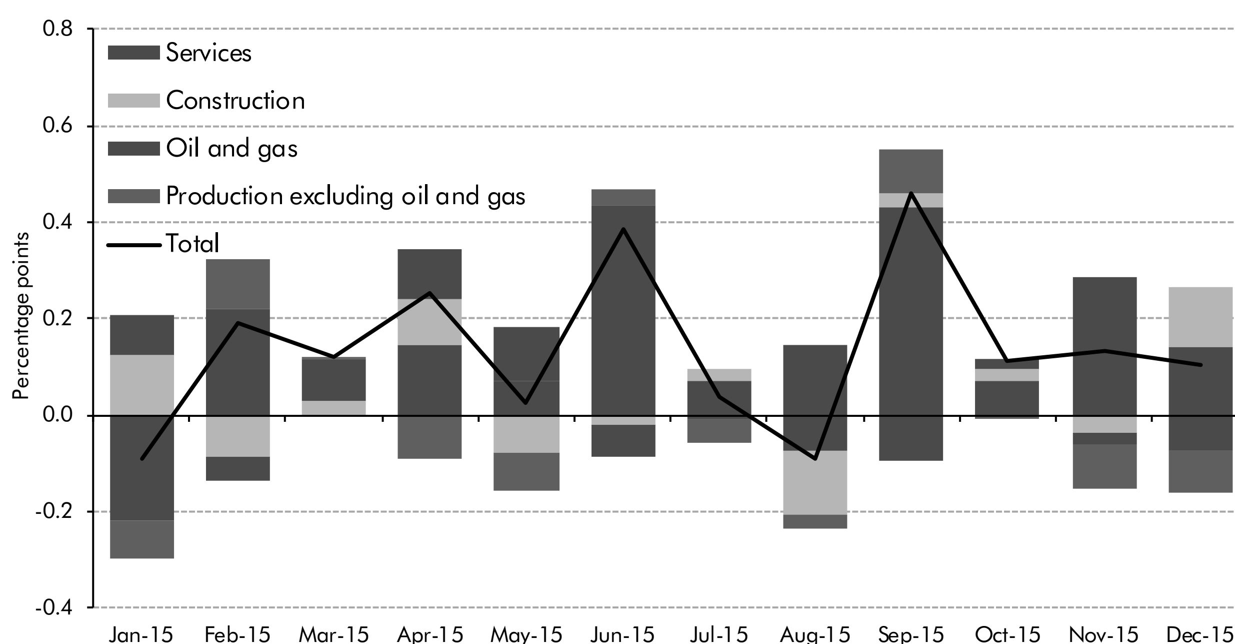
3.48 Risks and uncertainties associated with these assumptions and other facets of the forecast are discussed later in the chapter.

Prospects for real GDP growth

The short-term outlook for GDP

3.49 On a monthly basis, Chart 3.15 shows that the services sector made positive contributions to GDP growth in nine months during 2015, although these contributions were lower on average than in 2014 and also slightly more volatile. Manufacturing growth declined in each of the last three months of 2015 and fell over 2015 as a whole. Contributions from the North Sea and construction sectors have continued to be volatile.

Chart 3.15: Contributions to monthly output growth



Source: ONS

3.50 The economy grew by 0.5 per cent in the final quarter of 2015, in line with our November forecast. But quarterly GDP growth rates earlier in the year have been revised down since November, and they have been lower on average than in 2014. That has happened despite the fall in the oil price since the second half of 2014, which was expected to support real incomes and consumption. But that boost will have been partly offset by the in-year public spending cuts announced in June.

Table 3.3: 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]	0.6	0.8	0.7	0.7	0.4	0.6	0.4	0.5	0.5	0.5	0.5	0.5
November forecast[2]	0.6	0.9	0.6	0.8	0.4	0.7	0.5	0.5	0.5	0.7	0.7	0.6
Change[3]	**0.0**	**-0.1**	**0.0**	**-0.1**	**0.1**	**-0.1**	**-0.1**	**0.0**	**-0.1**	**-0.2**	**-0.2**	**-0.1**

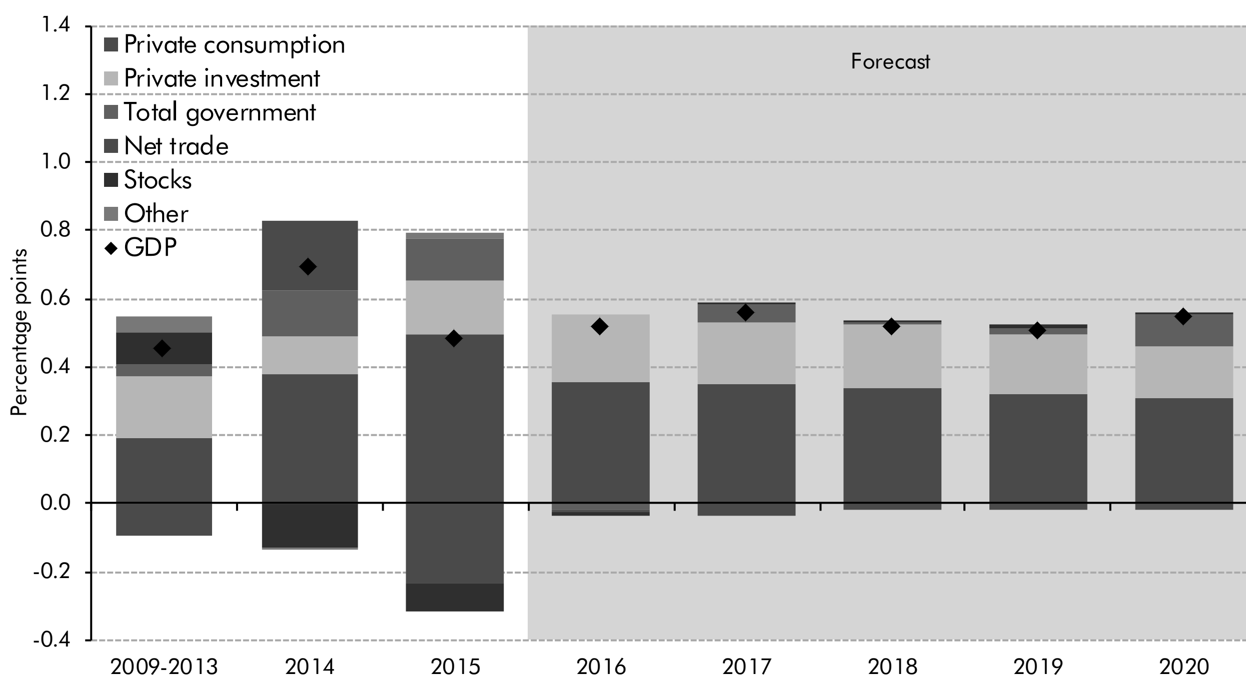
[1] Forecast from first quarter of 2016.
[2] Forecast from fourth quarter of 2015.
[3] Changes may not sum due to rounding.

The medium-term outlook

3.51 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 conditioning assumptions discussed in the previous section all inform that judgement.

3.52 Our latest estimates of the output gap indicate relatively little spare capacity at the end of 2015. The downward revision to our forecast of potential output growth means that we expect weaker GDP growth in the medium term, with quarterly GDP growth expected to average around 0.5 per cent. While this is slightly below the rates of growth in 2013 and 2014, it is similar to the average rate seen in 2015. Relative to the recent past, we expect the balance of growth to shift away from employment growth, with GDP growth supported by a gradual increase in productivity and average earnings growth. On the expenditure side, we expect private consumption and investment to account for nearly all GDP growth as the fiscal consolidation continues, with little contribution from net trade.

Chart 3.16: Contributions to average quarterly GDP growth

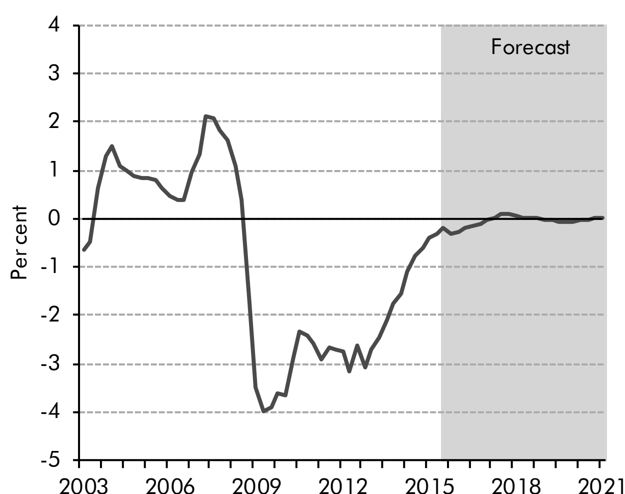


Note: 'Other' category includes the statistical discrepancy and the residual between GDP and the expenditure components prior to the base year (2012).
Source: ONS, OBR

3.53 Our forecast implies a cumulative increase in real GDP of 12.2 per cent between the third quarter of 2015 and the start of 2021 – a downward revision of 1.5 percentage points from the 13.7 per cent we expected in November. Of this downward revision, around 0.4 percentage points is accounted for by a narrower output gap at the start of the forecast, with the remainder accounted for by a downward revision to cumulative potential output growth. Charts 3.17 and 3.18 show our latest medium-term forecasts in terms of the output gap and the levels of actual and potential output. The slightly uneven path of the output gap

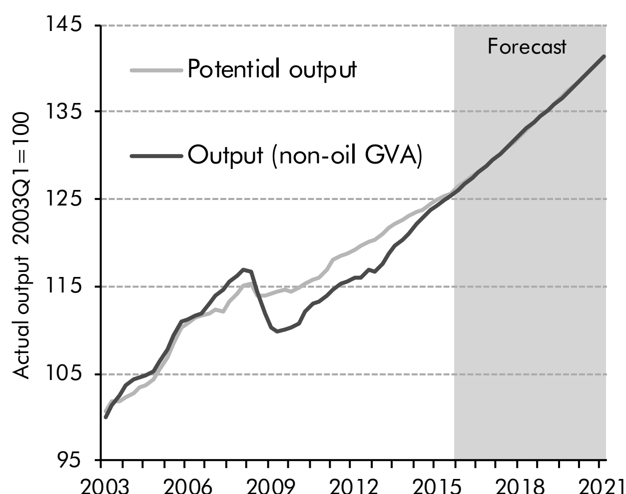
over the forecast period reflects the uneven year-on-year profile in the overall effect of policy decisions announced in the Budget (as explained in Box 3.2).

Chart 3.17: 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 3.18: Projections of actual and potential output



Source: ONS, OBR

3.54 Table 3.4 summarises the expenditure composition of our real GDP forecast. Growth in 2015 is estimated to have been lower than we forecast in November, with net trade acting as a drag rather than providing the small positive contribution we expected. This is partly offset by changes in inventories, which acted as less of a drag than we expected in November. Thereafter we have also revised down our forecast for GDP growth, with lower contributions from consumption and business investment. Later sections of this chapter discuss our forecasts for the expenditure components of GDP in more detail.

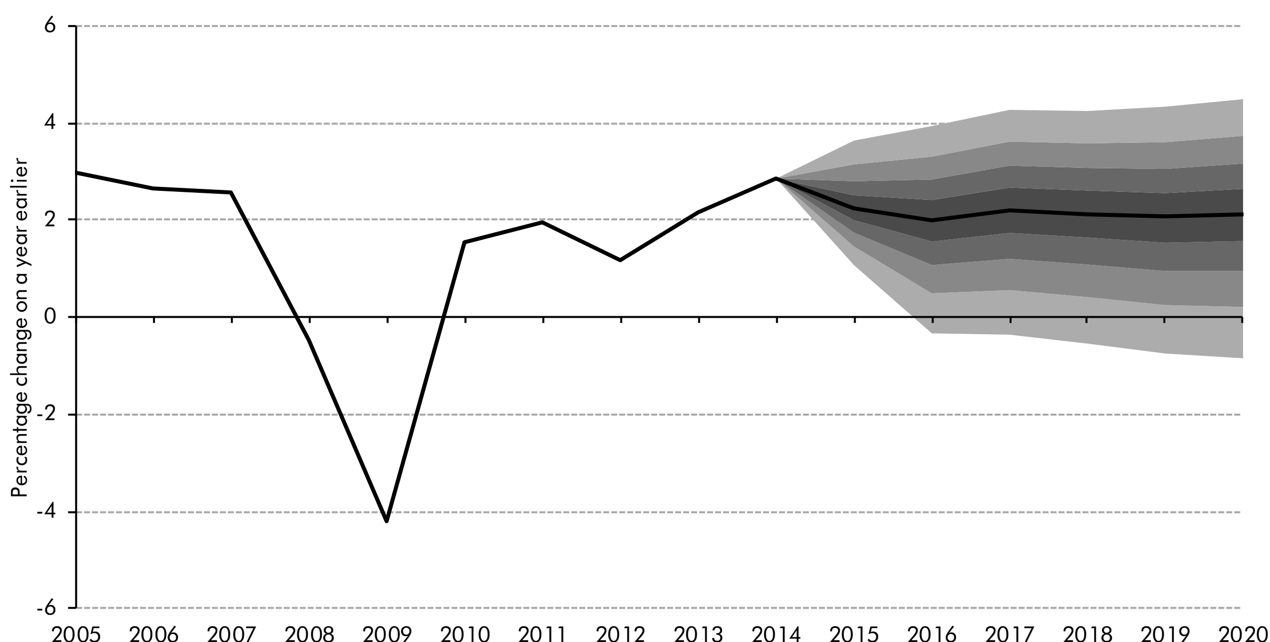
Table 3.4: Expenditure contributions to real GDP growth

	Percentage points, unless otherwise stated						
	Outturn	Forecast					
	2014	2015	2016	2017	2018	2019	2020
GDP growth (per cent)	**2.9**	**2.2**	**2.0**	**2.2**	**2.1**	**2.1**	**2.1**
Main contributions							
Private consumption	1.6	1.9	1.6	1.4	1.4	1.3	1.3
Business investment	0.4	0.5	0.2	0.6	0.6	0.6	0.5
Dwellings investment[1]	0.6	0.2	0.3	0.1	0.1	0.2	0.1
Government[2]	0.7	0.4	0.0	0.2	0.1	0.0	0.3
Change in inventories	0.2	-0.4	0.2	0.0	0.0	0.0	0.0
Net trade	-0.4	-0.5	-0.4	-0.1	-0.1	-0.1	-0.1

[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.

3.55 Our central GDP growth forecast is shown in Chart 3.19. History suggests that the outturn is unlikely to be anywhere near as smooth as this, but we judge that deviations are as likely to be above as below it. The distribution surrounding the central forecast 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 historical distribution of official forecast errors. 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. The Government's fiscal mandate requires us to say whether GDP growth has, or is expected to, fall below 1 per cent on a 4-quarter-on-4-quarter basis. This is discussed further in Chapter 5.

Chart 3.19: Real GDP growth fan chart



Source: ONS, OBR

Prospects for inflation

3.56 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 of our March 2015 *EFO* for details). We also forecast the GDP deflator and its components, which are used in generating our nominal GDP forecast.

3.57 The CPI and RPI measures of inflation are important because they both 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 ONS publishes other inflation measures, but these do not currently affect the public finances, so we do not forecast them.

CPI inflation

3.58 Annual CPI inflation was 0.1 per cent in the final quarter of 2015, in line with our November forecast. The latest monthly data show inflation at 0.3 per cent in January, the highest rate for a year. As discussed below, much of the present weakness is due to falling prices in volatile components including energy, food and alcohol. 'Core' CPI, which excludes these components as well as tobacco, has been stronger (although still relatively low), standing at 1.2 per cent in January. Inflation in import intensive goods and services has also remained relatively subdued following the appreciation of sterling that began in 2013 and which has only very recently begun to reverse. The final quarter of 2015 gave mixed signs for domestic inflationary pressures, with margins slightly falling over the year, but the sharp drop in productivity leading to a 1.1 per cent increase in unit labour costs.

3.59 Since our November forecast the price of oil has continued to fall, contrary to market expectations at the time (see Chart 3.12). This has fed through to fuel prices, which fell 12.8 per cent in the year to the final quarter of 2015, pulling down headline CPI inflation by 0.4 percentage points. Food prices fell 2.7 per cent over the same period, subtracting a further 0.3 percentage points from headline CPI.

3.60 These components continue to weigh on our CPI forecast in the near term, with a slow pick-up in inflation expected for the first three quarters of 2016. But they then contribute to the rise in inflation we expect in the medium term:

- markets expect substantial **oil price rises** from 2017, though the absolute price level is expected to remain low by recent historical standards. We expect this to feed through to higher petrol price growth over the same period, although with the level remaining below that implied in our November forecast;

- the recent sharp depreciation of the **sterling effective exchange rate**, as well as our conditioning assumption of further depreciation, is expected to slowly pass through to higher prices in import intensive goods and services across the forecast period; and

- **food price inflation** is expected to return to around its historical average over the next 18 months, reflecting both an expected stabilisation in global food commodity prices and the sterling depreciation.

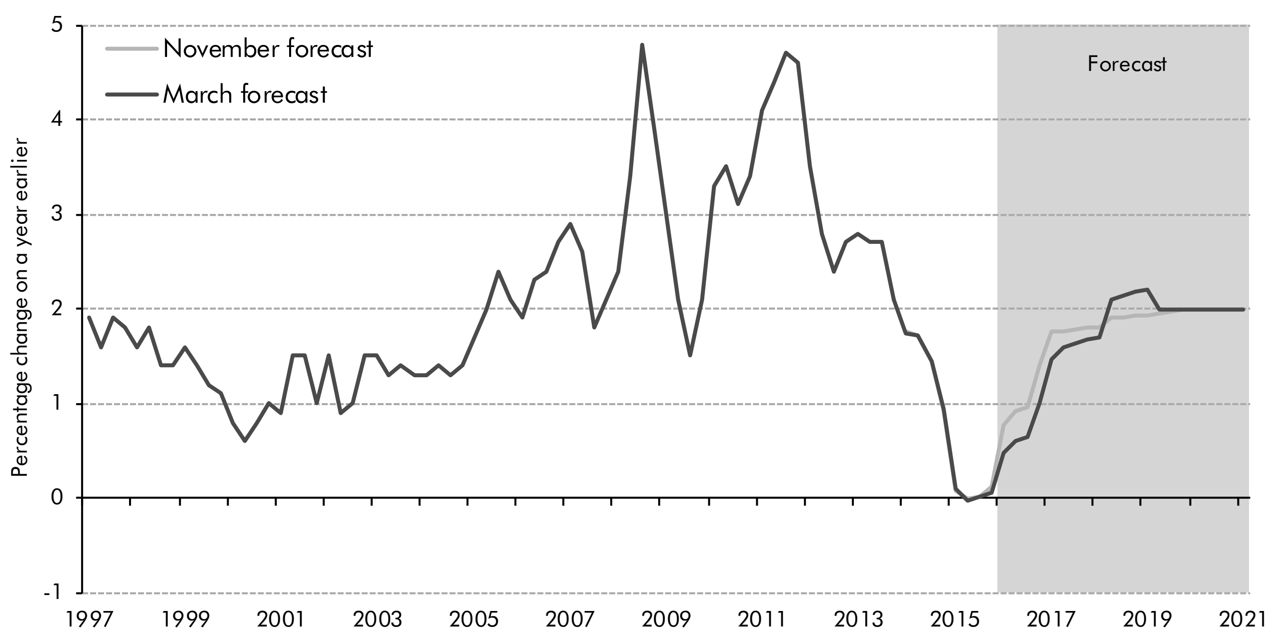
3.61 Working against these trends, recent falls in wholesale gas prices are forecast to act as a drag on inflation in the medium term as they pass through to retail prices. We expect this to happen slowly since utility companies buy wholesale energy up to two years in advance.

3.62 Inflation is forecast to move above the Bank of England's 2 per cent target in the second quarter of 2018, when the effect of the soft drinks industry levy announced in this Budget affects prices. We expect it to add around a quarter of a percentage point to CPI growth in 2018-19. Since the levy is unchanged in future years it affects the level, not the growth, of the CPI. We expect the Bank of England to look through this temporary effect, and so allow the rate of inflation to exceed 2 per cent until the impact of the levy dissipates. With the

output gap then close to zero and the expected transitory shocks to inflation complete, we assume that the Bank of England will keep inflation on target for the rest of the forecast. To the extent that the levy leads to reduced consumption of soft drinks, their weight in the CPI would fall in subsequent years, with the effect lagged because the ONS updates the weights in the index once a year to reflect the consumption patterns of two years previously.

3.63 As well as the soft drinks industry levy, we have also made small adjustments for several other policies announced in this Budget. These include changes to tobacco, fuel and most alcohol duties, the measures to reduce VAT fraud, and energy policies. The effects are small and broadly offsetting, and taken together imply almost no change to our CPI forecast.

Chart 3.20: CPI inflation



Source: ONS, OBR

RPI inflation

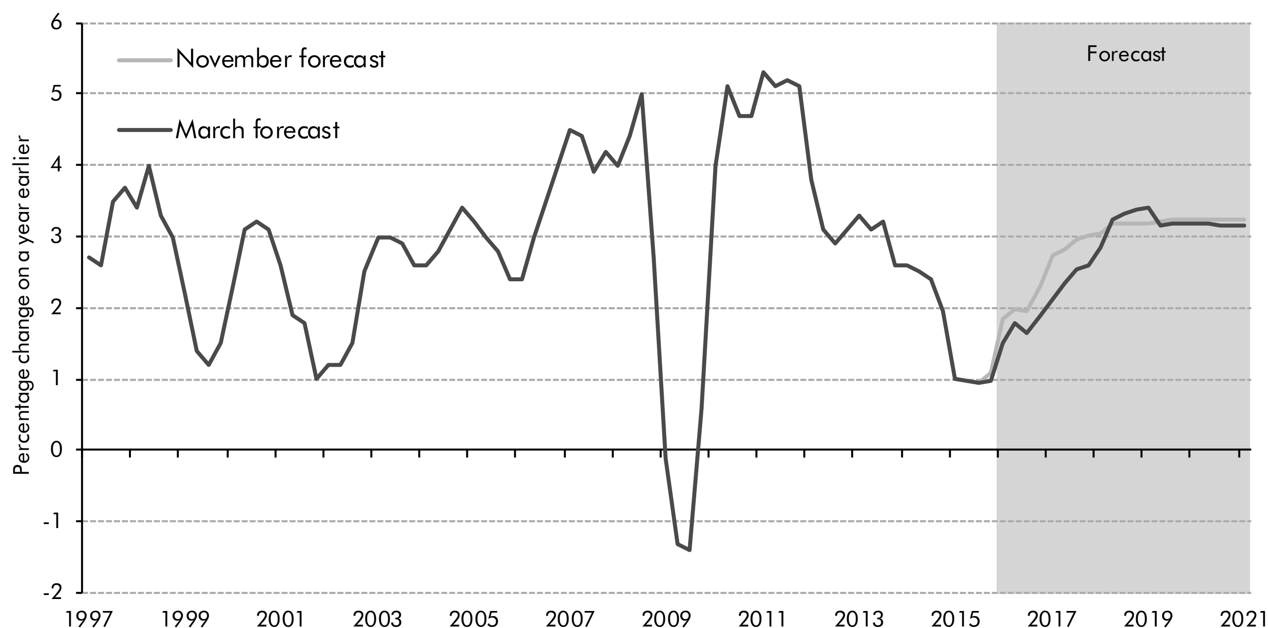
3.64 The calculation of RPI inflation in the UK does not meet international statistical standards,[8] but we continue to forecast it as an input in our fiscal forecasts – notably as a determinant of the interest paid on the large stock of index-linked gilts.

3.65 RPI inflation was 1.0 per cent in the fourth quarter of 2015, 0.1 percentage points lower than our November forecast. We expect RPI inflation to follow a similar path to CPI inflation over 2016, rising to 1.9 per cent by the end of the year. Across 2017 and 2018 we expect a rise in mortgage interest payments (MIPs), driven by small rises in the effective mortgage interest rate and the accumulation of mortgage debt. This feeds through to an increase in the wedge between RPI and CPI, which reaches 1.1 per cent in the first quarter of 2018 and is little changed for the rest of the forecast. Our RPI forecast is weaker than in November, in line with the weaker CPI profile.

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

3.66 The RPI profile has also been adjusted to account for the policies announced in this Budget and discussed above. They affect RPI in a very similar way to CPI, so make almost no difference to the wedge between the two.

Chart 3.21: RPI inflation



Source: ONS, OBR

The GDP deflator

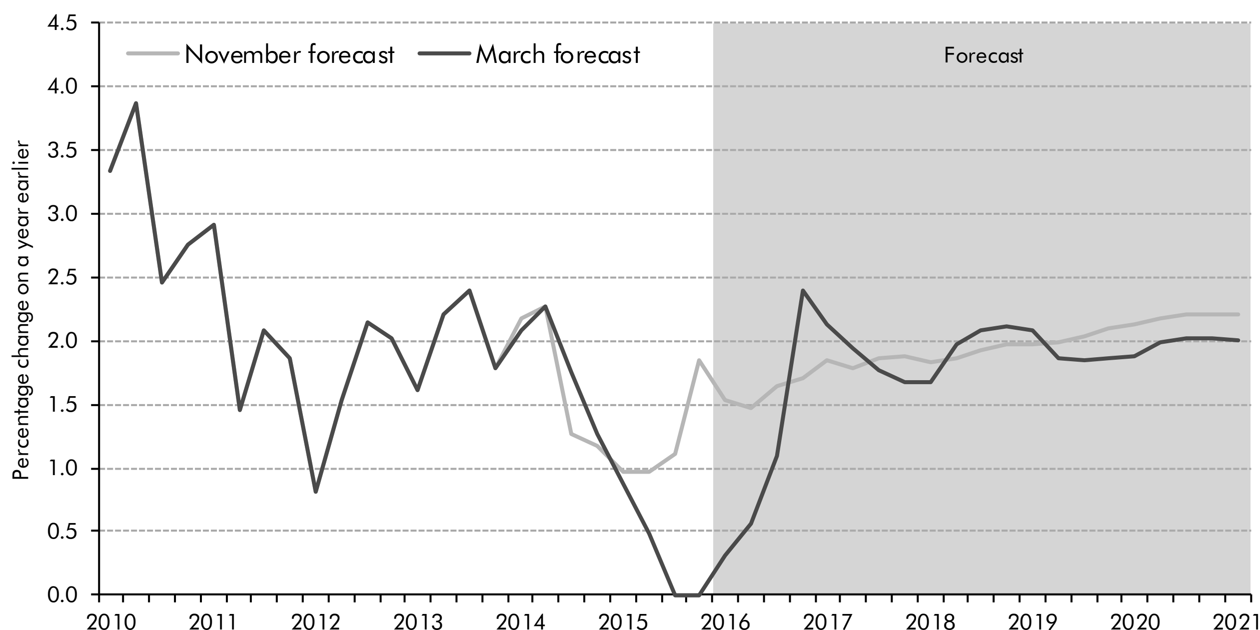
3.67 GDP deflator growth is the broadest measure of inflation in the domestic economy. It measures changes in the prices of the goods and services that make up GDP, including price movements in private and government consumption, investment and the relative price of exports and imports – the terms of trade.

3.68 As discussed in Chapter 2, the latest National Accounts data show that GDP deflator growth in the second half of 2015 was substantially below our November forecast. In the latest quarter its annual growth stood at zero – the (joint) lowest rate in 55 years – providing a very low starting point for the deflator forecast. This weakness was partly due to a very weak contribution from the change in inventories, a volatile component. We assume that the implied deflator for the change in inventories returns to a historical average over the next year. This unwinding, as well as a pick-up in the private and government consumption deflators, causes the GDP deflator level to increase steadily over the course of 2016. The low outturns in 2015 result in significant base effects in the annual growth rate, which spikes at 2.4 per cent at the end of 2016.

3.69 Annual growth in the GDP deflator falls away over 2017 as the base effects from the change in the inventories component wane. It then picks up from the middle of 2018, driven by the growth of the consumption deflator, which is linked to our CPI forecast. The path of GDP deflator growth in 2019 and 2020 is slightly uneven reflecting both CPI falling

back to target in the middle of 2019, and the uneven path of government consumption growth implied by the Government's latest fiscal plans.

Chart 3.22: GDP deflator



Source: ONS, OBR

Prospects for nominal GDP growth

3.70 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 – 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, grants and administration, and capital spending) or linked to measures of inflation (benefits, tax credits and interest on index-linked gilts).

3.71 The latest data indicate that nominal GDP growth slowed to 2.6 per cent in 2015, following growth of 4.2 per cent in 2013 and 4.7 per cent in 2014. On the expenditure side, part of this slowdown is attributable to a slowdown in consumption growth: while a fall in household saving helped to support consumer spending in 2013 and 2014, consumption growth was more closely in line with the growth of household disposable income in 2015, although consumption picked up sharply in the final quarter of the year (see paragraphs 3.79 to 3.80). Nominal government consumption growth also fell from 3.0 per cent in 2014 to 1.1 per cent in 2015, while nominal investment growth slowed from 9.0 per cent to 5.4 per cent as the growth of dwellings investment fell back sharply. On the income side the reduction in nominal growth in 2015 was largely attributable to a slowdown in profits growth, with the growth of labour income picking up slightly between 2014 and 2015.

3.72 We expect the weakness of nominal GDP growth to ease slightly in 2016, as some of the factors pushing down on nominal GDP growth at the end of 2015 are expected to unwind. It is then expected to increase to just over 4 per cent a year from 2017 onwards. Over the forecast period we expect nominal GDP to grow by a cumulative 23.7 per cent between the third quarter of 2015 and start of 2021, revised down from the cumulative growth of 26.5 per cent we expected in our November forecast. Of this 2.9 percentage point downward revision, around 1.5 percentage points is attributable to weaker real GDP growth, with the remainder is accounted for by slower growth of the GDP deflator.

Prospects for individual sectors of the economy

The household sector

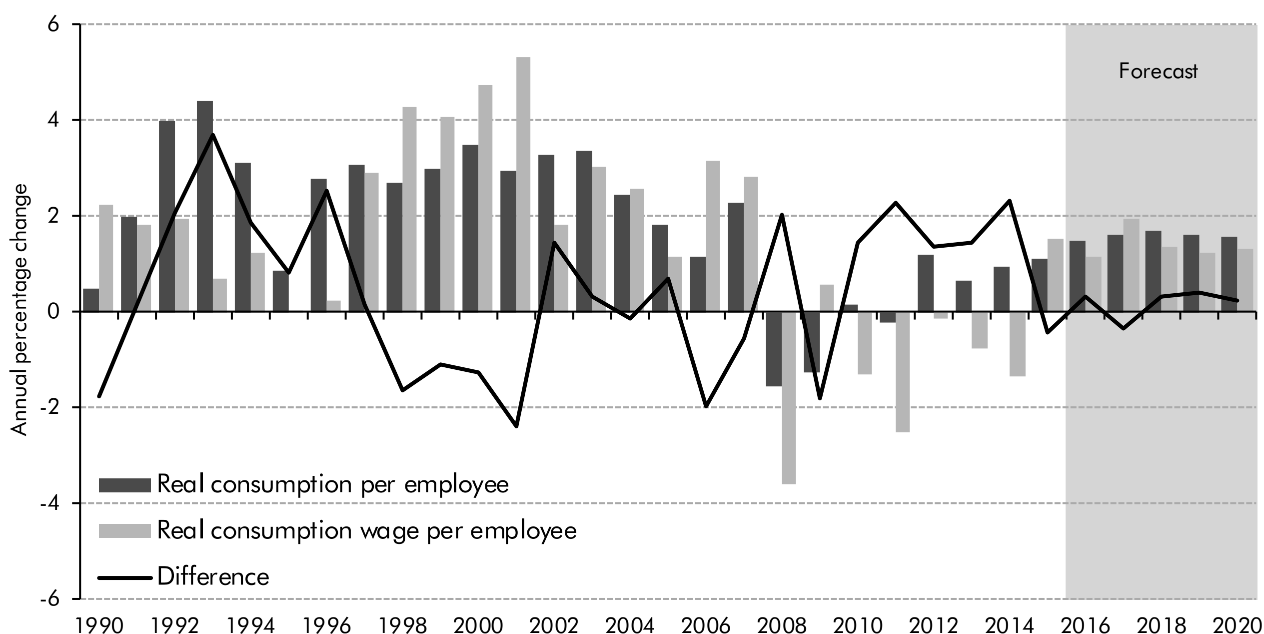
3.73 The household sector is the largest source of income and spending in the economy, with consumer spending making up 65 per cent of nominal GDP by expenditure and household disposable income making up 65 per cent of nominal GDP by income in 2014.

Real consumer spending

3.74 The latest data show that consumption increased 2.9 per cent in real terms in 2015, in line with our November forecast. Lower inflation caused the real consumption wage to increase in 2015, having fallen in 2014, but private consumption growth increased only slightly (Chart 3.23). We have revised down our forecast for consumption growth over the forecast, reflecting a downward revision to real wage growth from lower productivity growth. We assume that real consumption will grow broadly in line with real wages over the forecast period, having risen faster than real wages in each year from 2010 to 2014.[9]

[9] While consumption growth is expected to be broadly in line with labour income growth, it is expected to be stronger than household disposable income growth, as shown in Chart 3.26. This is because labour income includes employer pension contributions, which are expected to grow relatively strongly over the forecast period but which have a neutral effect on household disposable income.

Chart 3.23: Real consumption wage and real consumption



Source: ONS, OBR

The labour market and household income

3.75 The unemployment rate fell in the third and fourth quarters of 2015, reaching 5.1 per cent, 0.2 percentage points below our November forecast. We forecast the rate to decline more slowly over the coming year to a low of 4.9 per cent, as productivity growth picks up and firms expand output more through their existing workforce than through recruitment. The headline rate is then forecast to rise back to 5.4 per cent by the end of 2020, in part due to an increasing 'National Living Wage' which puts upward pressure on structural unemployment.[10] In the near term we expect the claimant count to fall slightly relative to the broader measure of unemployment. Thereafter we expect it to rise a little faster, as the lone parent obligation, which moves parents off income support and typically onto jobseeker's allowance in the first instance, is extended to lone parents of 3-year olds.

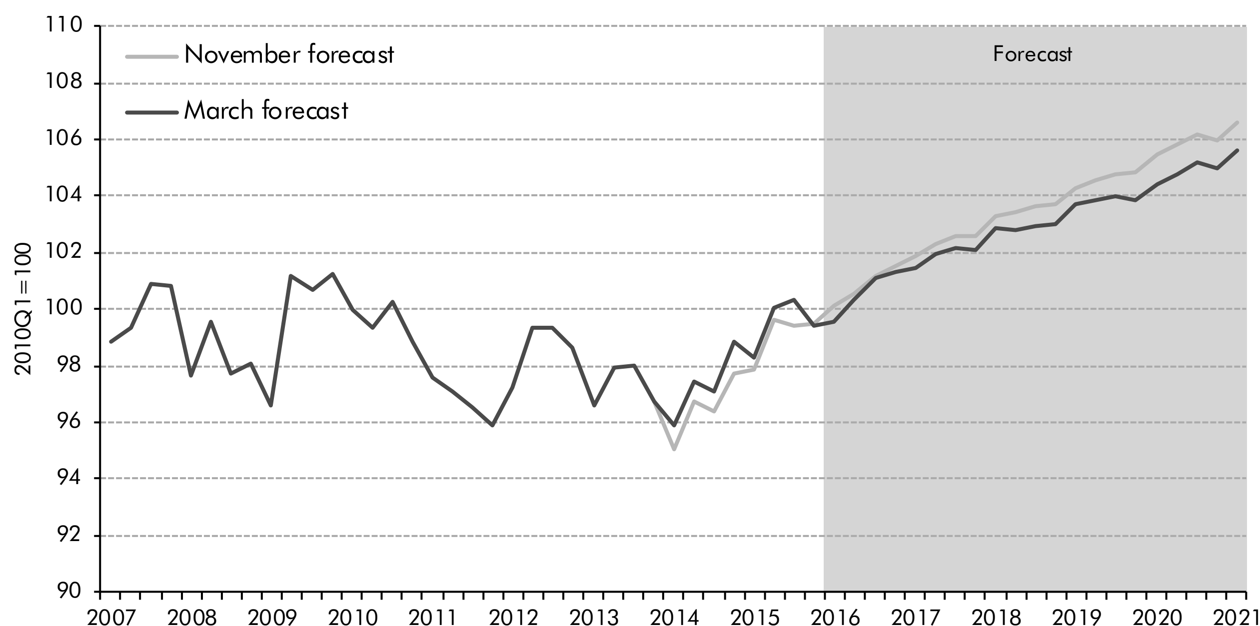
3.76 The participation rate has a relatively flat profile over the forecast, with the ageing population pushing it down and rising age-specific participation rates pushing it up. The participation rate is expected to stay broadly flat over the next four years, in part due to net inward migration (which is dominated by people of working age), and then to fall back to slightly below its current level as the population ages. The 0.9 million rise in employment over the forecast period can therefore be explained by additional population growth. The ONS population projections that underpin our forecast imply that around half the expected population growth over the forecast period will come from net migration, but that due to the concentration of migration among those of working age, around three-quarters of the increase in employment that we forecast would be accounted for by net migration.

[10] The level of the National Living Wage consistent with our forecast has been revised down since November – from £9.30 to £9.00 an hour in 2020. That reflects information from the 2015 Annual Survey of Hours and Earnings, which reported slower growth in median than mean hourly earnings, and the downward revision to our earnings growth forecast. The assumed annual path of the National Minimum Wage and National Living Wage consistent with our forecast are available in a supplementary table on our website.

3.77 Average earnings growth in the second half of 2015 has been lower than we expected in November. We have revised down average earnings growth in each subsequent year consistent with slower (but still rising) productivity growth over the next few years, although we continue to expect real average earnings to rise by slightly more than productivity per worker over this period. As in November, over the medium term, the weakness of earnings growth in part reflects our judgement that the additional costs created for firms and workers by the Government's introduction of the apprenticeship levy and ongoing auto-enrolment into workplace pensions – both of which are economically equivalent to payroll taxes – will largely be borne through lower wages. The announcement in this Budget that National Insurance contributions will be levied on termination payments over £30,000 has been judged to feed through into wages in a similar way. Lower whole economy inflation also translates into slower nominal earnings growth in the final two years of our forecast.

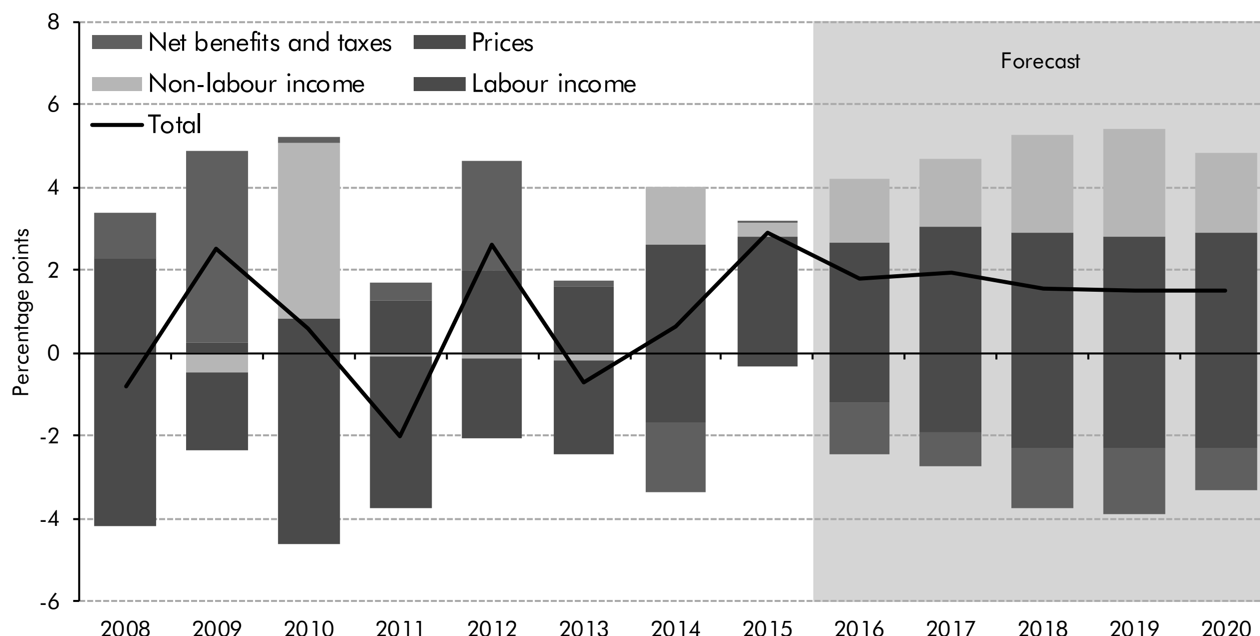
3.78 The significant fall in consumer price inflation over the past year has helped to support the growth of real household disposable income. We expect real household disposable income growth to have peaked at 2.9 per cent in 2015. We expect it to average 1.7 per cent a year from 2016 onwards. Over the forecast period we expect real household disposable income to grow more slowly than we assumed in November, with annual growth revised down by an average of 0.3 percentage points between 2016 and 2020, due mainly to the downward revision to productivity growth described above.

Chart 3.24: Real household disposable income per capita



Source: OBR

Chart 3.25: Contributions to real household income growth



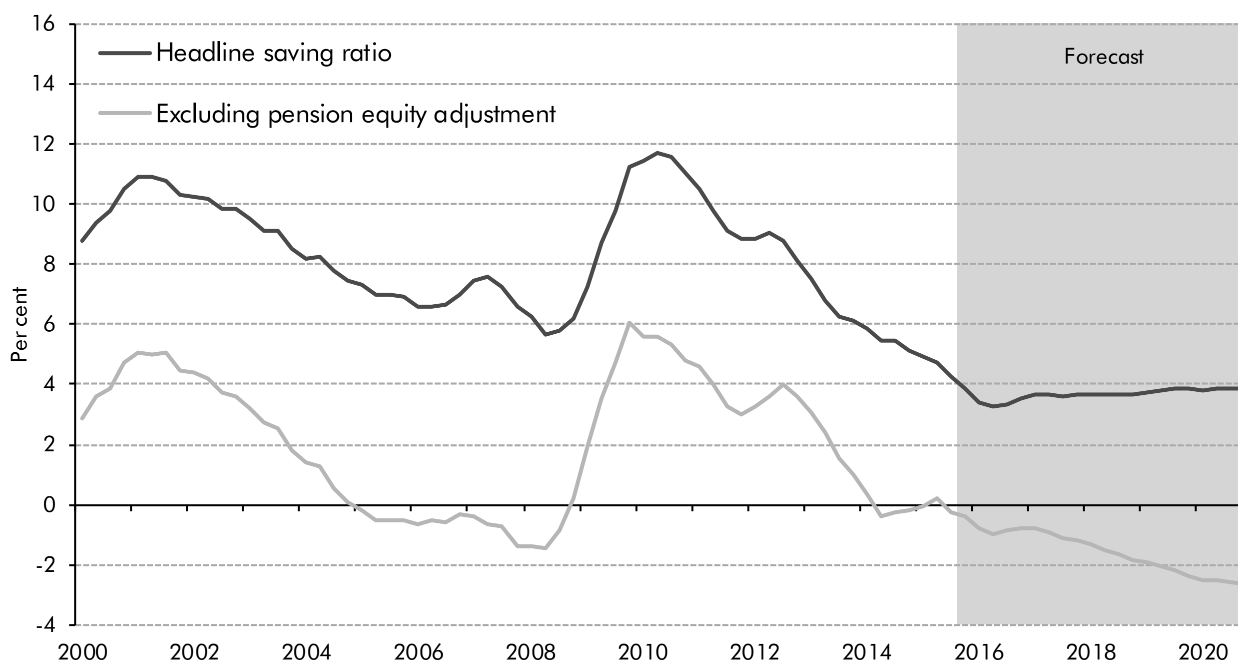
Source: ONS, OBR

The saving ratio

3.79 The headline saving ratio has fallen steadily since 2012, reaching 4.4 per cent in the third quarter of 2015 – the joint lowest ratio since 1963. While the fall in household saving over this period has largely reflected the strength of consumption relative to household disposable income, more recent falls have also reflected a reduction in measured pension saving. When pension saving is excluded, household saving stabilised between 2014 and the middle of 2015. (Chart 3.26).

3.80 Data on the household saving ratio in the final quarter of 2015 are not yet available, but consumption growth appears to have significantly outpaced the growth of labour income. Nominal consumer spending increased by 1.7 per cent on the previous quarter, while labour income was up 0.7 per cent, so household saving is likely to have fallen further. Over the forecast period we expect consumption to grow slightly faster than household disposable income, putting downward pressure on the saving ratio. This is offset by rising pension saving, as auto-enrolment coverage and contribution rates increase. It also reflects increases in gilt yields, which are used in the calculation of imputed employee pension contributions in the National Accounts.

Chart 3.26: The household saving ratio



Note: Both series show four-quarter moving averages. The estimate of the saving ratio excluding the pension equity adjustment is calculated as household disposable income less consumption, as a proportion of household disposable income.
Source: ONS, OBR

The housing market and dwellings investment

3.81 House price inflation picked up again in the fourth quarter of 2015, with year-on-year growth of 7.1 per cent (Chart 3.27). This is the first quarter where the growth rate has increased since the recent peak of 11.7 per cent in the third quarter of 2014. We expect house price inflation to rise further in the first quarter of 2016, to 8.3 per cent, before slowing thereafter. There remains considerable uncertainty about near-term prospects and the major lenders' house price indices have continued their recent divergence. The Halifax index is reporting year-on-year growth of 9.7 per cent in the year to February while the Nationwide index is up by just 4.8 per cent over the same period. Survey indicators from the Royal Institution of Chartered Surveyors have been broadly flat.

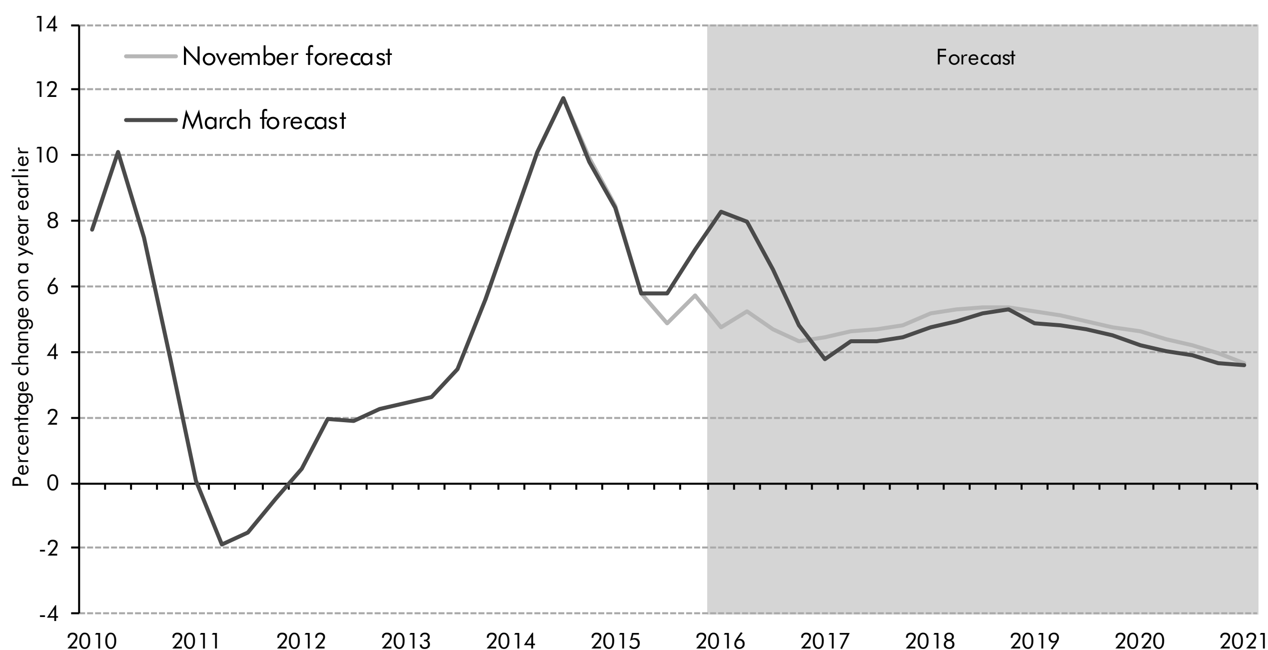
3.82 Beyond the near term, we use a house price model to inform our forecast.[11] Currently, this suggests that there is a significant amount of credit rationing in the mortgage market. Financial institutions are extending less secured debt than the model suggests households would like based on fundamental drivers of mortgage demand. This is consistent with changes to the regulatory environment, ongoing repair to bank balance sheets and changes to lenders' behaviour brought about by the Mortgage Market Review. We continue to assume this implied mortgage rationing will ease but we have slowed the rate at which it does so. This implies a higher level of rationing at the end of the forecast period than we assumed in November. This brings credit rationing in line with the downward adjustments we made to the levels of secured debt and property transactions in our November forecast.

[11] For more information on our house price model see Auterson (2014): *Working paper No. 6: Forecasting house prices*.

3.83 Over the forecast period, we expect house price inflation to persist at rates somewhat above earnings growth, consistent with historical trends in the UK. Revisions to the medium-term profile have been relatively small since our last forecast, with the level of house prices by the end of the forecast period 1.5 per cent higher than in November. House prices are expected to rise by 26.4 per cent by the first quarter of 2021.

3.84 We have made a small adjustment to our house price forecast to reflect the first-time buyer element of the lifetime ISA policy announced in this Budget. There is considerable uncertainty over how that might manifest itself, but we think it is more likely than not to lead to higher demand for the relatively fixed supply of housing in the UK and thus lead to higher prices. We have added 0.3 per cent to the level of house prices by the end of the forecast, but the effect could easily be larger (if more house deposit saving is channelled through lifetime ISAs than we have assumed) or smaller (perhaps if parents supporting their first-time buyer children's deposit saving reduce that support in light of the amount that will be provided by the Government).

Chart 3.27: House price inflation forecast



Source: ONS, OBR

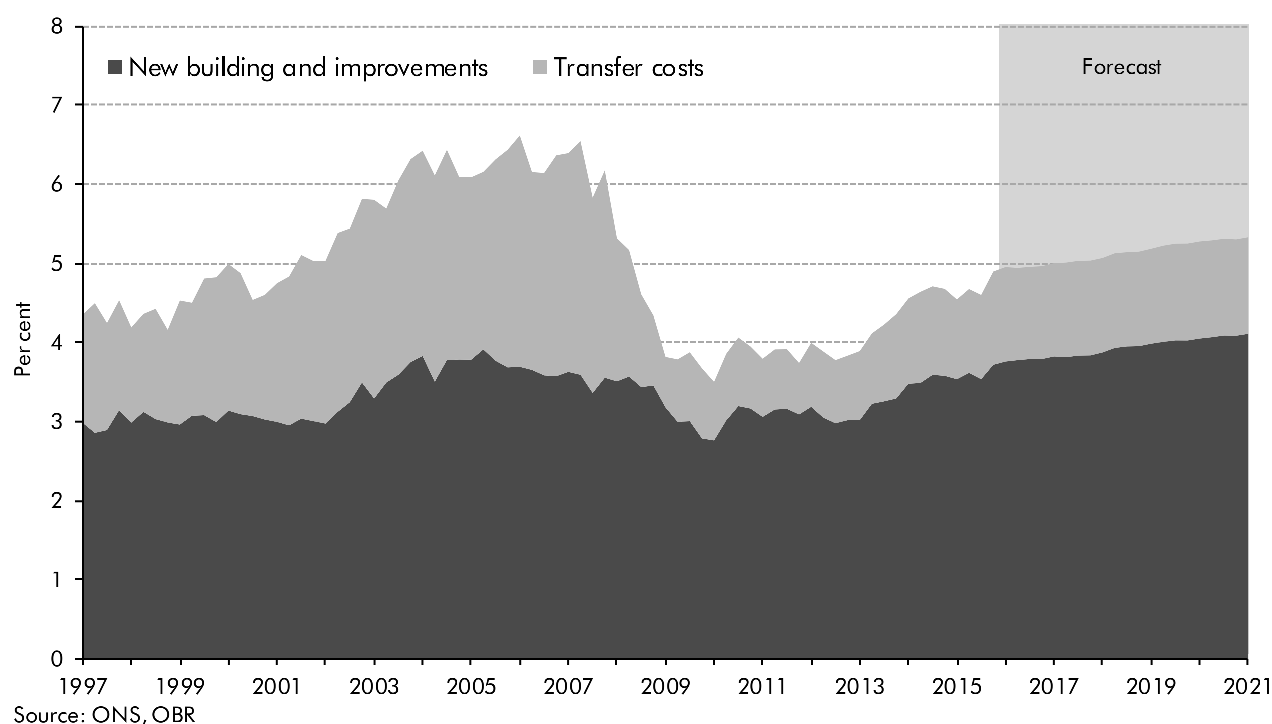
3.85 Our forecast for residential property transactions is little changed from November. Transactions grew by 8.6 per cent in the year to the fourth quarter of 2015, up from 2.9 per cent in the previous quarter. In the short term, we expect a slightly higher rate of growth in the first quarter of 2016, but a slowdown in growth in the second half of the year.

3.86 We lowered our medium-term forecast for residential transactions in November to reflect the near-doubling of privately renting households since 2000 and recent evidence that suggests rental properties are re-sold at about half the frequency of owner-occupied housing. We assume that the growth in private renting will continue and therefore reduced the number of residential property transactions. We also made downward adjustments in

November to capture the effects of policy measures targeting buy-to-let landlords. Due to the pre-announcement of the SDLT surcharge on second homes, we expect property transactions to be boosted temporarily in the run-up to its April 2016 introduction as investors bring forward transactions to avoid the new surcharge.

3.87 The latest National Accounts data show that residential investment grew by 3.4 per cent in 2015, higher than we forecast in November. The pattern of revisions to outturn data affect our forecast of residential investment growth in 2016, implying higher growth in that year. There was little change to our pre-measures forecast for residential investment from 2017 onwards, but we have adjusted our post-measures forecast to reflect several policies introduced in this Budget that affect housing associations' finances and which are therefore assumed to affect their housebuilding. These policy measures reduce total residential investment by 0.7 per cent by 2020-21.

Chart 3.28: Residential investment as a share of GDP



Source: ONS, OBR

Net lending and the household balance sheet

3.88 Our forecast for the household balance sheet is built up from a number of components:

- the accumulation of household **assets**, such as deposits, pension and insurance assets, equity, and other assets;
- the accumulation of **liabilities**, which are decomposed into mortgage debt and unsecured debt; and
- these are constrained to be consistent with our forecast for households' **net lending** position, which determines the rate at which households acquire assets relative to

liabilities (their 'net' asset accumulation). All else equal, positive net lending implies that households will accumulate more assets than liabilities and vice versa.

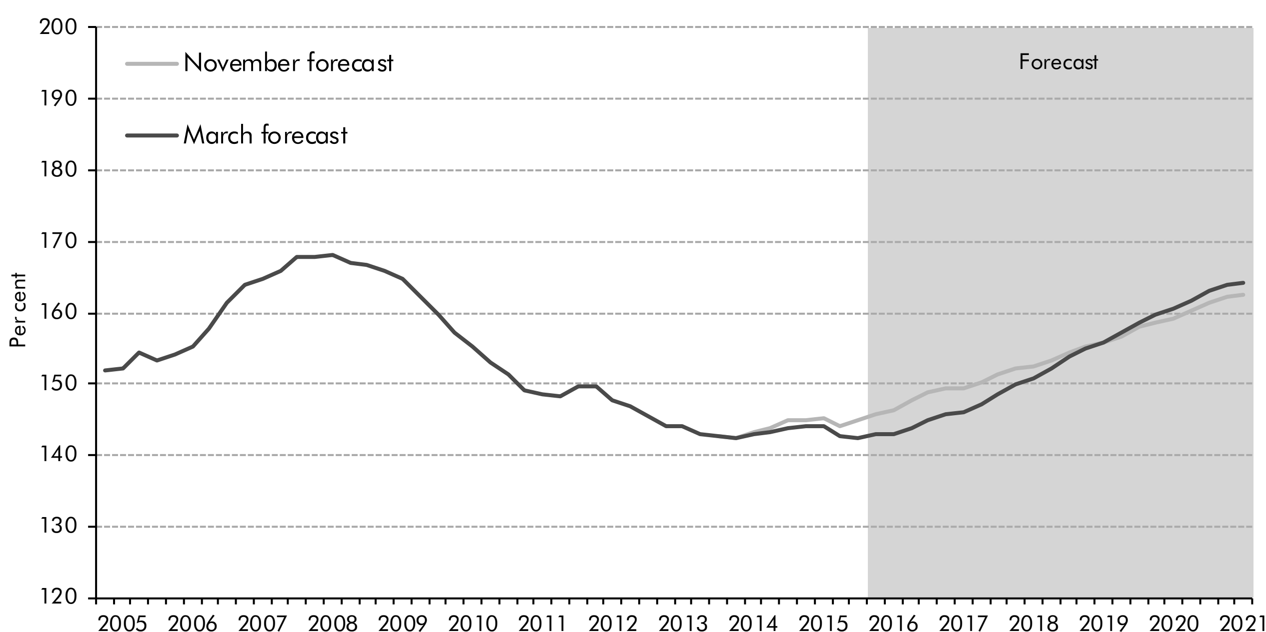
3.89 In November, we improved how we forecast the household balance sheet. We moved to a bottom-up approach to forecasting unsecured debt, based on its relationship with consumption and unemployment; and the use of 'other' assets as the residual to ensure consistency between the stock and flow positions of households' financial accounts. Further detail on these changes can be found in our November *EFO*.

3.90 We now expect gross household debt to reach 164 per cent of household disposable income by the end of the forecast, up slightly from an expected 163 per cent in November. We consider this upward trend at the whole economy level to be consistent with the macroprudential policy setting described in paragraphs 3.29 to 3.31, which is mainly focused on particular sectors or risks. The changes in our forecast since November reflect:

- in cash terms, **gross debt** is expected to be £5 billion lower by the start of 2021 than we expected in November. This is more than explained by a lower starting point, with the level of household debt £17 billion lower in the third quarter of 2015 than expected in November. This is partly offset by a £7 billion upward revision to the accumulation of secured debt over the forecast period and a £6 billion upward revision to the accumulation of unsecured debt; and

- the fall in gross debt is offset by a downward revision to our forecast of the level of **household disposable income**, which is expected to be around 1¼ per cent lower than our November forecast by the start of 2021.

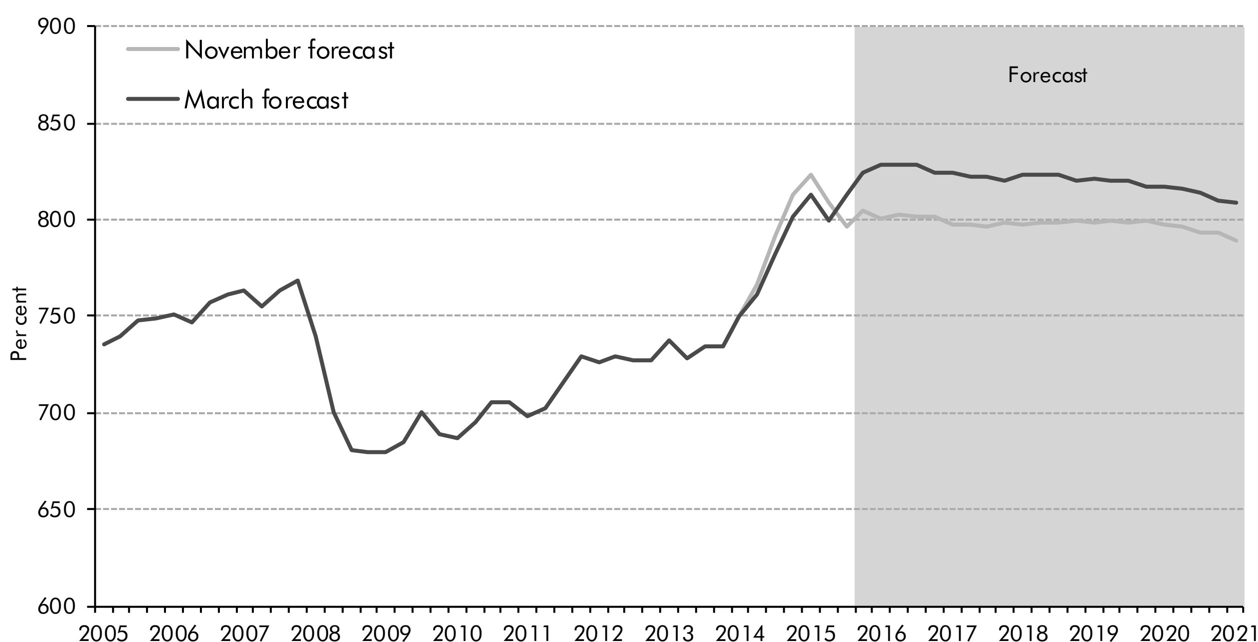
Chart 3.29: Household gross debt to income



Source: ONS, OBR

3.91 Chart 3.30 shows our forecast of household net worth, which includes housing equity as well as financial assets and liabilities. The ratio of net worth to income is expected to remain broadly stable over the next five years. The ongoing household deficit implies that the accumulation of financial assets is slower than the accumulation of liabilities over the forecast period, but the effect on household net worth is offset by the rising value of housing assets. Relative to November we expect a higher level of household net worth through the forecast, largely reflecting a higher level at the start. The higher starting point reflects a stronger than expected outturn for household net financial assets in the third quarter of 2015, as well as an updated estimate of the value of the housing stock.

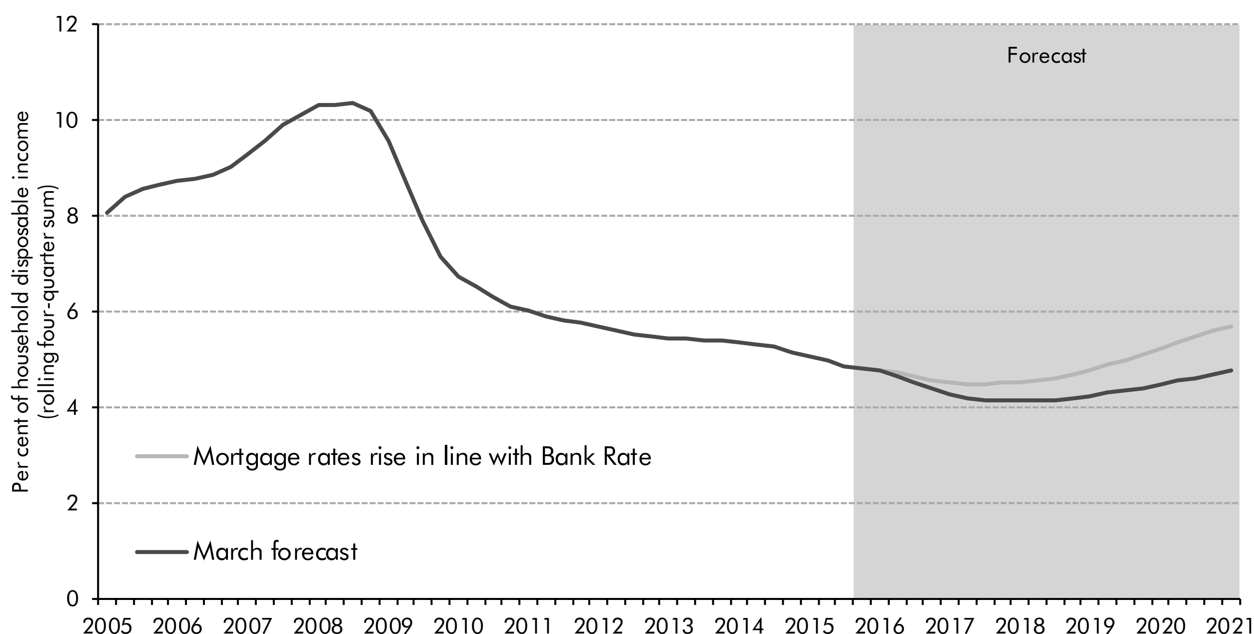
Chart 3.30: Household net worth relative to household income



Source: ONS, OBR

3.92 Household debt servicing costs are expected to remain low relative to household income, despite the expected increase in the stock of household debt (Chart 3.31). This reflects the fact that mortgage rates are expected to remain at historically low levels – consistent with the lagged effect of past falls in funding spreads, the exceptionally low level of Bank Rate and our assumption that lenders' margins on mortgage rates will narrow over the forecast. If mortgage rates increase at the same pace as Bank Rate, debt servicing costs would remain well below pre-crisis levels as a share of income, although they would be somewhat higher than our central forecast.

Chart 3.31: Household debt servicing costs



Source: ONS, OBR

The corporate sector

Business investment and stockbuilding

3.93 The latest data show that business investment fell in the final quarter of 2015. It is now estimated to have grown by 4.7 per cent in 2015, the same rate as in 2014, but lower than we forecast in November. The Bank of England's *Agents' Summary* reports investment intentions consistent with "*unchanged capital spending in manufacturing, but continued growth among services firms*", a weaker outlook than at the time of our November forecast. We now expect business investment growth of 2.6 per cent in 2016, a 4.9 percentage point downward revision since November, largely reflecting the 2.1 per cent fall in business investment in the final quarter of 2015. It is then expected to pick up from 2017, but to lower rates than we forecast in November. There were only tentative signs of uncertainty regarding the EU referendum result affecting investment intentions by the time we closed this forecast and we have made no adjustment to reflect a change in behaviour.[12]

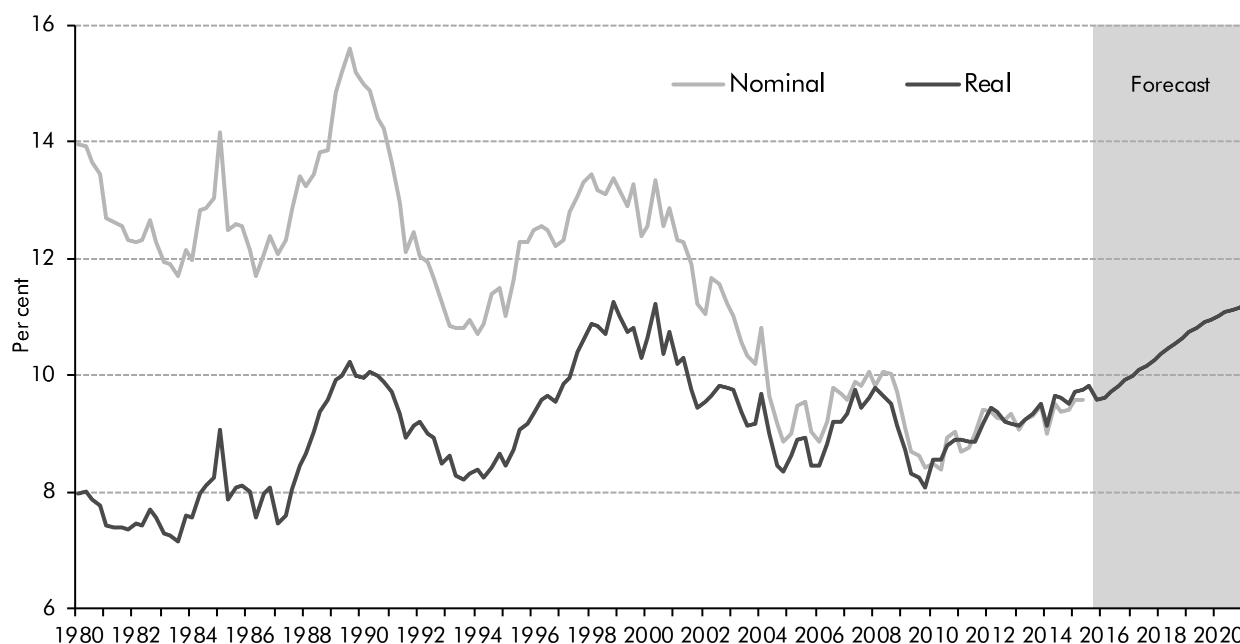
3.94 We adjusted our business investment forecast to reflect three business tax measures, but the Government informed us after our final economy forecast had been closed that one of those measures would not be going ahead. As a result, our business investment forecast is around 0.5 per cent higher than would be consistent with the final policy package announced in the Budget. The net effect of the other two measures was small.

3.95 As Chart 3.32 shows, our forecast implies that real business investment will rise as a share of GDP, as typically occurs during the later stages of a recovery. It also shows how the

[12] The clearest sign of an effect was seen in the latest EEF *Manufacturing outlook* where investment intentions fell to a six-year low, with the EU referendum cited as a possible cause.

nominal share has tended to fall relative to the real share because investment goods price inflation tends to be lower than whole economy inflation.

Chart 3.32: Business investment as a share of GDP



Source: ONS, OBR

3.96 The latest ONS data indicate that stocks acted as less of a drag on GDP growth in 2015 than we forecast in November. As discussed in paragraph 3.68, the implied price of the change in inventories is estimated to have fallen significantly in the final quarter of 2015, which contributed to a fall in the overall GDP deflator. We expect inventories to make a positive contribution to real GDP growth in 2016 and to be neutral thereafter.

Corporate profits

3.97 Data revisions have left the recent path of corporate profits significantly weaker than suggested by the data available to us at the time of our November forecast. The latest data indicate that non-oil corporate profits grew by 0.9 per cent in the year to the second quarter of 2015, revised down from a previous estimate of 4.4 per cent. The latest data on the high-level breakdown of income indicate a fall in corporations' gross operating surplus in the fourth quarter, pointing to a further slowdown in profit growth. As a result we have revised our forecast for non-oil profits growth in 2015 down from 6.3 to 1.9 per cent.

3.98 We expect non-oil profits to rise slightly more quickly than nominal GDP in the near term as the output gap continues to close. From 2017 we expect profits to grow slightly more slowly than nominal GDP, as the apprenticeship levy and auto-enrolment depress profit margins. These judgements are unchanged from November.

The government sector

3.99 Total public spending amounted to 40.8 per cent of GDP in 2014-15.[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 22.2 per cent of GDP in 2014-15.

Real government consumption

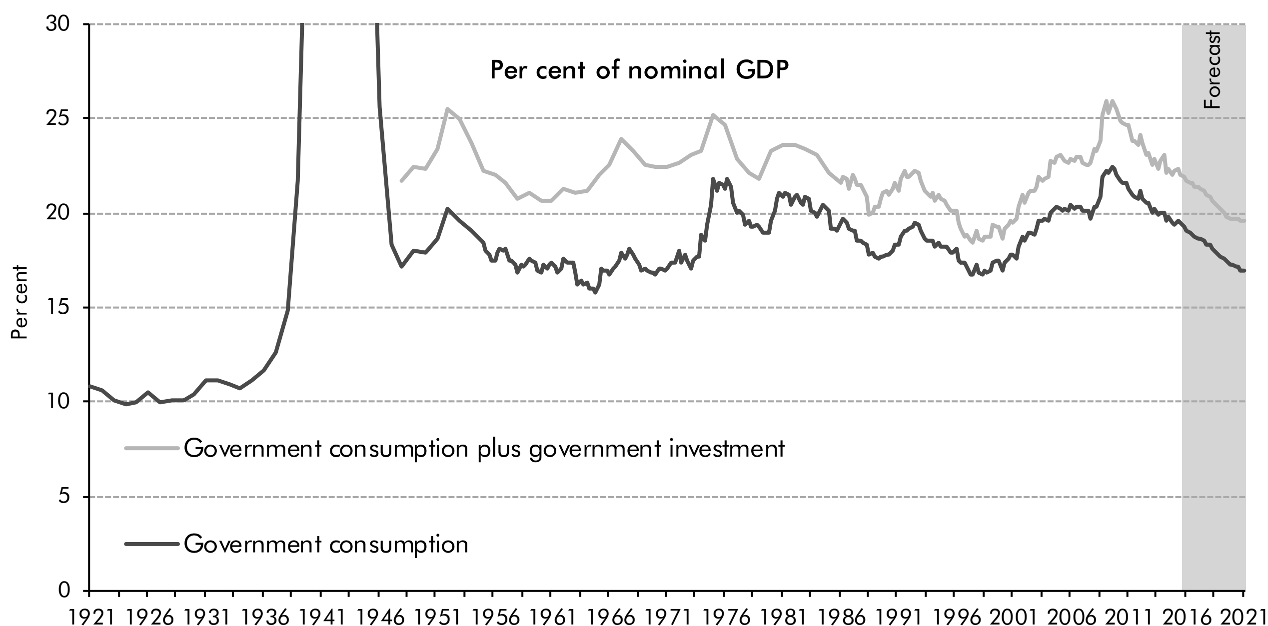
3.100 Real government consumption is estimated to have grown by 1.7 per cent in 2015, in line with our November forecast. We have revised our forecast down in 2016 and it is also slightly lower on average between 2017 and 2020, reflecting the Government's decisions on the pace and composition of fiscal consolidation.

Nominal government consumption

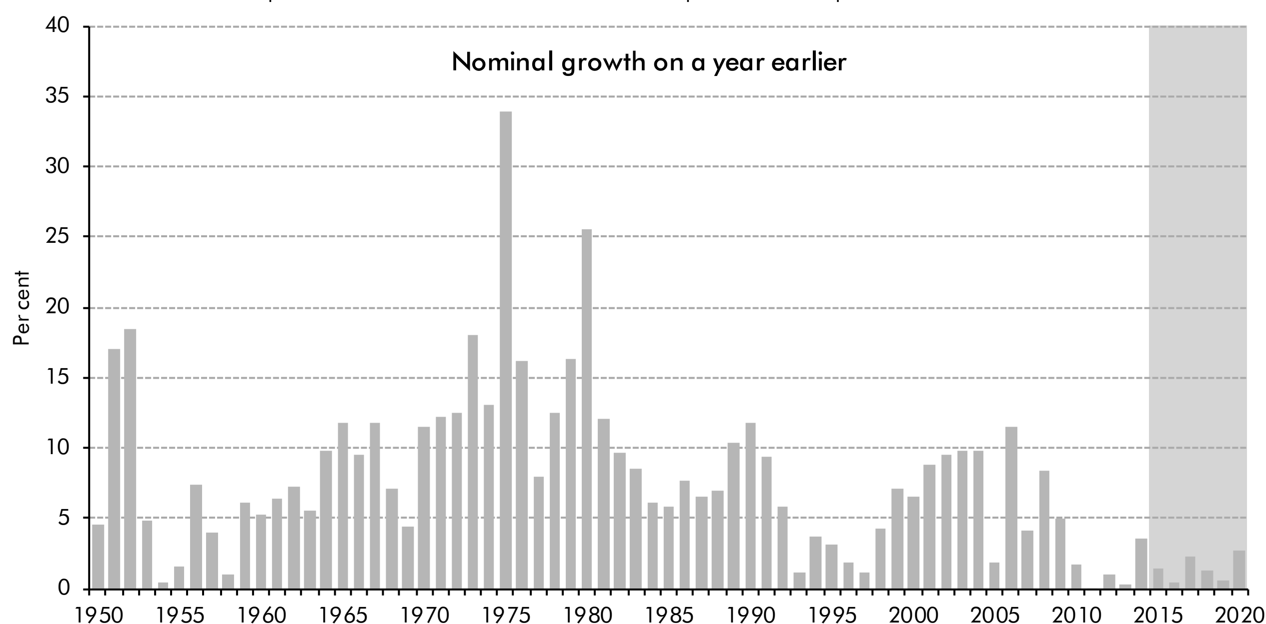
3.101 Nominal government consumption grew by 1.1 per cent in 2015, higher than our November forecast. But we have revised it down over the forecast. The Government's updated fiscal plans imply that nominal government consumption will grow by 1.3 per cent a year on average between 2016 and 2020, compared with 2.0 per cent in November. This implies that nominal government consumption will fall from 19.4 per cent of GDP in 2015 to 17.2 per cent of GDP in 2020, slightly higher than in November (Chart 3.33).

[13] Total managed expenditure (TME).

Chart 3.33: Government consumption and government investment



Note: Government consumption as a share of GDP is estimated to have peaked at 54.0 per cent of GDP in 1944.

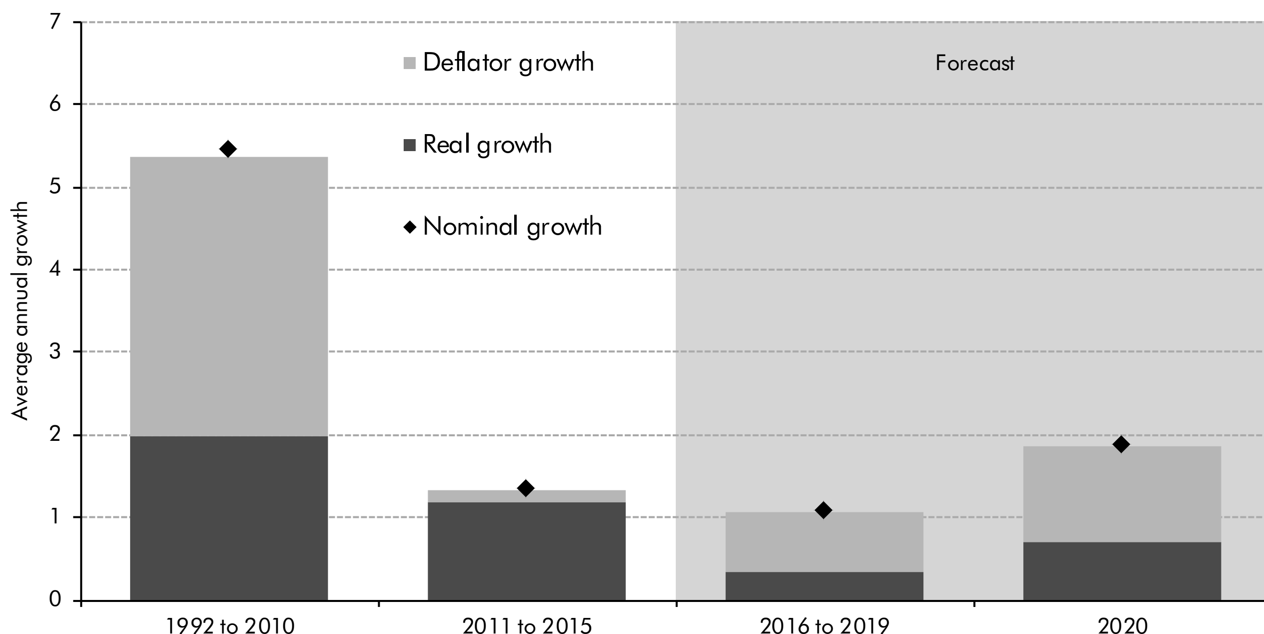


Note: Government consumption plus government investment on a National Accounts basis.
Source: ONS, OBR

3.102 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 (Chart 3.34). This largely reflects the way real government consumption is measured, as described in Box 3.3.

3.103 The government consumption deflator is estimated to have fallen by 0.6 per cent in 2015. This is less than we forecast in November, reflecting stronger growth in nominal government consumption. Revisions to our forecast since November are also driven by the Government's decisions on the pace and composition of fiscal consolidation.

Chart 3.34: General government consumption



Source: ONS, OBR

Box 3.3: International comparisons of the government consumption deflator

The government consumption deflator measures the implied price of government services. In the UK, around one-third reflects actual deflators – where the prices are measured directly – and the other two-thirds reflect implied deflators – where it is the volume that is measured directly and the price inferred. Our earlier forecasts did not take sufficient account of the effect on implied deflators of the Government's spending cuts, which reduce the value of spending more than the directly measured volumes. We therefore overestimated deflator growth and so underestimated the growth of real government consumption.

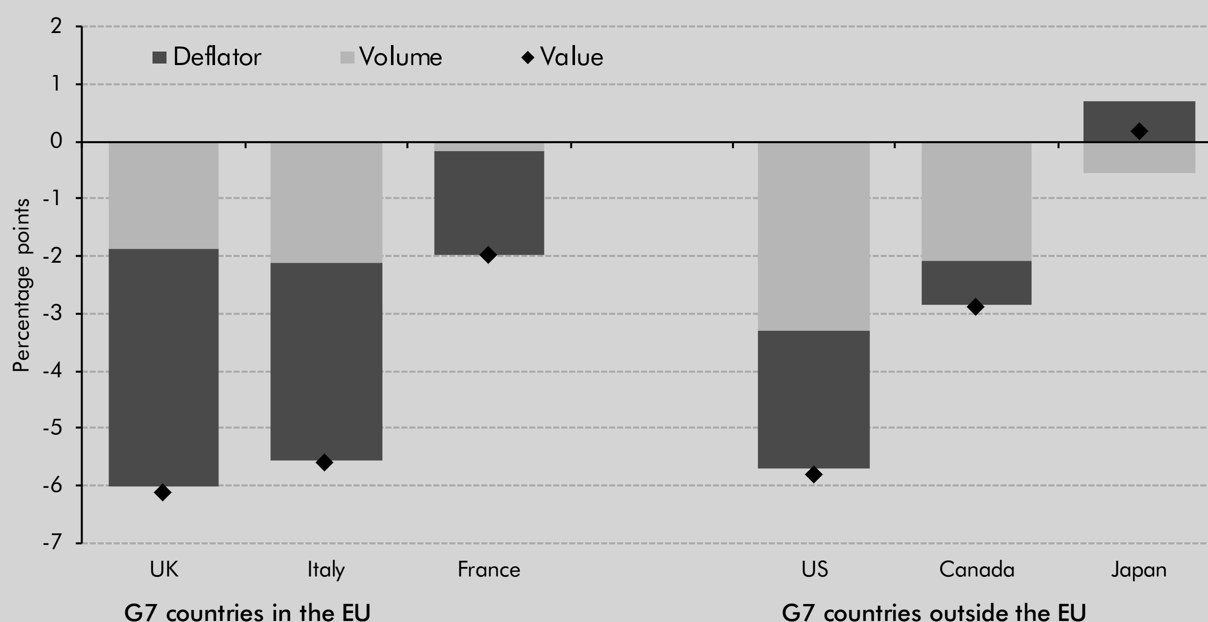
Methodologies for deriving the government consumption deflator vary across countries. Studies by the ONS[a] and OECD[b] suggest that non-EU countries tend to depend more on actual deflators and EU countries on implied deflators. That suggests that the effect of cuts in government consumption would be seen in the deflator to a greater extent in the UK and other EU countries than in non-EU countries.

Chart C shows how average annual growth in the value of six leading industrial countries'[c] government consumption since the third quarter of 2010 has changed relative to pre-recession averages (2000-2008). Growth in the value of government consumption is weaker in every country (bar Japan) than prior to the crisis. As we would expect, given the difference in deflator methodologies, lower deflator growth accounts for a greater proportion of cuts in the UK and other EU countries, while slower volume growth plays a bigger role in the non-EU countries. At the extremes, 90 per cent of the reduction in value growth has come via the deflator in France while 71 per cent came through volumes in Canada.

These differences in National Accounts methodologies may be important when considering international comparisons of the direct effect of government spending cuts on real GDP growth.

But comparisons in value terms should be less affected by such differences. In Box 3.3 of our November *EFO*, we showed that the planned cut in government consumption as a share of GDP in the UK would be the biggest ten-year fall seen in any G7 country in the past half century, according to OECD data dating back to 1960.

Chart C: Government consumption compared to pre-recession averages



Source: OECD

[a] Office for National Statistics, *Government implied deflators explained*, November 2014.
[b] OECD Working Paper, *Towards measuring the volume output of education and health services: A handbook*, April 2010.
[c] These are six of the seven members of the G7. Germany has not been included as growth in the value and volume of government consumption in Germany since mid-2010 has been greater than the pre-recession averages.

General government employment

3.104 In the absence of specific workforce plans, we project general government employment based on some simple and transparent assumptions. We begin by assuming that the total paybill will grow in line with a measure of current government spending. We also separately forecast government sector wage growth, taking into account recent data, stated government policy (such as limits on pay growth), historic rates of pay drift and whole economy earnings growth over the medium term. We then combine total and average pay growth to derive a projection of general government employment.

3.105 Slow growth in cash spending and low annual wage growth imply that general government employment will fall by 0.2 million between the first quarter of 2015 and the first quarter of 2021, leading to a total fall from early 2011 of 0.5 million.[14] We expect the fall to be more than offset by a rise in market sector employment.

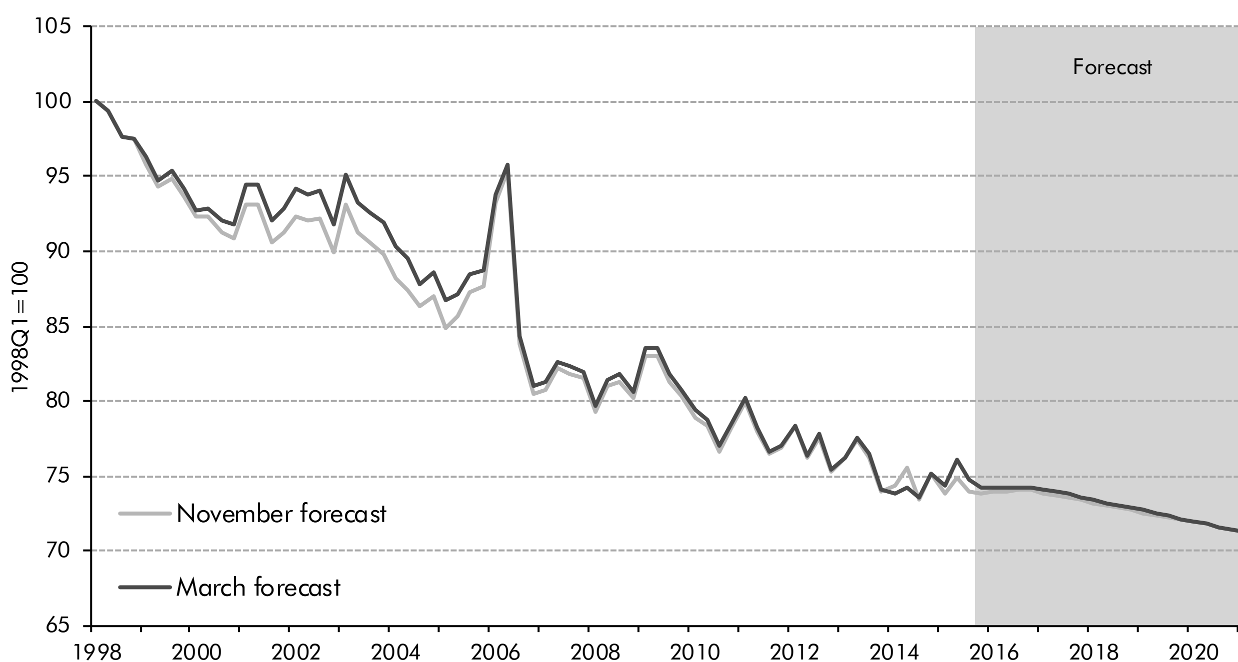
[14] These estimates exclude a classification change introduced in the second quarter of 2012, which moved around 196,000 employees from the public to the private sector. Further details about the assumptions for the public sector wages and employment can be found in the supplementary economy tables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

The external sector

Exports and imports

3.106 The latest National Accounts data revised up exports growth in late 2014 and early 2015 relative to the outturn data available at the time of our November forecast. Exports are then estimated to have fallen the final two quarters of 2015, having been expected to rise in November. Exports are estimated to have grown by 5.0 per cent in 2015, higher than we forecast in November, despite the weaker outturn data in the second half of the year. From 2016 onwards, we have revised down our forecast for exports to reflect a downward revision to UK export markets. Our key judgement – that the downward trend in UK export market share continues over the forecast period – is unchanged from November.

Chart 3.35: UK export market share



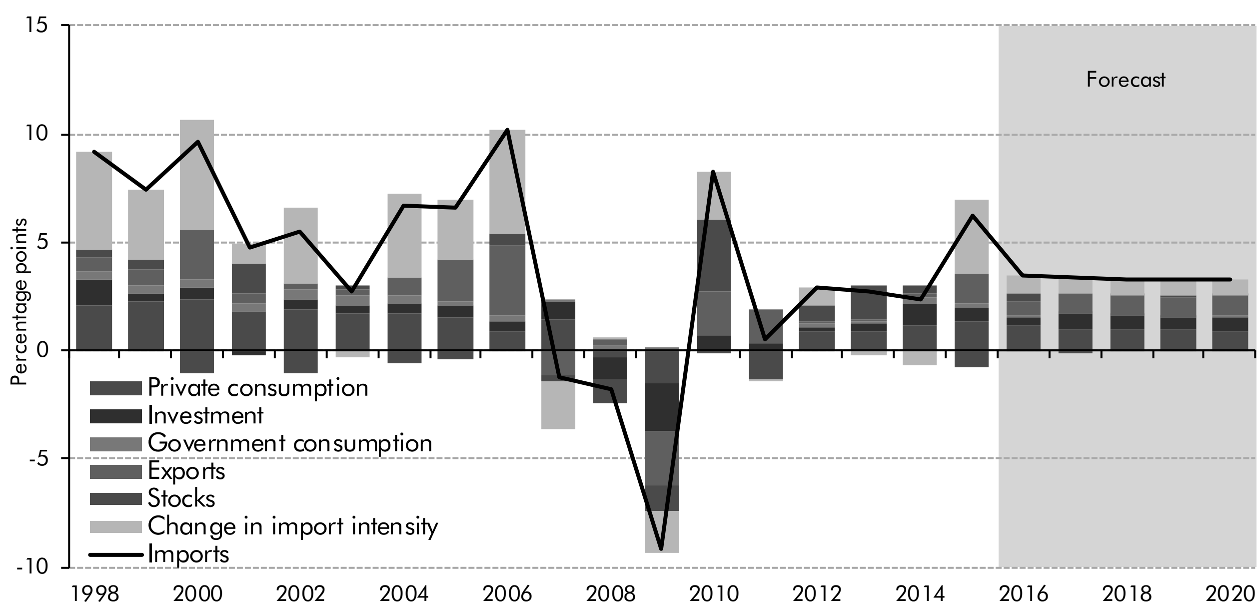
Note: UK export share defined as exports divided by UK export markets, where exports series have been adjusted to account for the effect of VAT Missing Trader Intra Community (MTIC) fraud, although there is uncertainty around MTIC data prior to 2007.
Source: OECD, ONS, OBR

3.107 At Budget 2012, the Government stated an aspiration to increase the cash value of exports to £1 trillion in 2020. That required export growth of £506 billion over nine years, whereas extending our March 2012 *EFO* forecast would have implied growth of £352 billion (see Box 3.4 of our November *EFO*). We now forecast that the value of total exports of goods and services will reach £643 billion in 2020, lower than we forecast in November and 36 per cent lower than the Government's aspiration.

3.108 Real imports are estimated to have grown by 6.2 per cent in 2015, significantly higher than we forecast in November. As with exports, this was driven by upward revisions to imports growth in late 2014 and early 2015.

3.109 Our forecast for UK imports is determined by the outlook for import-weighted domestic demand and a trend rise in the import intensity of that demand. We have not changed our judgement of the extent to which import intensity will rise over the forecast period. As Chart 3.36 shows, the contribution of rising import intensity to imports growth averaged 3.1 percentage points between 1998 and 2006, but it added just 0.2 percentage points to imports growth on average between 2007 and 2015. Our forecast assumes an average contribution of 0.8 percentage points between 2016 and 2020.

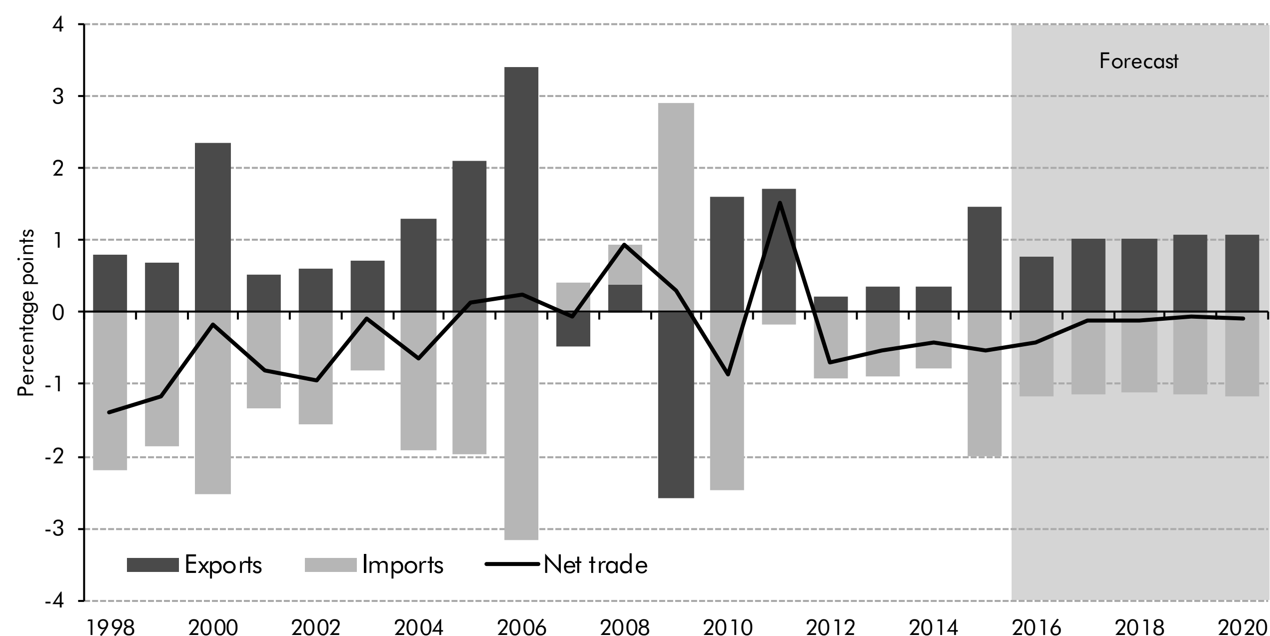
Chart 3.36: Contributions to import-weighted domestic demand and imports growth



Source: ONS, OBR

3.110 Net trade is estimated to have made a negative contribution to GDP growth in 2015, having been expected to make a positive contribution at the time of our November forecast. This change reflects an upward revision to imports growth, which is larger than the upward revision to exports. We expect net trade to subtract 0.4 percentage points from GDP growth in 2016, and 0.1 percentage points a year from 2017 onwards. Our net trade forecast reflects 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.

Chart 3.37: Net trade contribution to real GDP



Source: ONS, OBR

The current account balance

3.111 The latest data continue to indicate that the current account deficit widened significantly in recent years, reaching 5.1 per cent of GDP in 2014. However, recent data on foreign direct investment (FDI) may reduce this deficit when they are incorporated into the balance of payments.[15] Nevertheless the deficit in recent years remains large by historical standards, mainly as a result of a significant deterioration in the UK's net investment income balance: the income balance fell into deficit in 2013 and 2014 as the UK's net rate of return deteriorated, having averaged a surplus of just over 1 per cent of GDP in the decade prior to 2012.

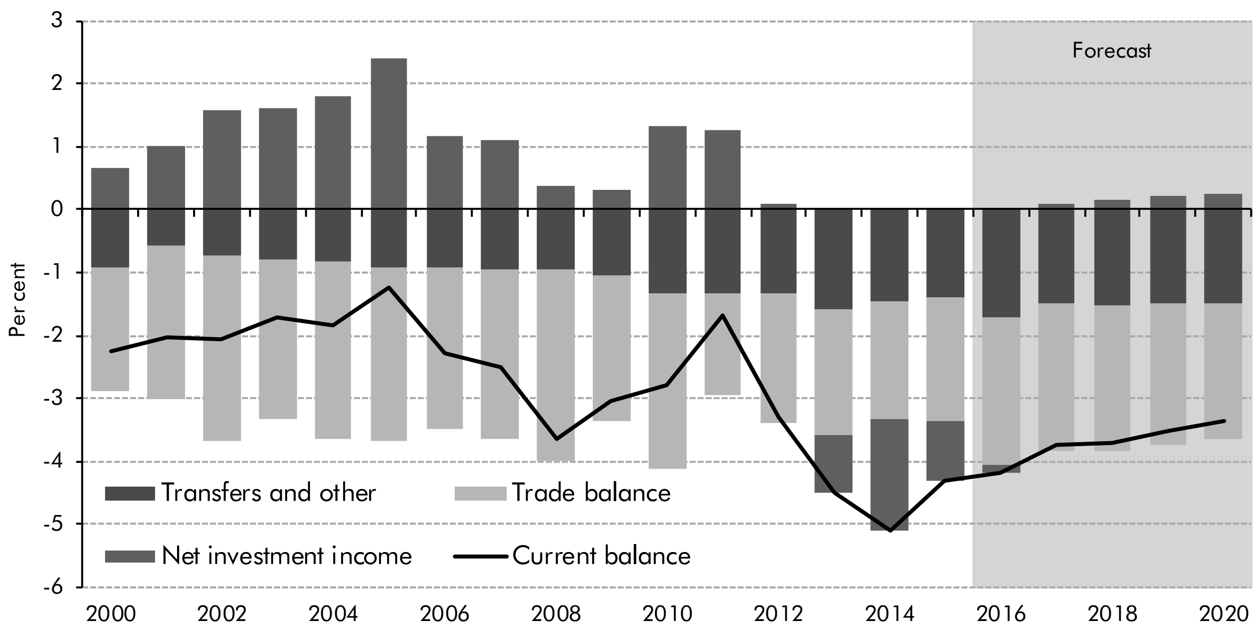
3.112 Recent quarterly data signal an improvement in the investment income balance, with the deficit narrowing from 2.4 per cent of GDP in the final quarter of 2014 to 0.7 per cent in the third quarter of 2015. We expect the investment income balance to continue to improve as rates of return normalise, a judgement conditioned on the assumption that the recent deterioration is partly temporary – reflecting, for example, the weaker growth outlook in the euro area or the possible effect of cross-border fines and compensation paid by UK firms abroad (although this is not verifiable from published data).

3.113 Despite the improvement in investment income, we expect the current account deficit to remain relatively large through the forecast as the trade deficit is expected to remain broadly stable. The current account deficit is expected to reach just over 3¼ per cent of GDP by 2020, a somewhat larger deficit than we expected in November, as a wider-than-expected trade deficit in the second half of 2015 has led to an upward revision to the size of the trade deficit through the forecast period.

[15] ONS, *Coherence between balance of payments Q3 2015 and the FDI 2014 bulletin*, December 2015.

3.114 The latest outturn trade data have a significant impact on the implied terms of trade, particularly in 2016. The terms of trade are now expected to fall in 2016, having been expected to rise relatively strongly in our November forecast. This affects the level of nominal GDP throughout the forecast period.

Chart 3.38: Current account balance as a share of GDP



Source: ONS, OBR

3.115 Table 3.5 shows how our forecast of the current account balance has changed since November:

- the increase in the current account deficit is almost entirely accounted for by an increase in our forecast of the trade deficit. This largely reflects a wider than expected trade deficit at the end of 2015. With little change to our forecast of net trade, this implies a wider trade deficit throughout the forecast period; and

- revisions to the investment income and transfers balance have been relatively small.

Table 3.5: Changes to the current account since November

	Current account (£ billion)						
	Outturn	Forecast					
	2014	2015	2016	2017	2018	2019	2020
November forecast	-92.9	-78.6	-58.9	-49.6	-50.7	-49.5	-48.6
March forecast	-92.5	-80.5	-80.3	-75.1	-77.0	-76.0	-76.1
Change	**0.4**	**-1.9**	**-21.4**	**-25.5**	**-26.4**	**-26.5**	**-27.5**
of which:							
Trade balance	0.1	-9.3	-21.8	-23.1	-24.4	-25.6	-26.5
Volumes	-1.1	-11.1	-13.8	-15.2	-15.8	-16.2	-16.8
Prices	1.2	1.8	-8.0	-7.9	-8.6	-9.3	-9.8
Investment income balance	0.2	5.3	2.5	-0.5	0.0	0.6	0.9
Transfers and other	0.1	2.1	-2.2	-1.9	-1.9	-1.6	-1.8

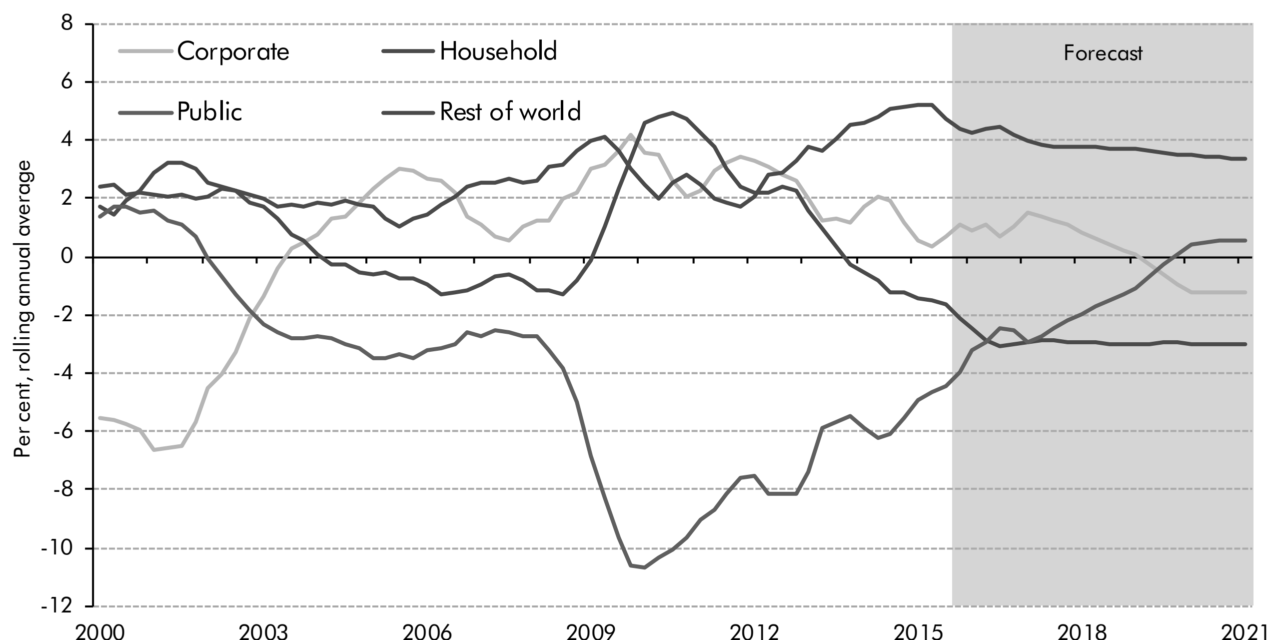
Sectoral net lending

3.116 In the National Accounts framework that we use for our economic forecast, the income and expenditure of the different sectors imply a path 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 2015, for which three quarters of data are now available, we estimate that the public and household sectors are in deficit, while the corporate and rest of world sectors are in surplus (Chart 3.39).

3.117 On current government policy we expect the public sector deficit to narrow, offset by a narrowing of the rest of the world surplus (a narrowing current account deficit) and a widening of the corporate deficit. We forecast little change in the household deficit, which is expected to remain around 3 per cent of GDP through the forecast period. The persistence of a household deficit of this size would be unprecedented in the latest available historical data, which extend back to 1987. Other datasets extending back to 1963 also suggest little evidence of a large, persistent household deficit, with the household surplus moving into negative territory in only one year between 1963 and 1987.[16] A household deficit of the size and persistence we expect over the forecast period might be considered consistent with the unprecedented scale of the fiscal consolidation and the extremely accommodative monetary policy upon which our forecast is conditioned. It nevertheless demonstrates that the adjustment to the fiscal consolidation is subject to very significant uncertainty, and alternative adjustment paths are quite possible (see paragraph 3.119).

[16] Based on historical estimates of the personal sector surplus on an ESA95 basis, as set out in Thomas, R. and Nolan, L., *National Accounts articles: Historical estimates of financial accounts and balance sheets*, January 2016.

Chart 3.39: Sectoral net lending



Source: ONS, OBR

Risks and uncertainties

3.118 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.

3.119 In addition, prevailing economic circumstances suggest some specific risks to the forecast. In this *EFO*, we would highlight:

- since November, **volatility in financial and commodity markets** has increased. If this persists it could have a negative effect on the UK economy via financial markets linkages and world trade;

- the IMF recently identified a sharper-than-expected **slowdown in China** as a risk to its global forecast. Although direct trade with China accounts for only 3.6 per cent of UK exports, China's contribution to world GDP and trade growth is significant and its increasing integration in global financial markets means that lower growth in China could have wider implications;

- we have revised down our forecast for potential output growth since November, but considerable uncertainty remains around this part of the forecast. If **productivity** fails to recover as predicted, but wage growth continues to accelerate, the MPC could be forced to raise interest rates more quickly, which could in turn have a negative impact on consumer spending and housing investment. Alternatively, lower productivity

growth could mean that wage growth falls short of expectations, in a similar manner to the revisions we have made in this forecast;

- even in our central forecast, the ratio of **households' gross debt** to income rises significantly over the forecast. That seems consistent with supportive monetary policy and other interventions to support demand in the housing market (to which the Government has added again in this Budget via the first-time buyer element of the lifetime ISA), but it could pose risks to the recovery over the longer term;

- our forecast assumes that the decline in public sector net borrowing is offset in a widening corporate deficit and a modest improvement in the current account. Some external commentators argue that the prospective path of the sectoral balances points to the risk of a **significant depreciation of sterling**; and

- whatever the long-term pros or cons of the UK's membership of the European Union, a vote to leave in the **forthcoming referendum** could usher in an extended period of uncertainty regarding the precise terms of the UK's future relationship with the EU. This could have negative implications for activity via business and consumer confidence and might result in greater volatility in financial and other asset markets (see Box 3.4).

Box 3.4: External analysis of 'Brexit' risks and uncertainties

The Government has announced that a referendum will be held on 23 June to determine whether the UK should remain a member of the European Union (EU) – and the Government is arguing that it should. Parliament has told us to prepare our forecasts on the basis of the current policy of the current Government and not to consider alternatives. So it is not for us to judge at this stage what the impact of 'Brexit' might be on the economy and the public finances.

Outside analysts have of course addressed this question. For example, a study published by the Centre for Economic Performance estimates that leaving the EU would result in lower trade and therefore lower GDP. It presents a 'pessimistic' scenario where incomes could fall by close to 10 per cent.[a] Conversely, a study published by the Institute of Economic Affairs argues that leaving the EU could increase UK GDP by 13 per cent.[b] The range of estimates in part reflects sensitivity to assumptions about what exactly would replace the current rules that are attached to EU membership. That was also apparent in the views presented at the National Institute of Economic and Social Research conference on the 'Economics of the UK's EU Membership' last month.[c]

These estimates are as large as they are in part because they incorporate 'dynamic' effects, reflecting for example long-term changes in UK productivity. As well as being highly uncertain, these take many years to materialise, with IMF research suggesting that it takes around 10 years for half the effect of changes in the trade share of GDP to be seen in income levels.[d] So even if we were to base our central forecast on an assumption of 'Brexit', the full impact would not show up within our five-year forecast horizon. A study by Open Europe modelled a scenario in which the UK leaves the EU in 2018 and found that GDP could be 2.2 per cent lower or 1.6 per cent higher by 2030, depending on the arrangements for trade and regulation that follow 'Brexit'.[e] It argued that much of the transition to either of these levels would take place beyond 2020.

Leaving aside the debate over the long-term impact of 'Brexit', there appears to be a greater consensus that a vote to leave would result in a period of potentially disruptive uncertainty while the precise details of the UK's new relationship with the EU were negotiated. For example:

- Goldman Sachs expects that delayed business investment spending would have a "*significantly negative*" impact on UK growth;[f]
- a JPMorgan study uses a VAR model to estimate that the uncertainty following a 'leave' vote could cause a 1 percentage point reduction in GDP growth in 2016.[g] Deutsche Bank predict a similar effect on GDP growth in the two-to-three years after a vote to leave;[h]
- Scotiabank predicts that GDP growth could slow by 2 to 5 per cent over a one-to-two-year horizon, due to a "*sharp drop*" in consumer confidence and lower consumption;[i]
- Bloomberg Intelligence modelled a fall in demand of 1.5 per cent of GDP, accompanied by an increase in credit spreads and a sterling depreciation. It argued that Bank Rate would be lower over our forecast period, with inflation higher initially but lower by the end of our forecast due to a persistent negative output gap;[j] and
- a number of forecasters suggest that uncertainty could lead to a significant sterling depreciation (especially given the UK's large current account deficit). Nomura estimate that sterling could depreciate by between 10 and 15 per cent following a vote to leave.[k]

There were only tentative signs that uncertainty regarding the referendum result was affecting business and consumer confidence and spending intentions by the time we closed this forecast.[l] But it may have contributed to recent financial market movements (and thus to some of the conditioning assumptions that underpin it). For example, sterling fell to a 7-year low against the dollar shortly after the date of the referendum was announced. That period fell within the 10-day window over which we have averaged market assumptions for this forecast.

[a] Centre for Economic Performance, *The costs and benefits of leaving the EU*, May 2014.
[b] Institute of Economic Affairs, *Should Britain leave the EU? An economic analysis of a troubled relationship*, February 2016.
[c] NIESR conference summary: *Economics of the UK's EU Membership*, held in February 2016.
[d] IMF working paper, *The long-run effects of trade on income and income growth*, February 2003.
[e] Open Europe, *What if…? The consequences, challenges and opportunities facing Britain outside the EU*, March 2015.
[f] Goldman Sachs Economics Research, *Brexit: The uncertainty shock of leaving the EU*, March 2016.
[g] JPMorgan Economic Research, *Brexit: What impact might uncertainty have on UK GDP?*, February 2016.
[h] Deutsche Bank Research, *The UK & EU: Exit emergency*, February 2016.
[i] Scotiabank, *Brexit – market and economic impact*, February 2016.
[j] Bloomberg Intelligence, *Brexit special: Modeling a surprise exit*, February 2016.
[k] Nomura Economic Insights, *Brexit carries a recessionary risk*, February 2016.
[l] Investment intentions in the latest EEF *Manufacturing outlook* were at a six-year low, with the EU referendum cited as a possible cause.

Comparison with external forecasters

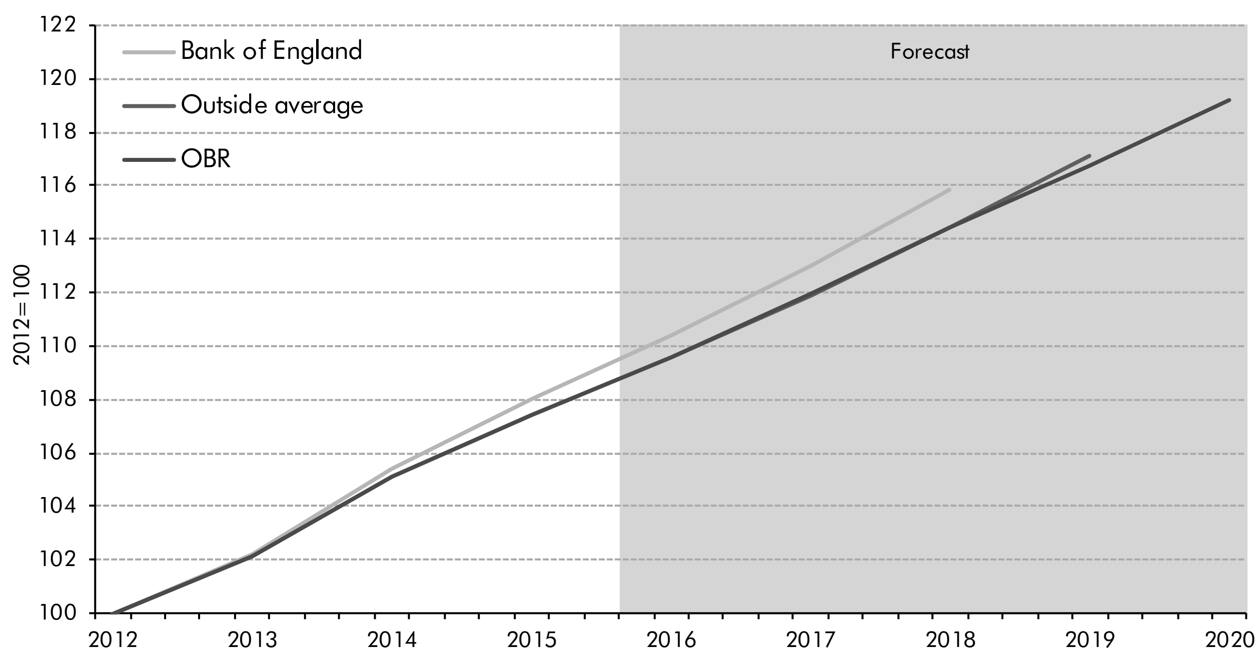
3.120 In this section, we compare our latest projections with those of selected outside forecasters. The differences between our forecast and those of external forecasters are generally small compared with the uncertainty that surrounds any one of them.

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

3.121 Alongside its February 2016 *Inflation Report*, the Bank of England published additional information about its forecast against which we can compare our own (see Table 3.6). This included the Bank staff's forecasts for the expenditure composition of GDP, consistent with the MPC's central forecasts of GDP, CPI inflation and the unemployment rate.

3.122 The MPC's modal forecast for GDP growth is 2.2 per cent in 2016, higher than our forecast due to stronger growth in private consumption and business investment, as well as a less negative contribution from net trade. The Bank's modal forecast is also higher than ours in 2017 and 2018, primarily due to stronger consumption growth in both years. The Bank's forecast for the level of GDP is 0.9 per cent higher than ours in 2017, the same as at the time of our last forecast in November.

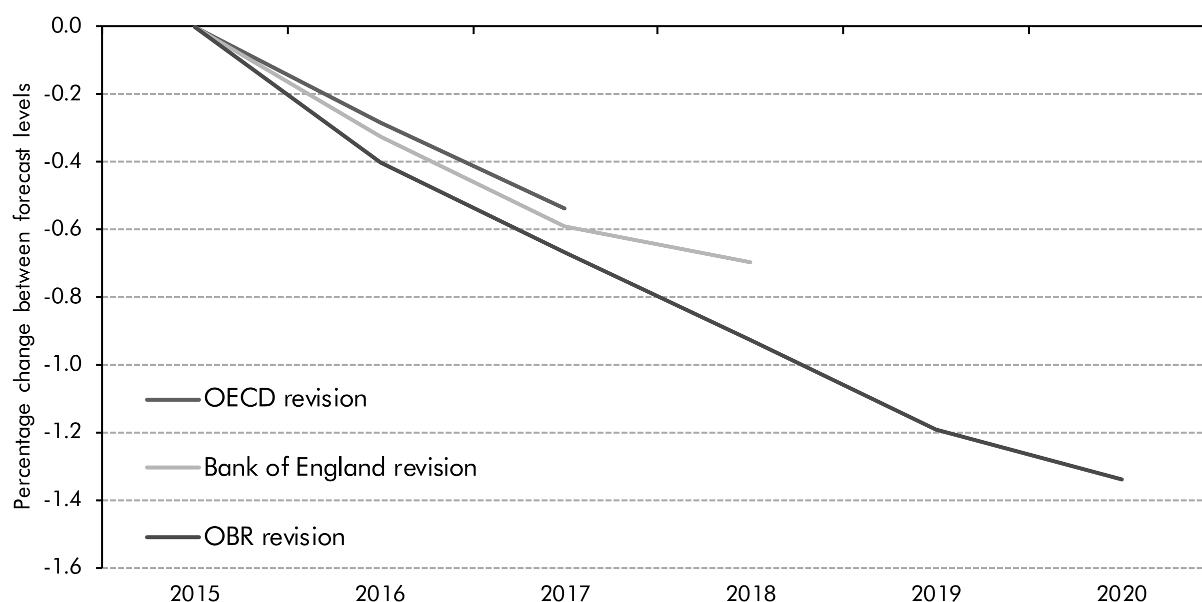
Chart 3.40: Comparison of forecasts for the level of GDP projections



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

3.123 While remaining more optimistic than us and the average of external forecasts, the MPC's best collective judgement on the implications of news since November has led them to revise down cumulative real GDP growth over their 3-year forecast horizon. These revisions are similar to the changes in our forecast since November. The OECD has also revised down its forecast for GDP growth in 2016 and 2017 (Chart 3.41).

Chart 3.41: Comparison with Bank of England and OECD revisions to real GDP since November



Note: All revisions are calculated on an annual basis.
Source: Bank of England, OECD, OBR calculations

Table 3.6: Comparison with the Bank of England's illustrative projections

	Per cent			
	2015[1]	2016	2017	2018
Bank of England February *Inflation Report* forecast				
Household consumption	2¾	2¾	2½	2¾
Business investment	6½	5½	6	6¼
Housing investment[2,3]	2¼	4	5½	5¾
Exports	5½	2¼	1¼	2
Imports	6¼	2½	2¼	2½
Employment[4]	2	¾	¾	¾
Productivity[5]	1	1¼	1¾	1¾
Average weekly earnings[3,4]	1¾	3	3¾	4¼
Difference from OBR forecast				
Household consumption	-0.1	0.3	0.3	0.6
Business investment	1.8	2.9	-0.1	0.4
Exports	0.5	-0.3	-2.1	-1.3
Imports	0.0	-1.0	-1.1	-0.8
Employment[4]	0.3	0.1	0.3	0.4
Productivity[5]	0.2	0.2	0.0	-0.3

[1] 2015 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.
[5] Output per hour.

Comparison with other external forecasters

3.124 In its most recent *World economic outlook*, the IMF's forecast for GDP growth was slightly above our central forecast in 2016 and in line with ours in 2017. Since publishing its most recent *Economic outlook*, the OECD has updated its short-term forecast for GDP growth. The OECD's updated forecast is slightly above ours in 2016 and slightly below it in 2017. In its February *Economic review*, the National Institute for Economic and Social Research (NIESR) forecast GDP growth of 2.3 per cent in 2016, higher than our forecast. NIESR forecast stronger consumption and investment growth in 2016, partly offset by a weaker forecast for net trade. NIESR's forecast for GDP growth is also higher than ours from 2017 onwards, with a positive contribution from net trade only partially offset by lower consumption growth. The European Commission's forecast for GDP growth is slightly higher than ours in 2016, due to higher growth in private consumption, government consumption and investment, partly offset by negative contributions from inventories and net trade. The Commission forecast for 2017 is slightly lower than ours, with higher private consumption growth offset by lower government consumption growth.

Table 3.7: Comparison with external forecasters

	Per cent					
	2014	2015	2016	2017	2018	2019
OBR (March 2016)						
GDP growth	2.9	2.2	2.0	2.2	2.1	2.1
CPI inflation	1.5	0.0	0.7	1.6	2.0	2.1
Output gap	-1.0	-0.3	-0.2	0.0	0.0	0.0
Oxford Economics (February 2016)						
GDP growth	2.9	2.2	2.2	2.5	2.2	2.2
CPI inflation	1.5	0.0	0.5	1.7	1.8	1.9
Output gap	-2.9	-2.8	-2.7	-2.5	-2.4	-2.2
Bank of England (February 2016)[1,2]						
GDP growth (mode)		2.5	2.2	2.4	2.5	
CPI inflation (mode)[3]		0.1	0.9	1.9	2.2	
European Commission (February 2016)						
GDP growth	2.9	2.3	2.1	2.1		
CPI inflation	1.5	0.0	0.8	1.6		
Output gap	-0.6	0.0	0.3	0.7		
NIESR (February 2016)[1]						
GDP growth	2.9	2.2	2.3	2.7	2.7	2.5
CPI inflation	1.4	0.1	0.3	1.3	2.1	2.2
OECD (November 2015)[4]						
GDP growth	2.9	2.4	2.4	2.3		
CPI inflation	1.5	0.1	1.5	2.0		
Output gap	-0.5	0.0	0.4	0.8		
IMF (October 2015)[5]						
GDP growth	3.0	2.5	2.2	2.2	2.2	2.2
CPI inflation	1.5	0.1	1.5	2.0	2.0	2.0
Output gap	-1.4	-0.7	-0.4	-0.2	-0.1	0.0

[1] Output gap not published.

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

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

[4] The OECD has since published its February 2016 *Interim economic outlook*. For the UK, GDP growth was revised down to 2.1 per cent in 2016 and 2.0 per cent in 2017.

[5] The IMF updated its short-term forecast in the January 2016 *World economic outlook update*. For the UK, GDP growth was revised down to 2.2 per cent in 2015. Growth in 2016 and 2017 were unrevised, also at 2.2 per cent.

Table 3.8: Detailed summary of forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2014	2015	2016	2017	2018	2019	2020
UK economy							
Gross domestic product (GDP)	2.9	2.2	2.0	2.2	2.1	2.1	2.1
GDP level (2014=100)	100.0	102.2	104.3	106.6	108.9	111.1	113.5
Nominal GDP	4.7	2.6	3.1	4.1	4.1	4.0	4.1
Output gap (per cent of potential output)	-1.0	-0.3	-0.2	0.0	0.0	0.0	0.0
Expenditure components of GDP							
Domestic demand	3.2	2.7	2.2	2.3	2.2	2.0	2.0
Household consumption[1]	2.5	2.9	2.4	2.2	2.1	2.0	1.9
General government consumption	2.5	1.7	0.2	0.6	0.5	0.2	0.7
Fixed investment	7.3	4.2	2.9	4.5	4.1	4.0	4.3
Business	4.7	4.7	2.6	6.1	5.8	5.5	4.4
General government[2]	5.8	2.2	0.2	1.9	-0.3	-0.2	6.5
Private dwellings[2]	14.0	3.4	5.1	2.8	3.0	3.0	2.9
Change in inventories[3]	0.2	-0.4	0.2	0.0	0.0	0.0	0.0
Exports of goods and services	1.2	5.0	2.5	3.3	3.3	3.4	3.4
Imports of goods and services	2.4	6.2	3.5	3.3	3.3	3.3	3.3
Balance of payments current account							
Per cent of GDP	-5.1	-4.3	-4.2	-3.8	-3.7	-3.5	-3.4
Inflation							
CPI	1.5	0.0	0.7	1.6	2.0	2.1	2.0
RPI	2.4	1.0	1.7	2.4	3.2	3.2	3.2
GDP deflator at market prices	1.8	0.3	1.1	1.9	2.0	1.9	2.0
Labour market							
Employment (millions)	30.7	31.2	31.6	31.7	31.9	32.0	32.1
Productivity per hour	0.1	0.8	1.0	1.7	2.0	2.0	2.0
Wages and salaries	2.9	4.1	3.6	4.2	3.9	3.8	3.9
Average earnings[4]	1.4	2.3	2.6	3.6	3.5	3.4	3.6
LFS unemployment (% rate)	6.2	5.4	5.0	5.0	5.2	5.3	5.3
Claimant count (millions)	1.04	0.80	0.75	0.78	0.84	0.86	0.87
Household sector							
Real household disposable income	0.6	2.9	1.8	1.9	1.6	1.5	1.5
Saving ratio (level, per cent)	5.4	4.2	3.3	3.6	3.7	3.9	3.9
House prices	9.9	6.8	6.9	4.2	5.0	4.7	3.9
World economy							
World GDP at purchasing power parity	3.4	3.1	3.3	3.5	3.8	3.9	3.9
Euro area GDP	0.9	1.5	1.6	1.6	1.6	1.6	1.6
World trade in goods and services	3.5	2.4	3.0	3.6	4.2	4.3	4.3
UK export markets[5]	3.9	4.1	3.4	3.9	4.4	4.5	4.5

[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 3.9: Detailed summary of changes to the forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2014	2015	2016	2017	2018	2019	2020
UK economy							
Gross domestic product (GDP)	-0.1	-0.1	-0.4	-0.3	-0.3	-0.3	-0.2
GDP level (2014=100)[1]	0.0	-0.1	-0.5	-0.8	-1.0	-1.3	-1.5
Nominal GDP	0.0	-1.1	-0.9	-0.2	-0.2	-0.4	-0.4
Output gap (per cent of potential output)	0.0	0.4	0.2	0.2	0.0	0.0	0.0
Expenditure components of GDP							
Domestic demand	0.0	0.4	-0.4	-0.2	-0.2	-0.3	-0.3
Household consumption[2]	-0.2	0.0	-0.2	-0.1	-0.2	0.0	0.1
General government consumption	0.6	0.0	-0.3	0.0	0.1	-0.3	-0.4
Fixed investment	-0.3	0.0	-2.5	-0.6	-0.6	-1.0	-0.5
Business	0.1	-1.3	-4.9	-1.0	-1.2	-1.1	-0.1
General government[3]	-1.8	-0.8	-0.6	1.3	1.3	-1.9	-2.7
Private dwellings[3]	-0.2	3.2	1.3	-0.6	-0.1	0.0	-0.1
Change in inventories[4]	-0.1	0.5	0.2	0.0	0.0	0.0	0.0
Exports of goods and services	-0.6	1.7	-0.9	-0.2	-0.2	-0.2	-0.2
Imports of goods and services	-0.4	3.4	-0.4	0.0	-0.2	-0.2	-0.2
Balance of payments current account							
Per cent of GDP	0.0	-0.1	-1.2	-1.3	-1.3	-1.3	-1.3
Inflation							
CPI	0.0	0.0	-0.3	-0.2	0.1	0.1	0.0
RPI	0.0	0.0	-0.3	-0.5	0.0	0.0	-0.1
GDP deflator at market prices	0.1	-0.9	-0.5	0.0	0.1	-0.1	-0.2
Labour market							
Employment (millions)	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Productivity per hour	-0.1	-0.2	-0.5	-0.2	-0.1	-0.2	-0.2
Wages and salaries	-0.1	-0.3	-0.9	-0.3	-0.3	-0.3	-0.4
Average earnings[5]	-0.1	-0.3	-0.7	-0.1	-0.1	-0.3	-0.3
LFS unemployment (% rate)	0.0	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1
Claimant count (millions)	0.00	0.00	-0.03	-0.03	-0.02	-0.01	-0.01
Household sector							
Real household disposable income	0.9	-0.5	-0.7	-0.2	-0.2	-0.1	-0.3
Saving ratio (level, per cent)	0.5	0.1	-0.8	-0.8	-0.7	-0.6	-0.8
House prices	0.0	0.6	2.1	-0.4	-0.3	-0.3	-0.4
World economy							
World GDP at purchasing power parity	0.0	0.0	-0.3	-0.3	-0.1	0.0	0.0
Euro area GDP	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
World trade in goods and services	0.2	-0.6	-0.5	-0.3	-0.1	-0.1	-0.1
UK export markets[6]	0.1	0.0	-0.2	-0.2	-0.2	0.0	0.0

[1] Per cent change since November.

[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 new policies** announced in this Budget – and since the November Spending Review and Autumn Statement – on the fiscal forecast (from paragraph 4.5);
- describes the **outlook for public sector receipts**, including a tax-by-tax analysis explaining how the forecasts have changed since November (from paragraph 4.21);
- describes the **outlook for public sector expenditure**, focusing on spending covered by departmental expenditure limits and the components of annually managed expenditure, including those subject to the Government's welfare cap (from paragraph 4.87);
- describes **the outlook for government lending to the private sector and other financial transactions**, including asset sales (from paragraph 4.150);
- describes the **outlook for the key fiscal aggregates**: headline and structural measures of public sector net borrowing and the current budget, and public sector net debt (from paragraph 4.172);
- summarises **risks and uncertainties** (paragraph 4.187); and
- provides a **comparison with forecasts from international organisations** (from paragraph 4.188).

4.2 Further breakdowns of receipts and expenditure and other details of our fiscal forecast are provided in the supplementary tables on our website. The medium-term forecasts for the public finances in this chapter start from outturn 2014-15 data.[1] We then present an in-year estimate for 2015-16 that makes use of published Office for National Statistics (ONS) outturn data for April to January and some administrative receipts data for February,

[1] Outturn data for 2014-15 are consistent with the *Public Sector Finances January 2016 Statistical Bulletin* (released in February) published by the ONS and HM Treasury.

followed by forecasts for 2016-17 to 2020-21. As in previous *Economic and fiscal outlooks (EFOs),* this fiscal forecast:

- **represents our central view** of the path of the public finances, conditioned on the current policies and policy assumptions of the Government. On that basis, we believe that the outturns – which will be affected by any errors in our forecast assumptions or future Government policy changes – are 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 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.

Economic determinants of the fiscal forecast

4.3 Our fiscal forecasts are based on the economic forecasts presented in Chapter 3. Most economic forecasts focus on the outlook for real GDP, but it is nominal GDP that matters most when forecasting the public finances. Forecasts of tax receipts are particularly dependent on the profile and composition of economic activity. 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. 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.

4.4 Table 4.1 sets out some of the key economic determinants of the fiscal forecast. Table 4.2 shows how these have changed since our November forecast. Detailed descriptions of these forecasts and changes are provided in Chapter 3. In summary:

- **nominal GDP** is forecast to grow by 3.7 per cent a year on average between 2015-16 and 2020-21. This is down from 4.3 per cent a year in November, reflecting weaker outturn growth in 2015 and a weaker outlook for underlying productivity growth. Box 4.1 describes the large data-driven revision to near-term growth in the non-seasonally adjusted measure of nominal GDP that is used as the denominator when expressing fiscal aggregates as a percentage of GDP;
- on the income side of GDP, **wages and salaries** are forecast to grow by 3.9 per cent a year on average between 2015-16 and 2020-21, down 0.4 percentage points from our November forecast. Within that, employment growth is broadly unchanged, while average earnings growth has been revised down due to lower expected productivity growth. Non-oil, non-financial **profits** grow by 3.5 per cent a year on average, down from 4.6 per cent in November;

- on the expenditure side of GDP, **nominal consumer spending** is forecast to grow by 4.0 per cent a year on average between 2015 and 2020, down by 0.1 percentage points from our November forecast reflecting the productivity-driven reduction in expected earnings growth;

- the CPI measure of **inflation** has been revised down in the near term, reflecting the pass-through of lower oil and gas prices to petrol prices and utility bills. It is expected to move slightly above the 2 per cent target during 2018-19 reflecting the introduction of the soft drinks industry levy in that year. Thereafter, it is assumed to return to target. We continue to expect RPI inflation to be higher than CPI inflation throughout the forecast period because of differences in the ONS approach to constructing the two measures;

- **house price inflation** has been revised up in the short term due to stronger outturns, but down towards the end of the forecast period due to weaker income growth. **Residential property transactions** are broadly unchanged since November;

- our pre-measures forecasts for **commercial property prices and transactions** are little changed since November. The Budget announced reforms to stamp duty on non-residential transactions and leases. We expect these reforms to reduce both the frequency of transactions and to increase the number of transactions that avoid SDLT, meaning that our forecast for SDLT-paying transactions falls next year. We also expect the increase in tax rates to reduce growth in commercial property prices next year;

- market-derived assumptions for **equity prices, interest rates** and the **oil price** reflect average prices in the 10 days to 25 February. Equity and oil prices have been revised down significantly since November in line with recent outturns, while market expectations of interest rates have fallen substantially further (from the already low levels that were assumed in November);

- our **oil and gas production** forecasts are informed by the central projections published by the Oil and Gas Authority (OGA). We have revised our oil production forecast up, reflecting stronger-than-expected growth in 2015. We expect higher production to persist over the forecast, reflecting a return from the high levels of investment in recent years. The sharp falls in oil and gas prices since November mean this forecast – always subject to uncertainty – may be even more uncertain than usual; and

- the **output gap** – which we use to estimate the structural health of the public finances – is narrower than in our November forecast. It is expected to average -0.3 per cent in 2015-16 and to close a year earlier in 2017-18.

Box 4.1: Non-seasonally adjusted nominal GDP

The economy and public finances are affected by many factors, including some predictable ups and downs during the course of the year: Christmas boosts high street spending; people are more likely to move house in the summer than the winter; and so on.

The headline GDP data that form the basis of our *economy forecast* are 'seasonally adjusted' by the Office for National Statistics (ONS) to strip out those regular patterns. But the headline ONS public finances data on which our *fiscal forecast* – and the Government's fiscal targets – are based are not. For consistency, when the ONS presents official estimates of the deficit or debt as a percentage of GDP, rather than in billions of pounds, it uses the non-seasonally adjusted (NSA) measure of nominal GDP as the denominator. Moreover, it uses different time periods to calculate the denominators:

- the ratio for the **deficit** in any given fiscal year is straightforward. It is the cash deficit divided by the sum of NSA nominal GDP over the four quarters that comprise the fiscal year. In other words, the second quarter of 2015 to the first quarter of 2016, for fiscal year 2015-16; and
- the ratio for **net debt** in a particular fiscal year is slightly less intuitive. Because debt is a stock rather than a flow, the conventional way to define the debt ratio for 2015-16 is to focus on the level of debt at the *end* of the year. This is calculated as the cash value of the debt at the end of the year divided by the sum of NSA nominal GDP for the previous and subsequent six months. In other words, from the fourth quarter of 2015 to the third quarter of 2016, for the 2015-16 fiscal year.

As a result, we need to forecast NSA nominal GDP for our fiscal forecast. We do that by applying a 3-year average of the quarterly seasonal factors implied by the ONS nominal GDP data to add a seasonal pattern to our forecast. This normally is not noteworthy, but in our November forecast it made a material difference to the path of the debt ratio and the revision between November and this forecast has been large. Chapter 5 sets out the implications this has had for the Government's target to reduce debt as a share of GDP each year.

Headline nominal GDP growth during 2015 has slowed significantly – to 1.9 per cent in the year to the final quarter of 2015, far below the 3.9 per cent we forecast in November. As discussed below, this reflects ONS revisions through the year as well as the first estimate for the fourth quarter, which was published last month. Slower growth in seasonally adjusted nominal GDP would have reduced our forecast of the NSA measure anyway. But a change in the ONS estimates of the seasonal pattern through 2015 has pushed it down even further.

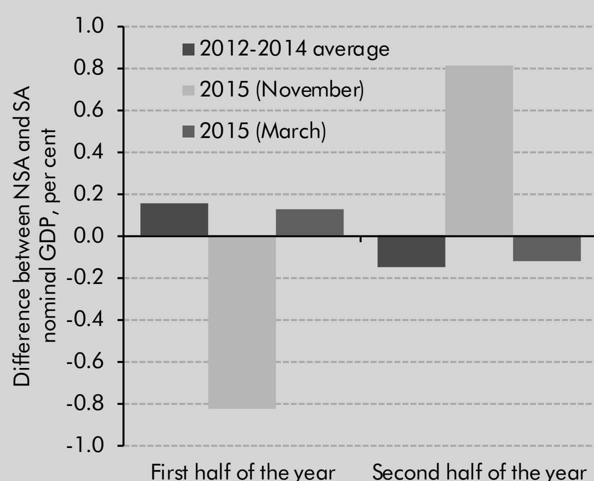
Chart A shows how the GDP estimates available at the time of our November forecast reported an unusually big gap between NSA and headline nominal GDP in the first half of 2015, with NSA low relative to the headline figure. These seasonal effects must by definition cancel out over the calendar year, so that meant that our forecast in November had to assume NSA GDP would be higher in the second half of the year, which boosted growth in NSA nominal GDP in the period used as the denominator for 2015-16 debt-to-GDP. The latest ONS data show a seasonal pattern through 2015 that looks more like previous years, which means the shortfall in NSA nominal GDP growth relative to our November forecast is even greater: 1.7 per cent year-

on-year in the final quarter of 2015 relative to our forecast of 4.7 per cent.

Chart B shows how the combination of weaker headline nominal GDP growth and revisions to the estimated seasonal pattern of activity through 2015 have affected annual average growth in NSA nominal GDP in the denominator period for the 2015-16 debt-to-GDP calculation:

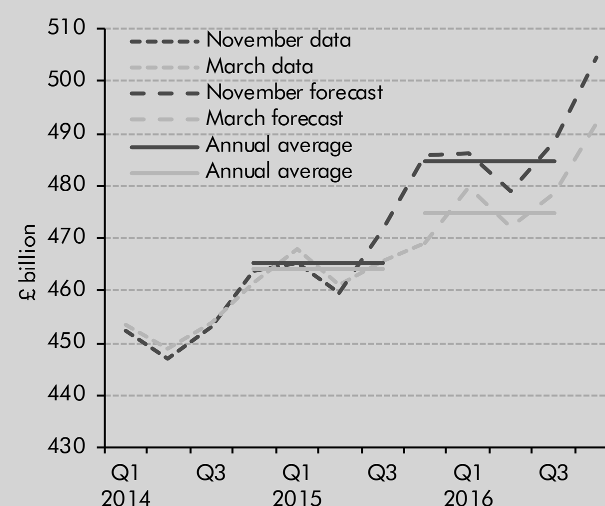
- in the **first two quarters of 2015**, the latest data have been revised up, as the revision to the implied seasonal factors more than offset weaker headline nominal GDP;
- in the **second half of 2015**, the latest data are much weaker than we forecast in November, with weakness in headline nominal GDP explaining around two-thirds of the shortfall and the change in the assumed seasonal pattern the rest;
- a **lower expected level of nominal GDP in 2016**, mainly due to the unexpected weakness at the end of 2015; and
- the combination of a slightly higher average level of NSA nominal GDP in the base year and a much lower level in the denominator year means that **annual growth has been revised down** from 4.3 per cent in November to 2.3 per cent in this forecast. For a given year-on-year change in the level of debt, it is that growth rate that affects the pace at which debt is estimated to rise or fall as a share of GDP.

Chart A: The seasonal profile of nominal GDP



For November, the first half of the year is data and the second half forecast. March is all data. Source: ONS, OBR

Chart B: Non-seasonally adjusted nominal GDP growth data and forecasts



Source: ONS, OBR

Table 4.1: Determinants of the fiscal forecast

	Percentage change on previous year unless otherwise specified						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
GDP and its components							
Real GDP	2.8	2.1	2.0	2.2	2.1	2.1	2.2
Nominal GDP[1]	4.3	2.4	3.6	4.0	4.2	3.9	4.2
Nominal GDP (£ billion)[1,2]	1832	1876	1943	2021	2106	2189	2281
Nominal GDP (centred end-March £bn)[1,3]	1856	1899	1983	2063	2147	2234	2328
Wages and salaries[4]	3.2	3.8	3.9	4.1	3.9	3.8	4.1
Non-oil PNFC profits[4,5]	10.0	1.9	3.8	3.5	3.8	3.9	4.2
Consumer spending[4,5]	4.2	3.2	3.6	4.1	4.4	4.4	4.2
Prices and earnings							
GDP deflator	1.5	0.2	1.5	1.8	2.1	1.9	2.0
RPI (September)[6]	2.3	0.8	1.7	2.6	3.3	3.2	3.2
CPI (September)[6]	1.2	-0.1	0.6	1.6	2.1	2.0	2.0
Average earnings[7]	1.3	2.4	3.0	3.5	3.5	3.3	3.8
'Triple-lock' guarantee (September)	2.5	2.9	2.5	3.6	3.5	3.5	3.4
Key fiscal determinants							
Claimant count (millions)	0.95	0.78	0.74	0.80	0.85	0.86	0.87
Employment (millions)	30.9	31.3	31.6	31.8	31.9	32.0	32.1
VAT gap (per cent)	10.8	11.4	11.5	11.2	10.9	10.5	10.3
Output gap (per cent of potential output)	-0.7	-0.3	-0.1	0.1	0.0	0.0	0.0
Financial and property sectors							
Equity prices (FTSE All-Share index)	3580	3400	3337	3471	3617	3760	3918
HMRC financial sector profits[1,5,8]	4.3	2.4	3.5	4.0	4.1	4.0	4.4
Residential property prices[9]	10.0	6.8	5.7	4.5	5.1	4.5	3.8
Residential property transactions (000s)[10]	1201	1258	1257	1282	1294	1301	1310
Commercial property prices[10]	17.6	7.4	2.1	1.8	1.9	1.9	2.2
Commercial property transactions[10]	8.6	3.5	-0.9	2.3	2.3	2.1	2.1
Volume of stampable share transactions	-8.6	10.3	0.0	0.0	0.0	0.0	0.0
Oil and gas							
Oil prices ($ per barrel)[5]	98.9	52.4	35.5	41.9	44.0	44.0	44.0
Oil prices (£ per barrel)[5]	60.0	34.3	24.9	29.3	30.7	30.6	30.4
Gas prices (p/therm)[5]	50.2	43.0	29.9	32.3	32.3	32.3	32.3
Oil production (million tonnes)[5]	40.0	45.0	43.2	43.3	43.4	41.3	39.2
Gas production (billion therms)[5]	13.0	14.0	13.0	12.4	11.8	11.3	10.7
Interest rates and exchange rates							
Market short-term interest rates (%)[11]	0.6	0.6	0.5	0.6	0.8	1.0	1.2
Market gilt rates (%)[12]	2.3	1.9	1.7	1.9	2.1	2.2	2.4
Euro/Sterling exchange rate (€/£)	1.28	1.37	1.28	1.27	1.26	1.25	1.24

[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] Q3 forecast used as a proxy for September.
[7] Wages and salaries divided by employees.
[8] HMRC Gross Case 1 trading profits.
[9] Outturn data from ONS House Price Index.
[10] Outturn data from HMRC information on stamp duty land tax.
[11] 3-month sterling interbank rate (LIBOR).
[12] Weighted average interest rate on conventional gilts.

Table 4.2: Changes in the determinants of the fiscal forecast

	Percentage change on previous year unless otherwise specified						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
GDP and its components							
Real GDP	-0.1	-0.1	-0.5	-0.2	-0.3	-0.2	-0.1
Nominal GDP[1]	0.1	-1.6	-0.4	-0.3	-0.3	-0.5	-0.3
Nominal GDP (£ billion)[1,2]	3	-27	-37	-44	-51	-62	-72
Nominal GDP (centred end-March £bn)[1,3]	-4	-40	-39	-46	-56	-67	-77
Wages and salaries[4]	-0.2	-0.4	-0.8	-0.3	-0.3	-0.3	-0.3
Non-oil PNFC profits[4,5]	-0.3	-4.4	-0.8	-0.3	-0.3	-0.4	-0.4
Consumer spending[4,5]	0.0	-0.2	-0.3	-0.3	-0.1	0.1	0.0
Prices and earnings							
GDP deflator	0.1	-1.2	-0.2	0.0	0.2	-0.2	-0.2
RPI (September)[6]	0.0	0.0	-0.3	-0.4	0.1	0.0	0.0
CPI (September)[6]	0.0	0.0	-0.4	-0.2	0.2	0.0	0.0
Average earnings[7]	-0.2	-0.5	-0.5	-0.2	-0.2	-0.4	-0.2
'Triple-lock' guarantee (September)	0.0	0.0	-0.7	-0.1	-0.1	-0.2	-0.5
Key fiscal determinants							
Claimant count (millions)	0.00	-0.01	-0.03	-0.04	-0.02	-0.02	-0.01
Employment (millions)	0.0	0.1	0.0	0.0	0.0	-0.1	-0.1
VAT gap (per cent)	0.4	0.3	0.6	0.3	0.2	0.0	0.0
Output gap (per cent of potential output)	0.1	0.4	0.2	0.2	0.0	0.0	0.0
Financial and property sectors							
Equity prices (FTSE All-Share index)	0	-80	-285	-306	-326	-357	-385
HMRC financial sector profits[1,5,8]	-0.1	-1.2	-0.6	-0.4	-0.4	-0.4	0.0
Residential property prices[9]	0.0	1.5	1.0	-0.3	-0.2	-0.4	-0.3
Residential property transactions (000s)[10]	-1	0	8	5	3	1	0
Commercial property prices[10]	0.0	0.0	-1.0	0.0	0.0	-0.2	0.1
Commercial property transactions[10]	0.0	-0.2	-3.3	-0.2	-0.2	-0.2	-0.2
Volume of stampable share transactions	0.0	10.3	0.0	0.0	0.0	0.0	0.0
Oil and gas							
Oil prices ($ per barrel)[5]	0.0	-1.4	-18.1	-16.2	-14.8	-14.8	-14.8
Oil prices (£ per barrel)[5]	0.0	-0.8	-9.9	-8.4	-7.4	-7.4	-7.5
Gas prices (p/therm)[5]	-0.1	0.0	-9.2	-7.8	-7.8	-7.8	-7.8
Oil production (million tonnes)[5]	0.0	3.8	5.3	7.3	9.2	8.8	8.3
Gas production (billion therms)[5]	0.0	0.6	0.6	0.6	0.6	0.7	0.6
Interest rates and exchange rates							
Market short-term interest rates[11]	0.0	0.0	-0.3	-0.6	-0.7	-0.8	-0.8
Market gilt rates[12]	0.0	-0.1	-0.4	-0.4	-0.4	-0.4	-0.4
Euro/Sterling exchange rate (€/£)	0.00	-0.01	-0.09	-0.09	-0.08	-0.07	-0.07

[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] Q3 forecast used as a proxy for September.
[7] Wages and salaries divided by employees.
[8] HMRC Gross Case 1 trading profits.
[9] Outturn data from ONS House Price Index.
[10] Outturn data from HMRC information on stamp duty land tax.
[11] 3-month sterling interbank rate (LIBOR).
[12] Weighted average interest rate on conventional gilts.

Policy announcements, risks and classification changes

4.5 The Government publishes estimates of the direct impact on the public finances of tax and selected spending policy decisions in its 'scorecard', after detailed discussions with the OBR. It also makes changes to departmental spending – only some of which are shown on the scorecard – on top of the changes already announced in the Spending Review. If we were to disagree with any of the final scorecard 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 our economy forecast.[2] 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

4.6 In Annex A, we reproduce the Treasury's scorecard of the direct effect on PSNB of policy decisions in the Budget or announced since the November Spending Review and Autumn Statement. Annex A also includes our formal assessment of the degree of uncertainty associated with each costing that we have certified.

4.7 Table 4.3 summarises the Treasury's policy scorecard and the changes since our last forecast to the Government's plans for spending subject to departmental expenditure limits (DELs). These encompass spending on public services, grants, administration and capital investment. 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.)

[2] 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.*

Table 4.3: Summary of the effect of Government decisions on the budget balance

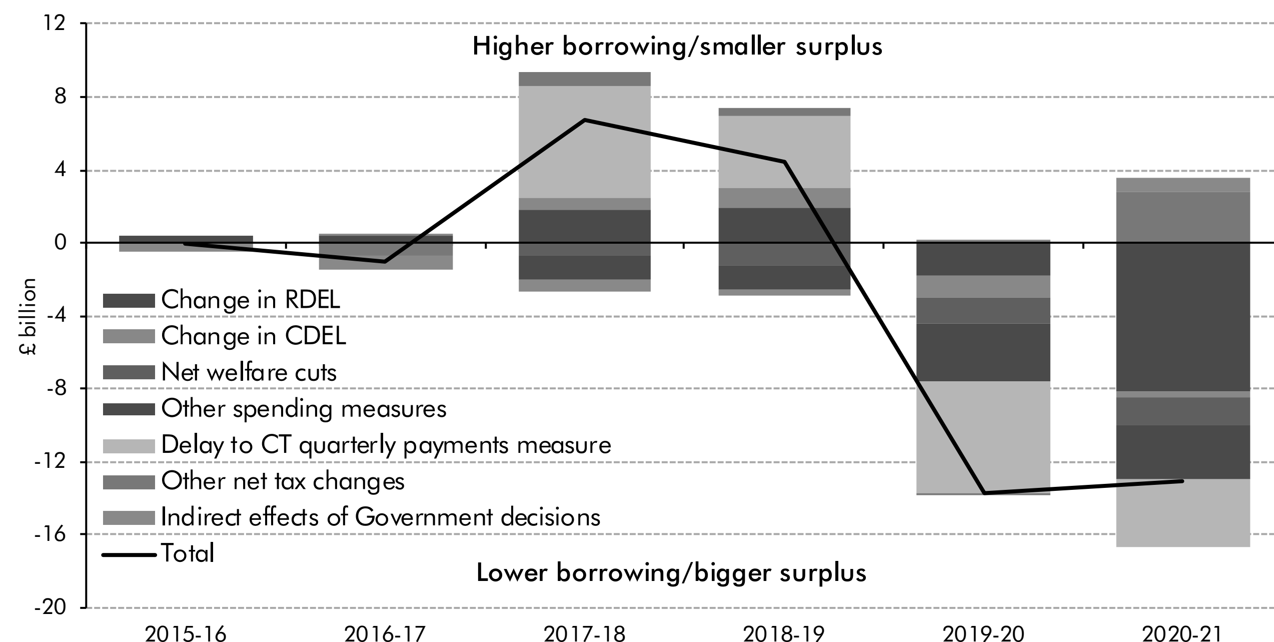
	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Total effect of scorecard measures	**0.0**	**0.3**	**-7.6**	**-4.8**	**13.9**	**4.2**
Effects of scorecard receipts measures	**0.0**	**0.6**	**-7.0**	**-4.3**	**6.3**	**0.8**
of which:						
Onshore corporation tax	0.0	0.5	-3.1	-0.5	8.3	4.8
Business rates	0.0	0.0	-1.4	-1.5	-1.5	-1.9
Income tax and NICs	0.0	0.2	-1.8	-2.3	-1.7	-2.8
Fuel duty	0.0	-0.4	-0.4	-0.4	-0.4	-0.4
Soft drinks levy	0.0	0.0	0.0	0.5	0.5	0.5
Stamp duty land tax	0.0	0.5	0.6	0.6	0.7	0.7
Capital gains tax	0.0	-0.1	-0.2	-0.4	-0.4	-0.3
Oil and gas revenues	0.0	-0.2	-0.3	-0.2	-0.2	-0.2
VAT	0.0	0.1	0.2	0.2	0.4	0.4
Other	0.0	0.0	-0.5	-0.4	0.6	0.1
Effects of scorecard AME measures	**0.0**	**0.1**	**2.1**	**2.6**	**4.6**	**4.5**
of which:						
Welfare	0.0	0.0	0.7	1.3	1.4	1.4
Locally financed current expenditure	0.0	-0.1	0.6	0.8	1.1	1.4
Public service pensions	0.0	0.0	0.0	0.0	2.0	2.0
Other AME measures	0.0	0.2	0.8	0.5	0.1	-0.3
Effects of scorecard DEL measures	**0.0**	**-0.4**	**-2.7**	**-3.0**	**3.0**	**-1.1**
	Summary of changes					
Total effect of Government decisions	**0.1**	**1.0**	**-6.7**	**-4.5**	**13.7**	**13.1**
of which:						
Receipts and AME scorecard measures	0.0	0.7	-4.9	-1.7	10.9	5.3
RDEL changes	-0.4	-0.3	-1.8	-1.9	1.8	8.1
CDEL changes	0.4	-0.1	-0.7	-1.1	1.2	0.4
Indirect effect of Government decisions	0.1	0.7	0.6	0.3	-0.2	-0.7
Financial transactions[1]	0.0	0.0	0.0	0.1	0.2	0.3
Memo: gross tax increases	0.0	1.6	5.8	7.9	15.2	11.5
Memo: gross tax cuts	0.0	-0.9	-12.7	-12.2	-8.9	-10.7

[1] Affects PSNCR, not PSNB.

Note: The full Treasury scorecard can be found in Annex A. This table uses the Treasury scorecard convention that a positive figure means an improvement in PSNB, PSNCR and PSND.

4.8 Chart 4.1 summarises the impact of Government decisions on PSNB across the forecast. It shows how the Government has loosened policy in the short term and then tightened it significantly in 2019-20 and 2020-21 – the years in which its surplus target applies. This uneven path has meant the overall pace of fiscal tightening over the coming five years – which in November was relatively smooth and diminishing over time – is set to pick up slightly over the next three years, then dramatically in 2019-20 before slowing abruptly in 2020-21. This is shown in Chart 4.13 in the fiscal aggregates section of this chapter.

Chart 4.1: The effect of Government decisions on public sector net borrowing



Source: OBR

Policy risks

4.9 Parliament requires that our forecasts only reflect current Government policy. As such, when the Government or governing party sets out 'ambitions' or 'intentions' we ask the Treasury to confirm whether they represent firm policy that should be reflected in our forecast. Where they are not yet firm policy, we note them as a source of risk to our central forecast. For this forecast, there are a number that we need to note:

- commitments on **income tax allowances**: in November's Autumn Statement, the Government stated that it "*is determined to support those in work by continuing to reduce taxes. In recognition of this, the government has committed to raise the personal allowance to £12,500 and the higher rate threshold to £50,000 by the end of this Parliament.*" These objectives are specified in terms of the levels being targeted and by when (the end of the Parliament), but the Government has not set out how it would get from the current level to £12,500. The Treasury argues that it will do so progressively, assessing the affordability of incremental steps at each stage. As such, we are not able to quantify the effect on each year of the forecast of achieving this goal. In this Budget it has announced increases to £11,500 and £45,000 respectively, with a scorecard cost of £2.5 billion in 2019-20 and £2.6 billion in 2020-21. Our central forecast assumes that thresholds are uprated in line with CPI inflation in years for which the Government has not set specific parameters, so by 2019-20 the personal allowance reaches £11,950 and by 2020-21 it reaches £12,190. For the higher rate threshold, those figures are £46,850 and £47,790. Due to the much larger number of taxpayers affected by changes in the personal allowance, it is that element of the Government's commitment that would be most costly to meet. HMRC has provided an estimate of the cost in 2020-21 alone of closing the remaining gaps between the levels of the

personal allowance and higher rate threshold reached in our central forecast and the Government's commitments: £2.4 billion. If 'the end of this Parliament' was interpreted as 2019-20, the cost would be closer to £4 billion (reflecting the larger gaps that would remain to be closed);

- the **intention to localise all business rates** and to provide some additional discretion to local authorities in setting business rates, while also shifting some new spending responsibilities to local authorities. There are elements of this prospective package of measures that could be quantified now, but it would be misleading to include only part it in our central forecast when the Government has stated that when fully specified it will be fiscally neutral as a whole. When the package is fully specified, we will include it in the forecast and judge whether it is in fact fiscally neutral (see Box 4.3);

- the outcome of **the consultation on fee proposals for grants of probate**. Depending on classification, these fees could boost receipts or leave more space for departmental spending. The fees may also affect inheritance tax receipts; and

- the **intention to expand right-to-buy to tenants of housing associations**, which is currently being piloted and features in the Housing Bill that is progressing through Parliament, but which the Government has not yet specified in a manner that would allow its effects to be estimated on a year-by-year basis.

4.10 We are not able to estimate the effects of the planned restrictions on EU migrants' access to certain in-work benefits and tax credits at this stage because the Government has not set out the precise parameters of these policies that would be necessary for us to quantify specific effects in specific years. The Treasury has confirmed that the final details of the policy will be set out following the EU referendum, consistent with the conclusions of the February European Council. It intends to cost the policy at the Autumn Statement.

4.11 The Government has announced further cuts to departmental spending in 2019-20 and 2020-21, but these have not been fully allocated to individual departments. For 2019-20, where detailed plans were set in November's Spending Review, it has stated that the cuts will be allocated to departments following an 'efficiency review' that will report in 2018. Given the Treasury's long-standing track record in keeping departmental spending within its published limits, we have reflected these planned cuts in our forecast, although we have also reduced the amount by which we expect departments to underspend the lower spending limits. (It is not for us to judge now or later whether the cuts would in fact be genuine efficiency savings or cuts in the quality and quantity of public services.) The planned cuts in 2020-21 are much larger, but relate to totals that were not fully allocated in the Spending Review. Again, we have reduced our assumption of underspending as a result. This process of adjusting assumed departmental spending totals by sometimes large amounts between forecasts was a feature of the last Parliament too.

Contingent liabilities

4.12 We have asked the Treasury to identify any changes to future contingent liabilities as a result of policy announcements since November. One announcement appears relevant:

- the new **Scottish Government fiscal framework** includes additional borrowing powers for the Scottish Government, allowing it to borrow for current spending in specific circumstances and extending its existing ability to borrow for capital spending. These borrowing powers will not be a contingent liability in the Whole of Government Accounts (WGA), but they do transfer certain economy-related fiscal risks from the UK to the Scottish Government.

4.13 A small number of universities in the UK have recently issued bonds in their own names, typically raising around £¼ billion each. Universities are classified as 'non-profit institutions serving households' in the National Accounts, so are part of the private sector. As such, these liabilities will not add to the ONS measure of public sector net debt or feature in our fiscal forecast. Moreover, since the bonds are not issued with a government guarantee, they are not contingent liabilities in WGA terms either. But given the public service nature of universities' roles, it is possible that if one or more were to default on their bonds, the liabilities could ultimately be transferred to government. Investors in universities' bonds might even anticipate such an implicit guarantee. This could represent a broader fiscal risk of the type that we will aim to address in the new *Fiscal risks report (FRR)* that Parliament – in the October 2015 update to the *Charter for Budget Responsibility* – has asked us to produce. We plan to publish a *FRR* discussion paper this autumn and our first full report next summer.

Classification changes

4.14 In our November forecast, we anticipated the effect on the public finances of the ONS decision to reclassify housing associations into the public sector.[3] The ONS has now implemented that decision in the official data. Box 4.2 sets out how the latest data compare with the assumptions we made in November and the changes we have made to our forecasts since then. The Government is in the process of reforming the regulation of housing associations, with one of its stated aims being to reduce control sufficiently that they are reclassified back to the private sector. At this stage it is unclear whether this would lead the ONS to consider another classification decision.

4.15 Our November forecast included a number of other items that anticipated future revisions and classification changes that the ONS had announced, but had not yet implemented (see Box 4.1 of the November *EFO*). A number of these items are now included in outturn, including community infrastructure levy receipts, the heavy goods vehicle road user levy and other smaller items related to work that the ONS, Treasury and we have been undertaking to resolve previously unexplained differences between accrued and cash measures of

[3] *'Classification announcement: "Private registered providers" of social housing in England'*, ONS, 30 October 2015.

borrowing. Our current forecast includes further items related to this work, the details of which can be found in a supplementary fiscal table on our website.

4.16 The possibility of future classification decisions will always represent a source of uncertainty around our forecasts. The ONS publishes a quarterly forward workplan that lists classification issues currently under consideration. In its December 2015 publication, 13 items were listed, some of which – e.g. the treatment of various pension schemes and the classification of contracts under the Government's 'priority schools building programme' – could have a substantial impact on the public sector finances were any classification decisions to result from these reviews.[4]

Box 4.2: The reclassification of housing associations into the public sector

In our November forecast, we anticipated the effect on the public finances of the ONS decision to reclassify private registered providers of social housing in England – which includes most housing associations (HAs) and some other private sector providers – into the public sector (see Annex B of that *EFO*.) The ONS has now implemented that decision in the official data, reflecting 2014-15 'global accounts' data for HAs that were not available when we completed our November forecast. The ONS estimates that HAs increased public sector borrowing by £3.6 billion and net debt by £60 billion (3.3 per cent of GDP) in 2014-15. That is around £1 billion lower for borrowing than we had estimated (due to lower capital spending), but about £0.5 billion higher for debt (due to the inclusion of certain lease obligations and other items).

Our pre-measures forecast for HAs' borrowing in 2015-16 is £0.7 billion lower than in November, mainly due to lower capital spending. We have recalibrated our forecast model to be consistent with the latest ONS estimate for 2014-15, which implied that HAs had leveraged grants and cash surpluses by less than we had assumed. All else equal, that would reduce capital spending in the initial years of the forecast. Offsetting that, we have revised up our forecast of rental income and cash surpluses to make the forecast consistent with how the ONS has grossed up the 'global accounts' data for small providers not covered in that report. That pushes up capital spending via our assumption about leveraging. By 2020-21, that means our pre-measures HAs borrowing forecast has been revised up by £0.4 billion. Effects on PSND have been largely offsetting, with revisions since November averaging less than £1 billion a year across the forecast period.

Our forecast now factors in the effect of the **right-to-buy pilot** that was announced in November, but that the Government did not provide us with a costing at that time. The full expansion of right-to-buy to HA tenants has not yet been specified sufficiently to be included in our forecast. In this Budget, the Government has announced two further policy measures that affect our HAs fiscal forecast:

- the **pay to stay** policy announced in July 2015 has been amended in two ways. First, it has been made voluntary for HAs (although it remains mandatory for local authorities) as the Government seeks to reduce its control over HAs. Some HAs are expected not to charge tenants the additional rent and some to implement the policy in a way that is

[4] *'National Accounts Sector Classification: December 2015'*, ONS, 31 December 2015.

more generous to tenants. The Government has also announced that rent increases will now be tapered as income rises, replacing the 'cliff-edge' policy design whereby rents would jump to 80 per cent of market rent when a households' income topped £30,000 (£40,000 in London) and 100 per cent of market rent when it topped £40,000 (£50,000 in London). Both amendments are expected to reduce HAs' rental incomes; and

- the **1 per cent a year social sector rent cuts for supported housing** will also be deferred by a year, raising HAs' rental income.

The pay to stay policy amendments have the biggest effect on our HAs' borrowing forecast, because they reduce rental income and cash surpluses. We assume that this feeds more than one-for-one into lower capital spending on housebuilding.

Table A: March forecast for HAs' effects on the public finances

	£ billion, unless otherwise stated						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Current receipts (a)	6.5	6.9	6.7	6.8	6.6	6.4	6.9
Current spending (b)	3.0	2.9	3.0	3.2	3.4	3.6	3.8
Depreciation (c)	1.6	1.6	1.7	1.7	1.8	1.8	1.9
Capital spending (d)	7.1	7.9	6.9	6.4	5.8	5.1	6.3
of which: Additional capital	6.4	7.0	5.9	5.5	6.4	7.0	9.7
Current deficit (b+c-a)	**-1.9**	**-2.3**	**-2.1**	**-1.9**	**-1.4**	**-1.0**	**-1.2**
Pre-measures borrowing (b+d-a)	3.6	3.9	3.2	2.8	2.7	2.3	3.2
Budget policy measures (e)	0.0	0.0	0.0	-0.3	-0.3	-0.4	-0.4
Post-measures net borrowing (b+d-a+e)	3.6	3.9	3.2	2.4	2.4	2.0	2.8
Net debt (post measures)	**60**	**64**	**67**	**69**	**72**	**74**	**77**
Net debt (post measures) as a share of GDP	**3.2**	**3.3**	**3.4**	**3.4**	**3.3**	**3.3**	**3.3**

Table B: Changes in post-measures HAs forecast since November

	£ billion, unless otherwise stated						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Current receipts (a)	0.1	0.3	0.3	0.3	0.2	0.3	0.3
Current spending (b)	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Depreciation (c)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital spending (d)	-1.2	-0.4	0.4	0.6	0.6	0.6	0.6
of which: Additional capital	-1.1	-0.2	0.6	1.0	1.0	1.2	1.4
Current deficit (b+c-a)	**0.3**	**-0.3**	**-0.3**	**-0.2**	**-0.2**	**-0.2**	**-0.2**
Pre-measures borrowing (b+d-a)	-1.0	-0.7	0.1	0.4	0.3	0.3	0.4
Post-measures net borrowing	-1.0	-0.7	0.0	0.0	0.0	0.0	-0.1
Net debt (post measures)	**0.5**	**-0.2**	**-0.1**	**0.2**	**0.5**	**0.9**	**1.2**
Net debt (post measures) as a share of GDP	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**

Financial sector interventions

4.17 The Government undertook a number of interventions in the financial sector as a result of the crisis and recession of the late 2000s. In each *EFO* we provide an update on the estimated net effect of those interventions on the public finances. Table 4.4 summarises the position as at the end of December 2015.[5]

4.18 In total, £133 billion was disbursed by the Treasury during and following the crisis. By the end of December, principal repayments on loans, proceeds from share sales and redemptions of preference shares amounted to £56 billion, up from the £50 billion reported in our last *EFO*. The additional proceeds mainly relate to a £4.5 billion repayment on the Government's loan to NRAM, associated with the sale of the Granite securitisation vehicle and some other assets. The figures in the table predate the final repayment from Icesave that was received in January. In total, the Treasury also received a further £21 billion in other fees and interest, so the net cash position stood at around a £56 billion shortfall.

4.19 As of the end of December, the Treasury was owed £31 billion (largely the value of loans outstanding). The value of the shares it still retained in Lloyds and RBS by the end of February had fallen to £25 billion, down from £34 billion in November, as their share prices fell and some Lloyds shares were sold. Its holdings in B&B and NRAM plc had an equity book value of around £7½ billion.

Table 4.4: Gross and net cash flows of financial sector interventions

	£ billion						
	Cash outlays	Principal repayments	Other fees received[1]	Outstanding payments	Market value[2]	Implied balance	Change since November *EFO*[3]
Lloyds	-20.5	16.9	3.0	0.0	4.1	3.4	-0.9
RBS	-45.8	2.6	4.1	1.2	20.7	-17.2	-6.7
UK Asset Resolution[4]	-40.8	26.9	4.0	13.4	7.6	11.2	0.6
FSCS[5]	-20.9	5.2	2.7	15.7	-	2.7	0.4
Other interventions	-5.3	4.5	0.2	0.7	-	0.2	0.1
Credit Guarantee Scheme	-	-	4.3	-	-	4.3	0.0
Special Liquidity Scheme	-	-	2.3	-	-	2.3	0.0
Pre-financing total	**-133.2**	**56.2**	**20.6**	**31.0**	**32.3**	**6.9**	**-6.5**
Exchequer financing						**-24.4**	**-0.8**
Total						**-17.5**	**-7.2**

[1] Fees relating to the asset protection scheme and contingent capital facility are included within the Lloyds and RBS figures.
[2] Lloyds and RBS figures are based on average share prices in the 10 working days to 25 February 2016. UKAR is book value of equity derived from its Interim Financial Report for the 6 months to 30 September 2015.
[3] November *EFO* figures were consistent with 30 September 2015 data.
[4] Holdings in Bradford & Bingley and Northern Rock Asset Management plc are now managed by UK Asset Resolution.
[5] Financial services compensation scheme.

4.20 If the Treasury was to receive all loan payments in full, and sold its remaining shares at their end-February 2016 values, it would realise an overall cash surplus of £6.9 billion. But that

[5] The Lloyds and RBS figures show the position at 25 February, so they are consistent with the market-derived assumptions used in the rest of our fiscal forecast. All other figures reflect end-December data, allowing time for detailed scrutiny before the figures are provided to us.

excludes the costs to the Treasury of financing these interventions. If all interventions were financed through debt, the Treasury estimates that additional debt interest costs would have amounted to £24.4 billion by the end of December 2015, implying an overall cost of £17.5 billion to the Government. This is £7.2 billion higher than we estimated in the November, reflecting the fall in the value of Lloyds and RBS shares.

Public sector receipts

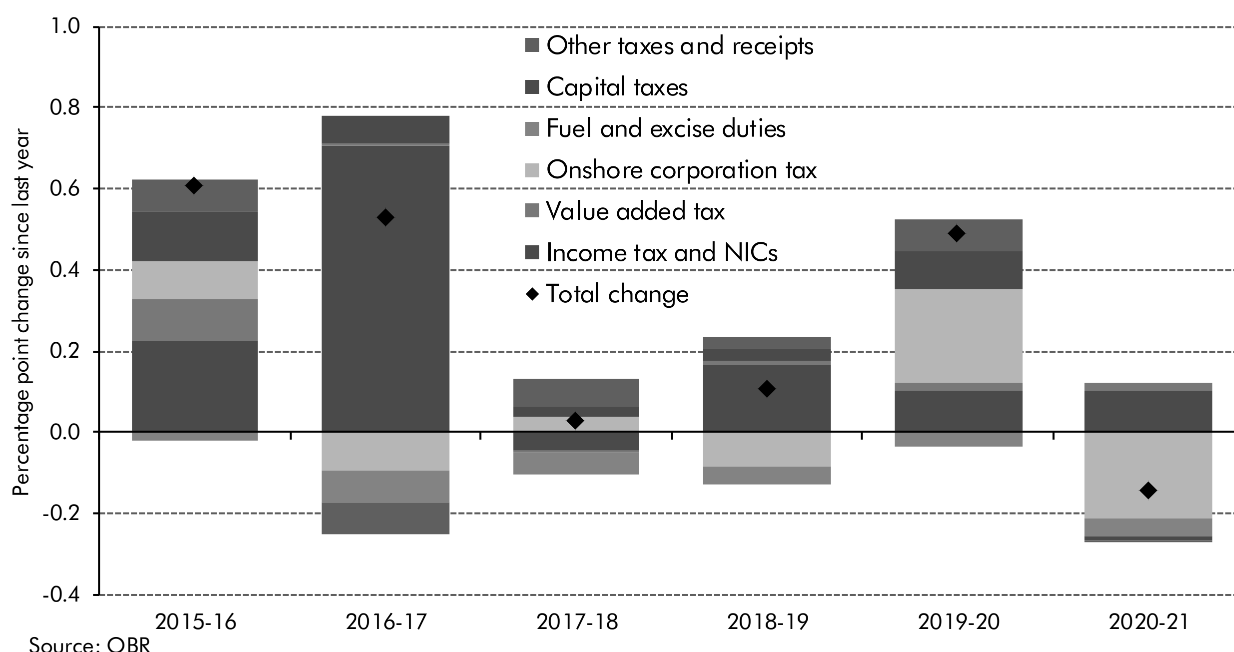
4.21 Table 4.5 summarises our receipts forecast. The tax-to-GDP ratio is expected to rise between 2014-15 and 2019-20, then fall in 2020-21.

Table 4.5: Major receipts as a per cent of GDP

	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Income tax and NICs	15.0	15.2	15.9	15.8	16.0	16.1	16.2
Value added tax	6.1	6.2	6.2	6.2	6.2	6.2	6.2
Onshore corporation tax	2.2	2.3	2.2	2.3	2.2	2.4	2.2
Fuel duties	1.5	1.5	1.4	1.4	1.3	1.3	1.3
Business rates	1.5	1.5	1.5	1.4	1.4	1.4	1.3
Council tax	1.5	1.5	1.5	1.6	1.6	1.6	1.6
Excise duties	1.1	1.1	1.0	1.0	1.0	1.0	1.0
Capital taxes	1.3	1.4	1.5	1.5	1.5	1.6	1.6
UK oil and gas receipts	0.1	0.0	-0.1	-0.1	0.0	0.0	0.0
Other taxes	2.9	3.0	3.0	3.2	3.2	3.2	3.2
National Accounts taxes	**33.0**	**33.6**	**34.2**	**34.2**	**34.3**	**34.8**	**34.6**
Interest and dividend receipts	0.3	0.3	0.3	0.3	0.3	0.4	0.5
Other receipts	2.4	2.4	2.4	2.3	2.3	2.3	2.3
Current receipts	**35.7**	**36.3**	**36.9**	**36.9**	**37.0**	**37.5**	**37.4**

4.22 Chart 4.2 shows the year-on-year change in the receipts-to-GDP ratio over the forecast. It shows that the rise in 2015-16 is broad-based as receipts hold up despite the weakness in nominal GDP growth recorded in the latest ONS data. In 2016-17, the abolition of the NICs contracting out rebate and other measures help boost income tax and NICs receipts by 0.7 per cent of GDP. The tax-to-GDP ratio flattens off in 2017-18 and 2018-19, before jumping in 2019-20 thanks to the one-off boost to corporation tax receipts from bringing forward large firms' payments (in effect recording five quarterly payments in that year). That boost is not repeated in 2020-21, so the tax-to-GDP ratio falls back again. Non-tax receipts – in particular interest and dividend receipts – are also expected to rise over the forecast period, so that total receipts rise by 1.0 per cent of GDP between 2015-16 and 2020-21.

Chart 4.2: Year-on-year changes in the receipts-to-GDP ratio



Source: OBR

Sources of changes in the tax-to-GDP ratio

4.23 Movements in the tax-to-GDP ratio arise 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.

4.24 We have used this approach to identify the main drivers of the rise in the tax-to-GDP ratio over the forecast period.

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

4.25 Chart 4.2 shows that the main sources of the 0.9 percentage point rise in the tax-to-GDP ratio between 2015-16 and 2020-21 are:

- a 0.9 per cent of GDP rise in **PAYE income tax and NICs receipts**. This is driven almost entirely by a rise in the effective tax rate. Most of this is explained by the return of 'fiscal drag', as productivity and real earnings growth are assumed to pick up (although to still historically subdued rates), 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 from April 2016. This is expected to raise NICs receipts by over £5 billion in 2016-17;
- a 0.2 per cent of GDP rise in **self-assessment (SA) receipts**. This largely reflects the strong receipts boost in 2016-17 from a number of measures announced in previous Budgets and Autumn Statements; and

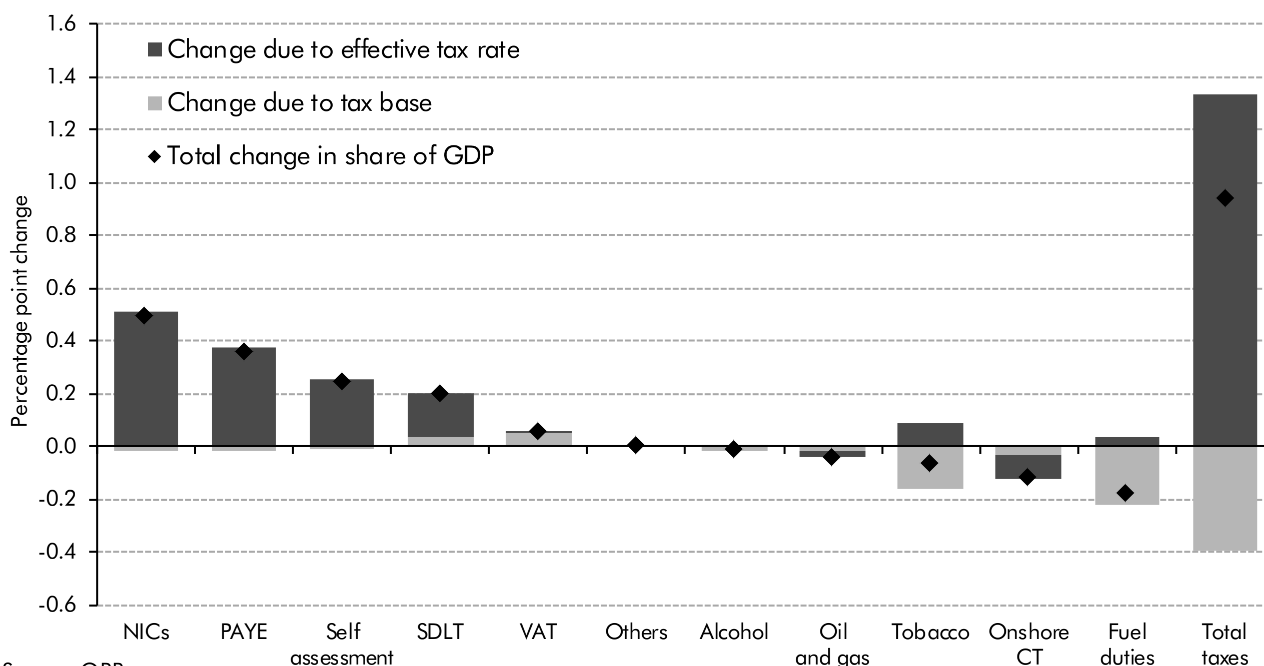
- a 0.2 per cent of GDP rise in **stamp duty land tax (SDLT)** receipts (including the Scottish land and buildings transaction tax (LBTT)). This reflects both the tax base and the effective tax rate. Growth in the base reflects rising prices and transactions. With SDLT thresholds still fixed in cash terms over the forecast period, rising house prices drag a greater proportion of the value of residential transactions into higher tax brackets.

4.26 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 alcohol and tobacco consumption and rising fuel efficiency. These falls are only partly offset by assumed rises in duty rates, raising the effective tax rate; and

- a 0.1 per cent of GDP fall in **onshore corporation tax** receipts. This is volatile between years given the measure to change the timing of payments for large companies. Over the whole of the forecast period, the fall in the ratio is driven by a falling effective tax rate: the main corporation tax rate is set to fall to 17 per cent in 2020-21, strong growth in investment increases the use of capital allowances and the financial sector is expected to set past losses against future liabilities.

Chart 4.3: Sources of changes in the tax-to-GDP ratio (2015-16 to 2020-21)



Source: OBR

Detailed current receipts forecast

4.27 Our detailed receipts forecasts and changes since November are presented in Tables 4.6 and 4.7. Further detailed breakdowns of other taxes and non-tax revenues are available in supplementary fiscal tables on our website. Our forecasts for Scottish and Welsh devolved taxes are discussed in more detail in *Devolved tax forecasts*, also available on our website.

Table 4.6: Current receipts

	£ billion						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Income tax (gross of tax credits)[1]	163.7	169.8	182.1	186.6	198.2	208.1	218.8
of which: Pay as you earn	*140.0*	*146.5*	*153.4*	*161.1*	*169.7*	*177.8*	*186.4*
Self assessment	*23.6*	*24.1*	*30.2*	*28.0*	*30.9*	*33.1*	*34.9*
National insurance contributions	110.3	114.9	126.5	133.4	138.9	144.5	151.1
Value added tax	111.2	115.8	120.1	124.8	130.3	135.9	142.0
Corporation tax[2]	43.0	44.1	43.5	46.0	46.1	52.8	50.2
of which: Onshore	*40.9*	*43.6*	*43.4*	*45.9*	*46.1*	*53.0*	*50.4*
Offshore	*2.1*	*0.5*	*0.1*	*0.1*	*0.0*	*-0.1*	*-0.1*
Petroleum revenue tax	0.1	-0.5	-1.1	-1.1	-0.9	-0.9	-0.8
Fuel duties	27.2	27.5	27.6	27.8	28.2	28.7	29.3
Business rates	27.5	27.8	28.4	27.7	28.7	29.8	30.5
Council tax	28.2	28.8	30.1	31.4	32.8	34.1	35.6
VAT refunds	13.7	14.3	14.7	15.0	15.0	15.1	15.5
Capital gains tax	5.6	7.0	7.0	6.9	7.5	9.2	8.9
Inheritance tax	3.8	4.6	4.8	4.9	5.0	5.3	5.6
Stamp duty land tax[3]	10.9	10.7	12.9	14.2	15.2	16.3	17.4
Stamp taxes on shares	2.9	3.2	3.0	3.2	3.3	3.4	3.5
Tobacco duties	9.3	9.2	9.2	9.3	9.4	9.5	9.7
Spirits duties	3.0	3.3	3.3	3.4	3.6	3.8	3.9
Wine duties	3.8	4.0	4.2	4.4	4.7	5.0	5.3
Beer and cider duties	3.7	3.6	3.5	3.7	3.7	3.8	3.8
Air passenger duty	3.2	3.1	3.2	3.3	3.5	3.7	3.9
Insurance premium tax	3.0	3.6	4.6	4.8	4.9	4.9	5.0
Climate change levy	1.6	1.8	2.1	2.2	2.1	2.4	2.2
Other HMRC taxes[4]	6.6	7.1	7.0	7.1	7.4	7.6	7.8
Vehicle excise duties	5.9	5.6	5.5	5.7	5.8	6.0	6.2
Bank levy	2.8	3.5	2.9	2.7	2.5	2.3	2.2
Bank surcharge	0.0	0.0	0.8	1.1	1.1	1.5	1.5
Apprenticeship levy	0.0	0.0	0.0	2.7	2.8	2.9	3.0
Licence fee receipts	3.1	3.1	3.1	3.2	3.2	3.3	3.4
Environmental levies	3.6	6.2	7.4	8.6	10.4	11.9	12.3
EU ETS auction receipts	0.6	0.5	0.5	0.4	0.4	0.4	0.4
Scottish taxes[5]	0.0	0.5	0.6	0.7	0.8	0.8	0.9
Diverted profits tax	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Soft drinks industry levy	0.0	0.0	0.0	0.0	0.5	0.5	0.5
Other taxes	6.5	7.3	7.8	8.0	8.1	8.4	8.8
National Accounts taxes	**604.5**	**630.5**	**665.1**	**692.1**	**723.3**	**761.4**	**788.3**
Less own resources contribution to EU	-3.0	-3.2	-3.3	-3.2	-3.2	-3.4	-3.6
Interest and dividends	6.0	6.3	5.6	6.3	7.3	9.3	11.1
Gross operating surplus	44.1	45.4	47.0	48.6	50.0	51.5	54.1
Other receipts	3.3	2.7	2.0	2.0	2.1	2.1	2.2
Current receipts	**654.8**	**681.8**	**716.5**	**745.8**	**779.5**	**820.9**	**852.2**
Memo: UK oil and gas revenues[6]	*2.2*	*0.0*	*-1.1*	*-1.0*	*-0.9*	*-1.0*	*-0.9*

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

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

[3] Forecast for SDLT is for England, Wales and Northern Ireland from 2015-16.

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

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

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

Table 4.7: Change to current receipts since November

	£ billion						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Income tax (gross of tax credits)[1]	0.0	-2.0	-4.8	-8.5	-10.0	-11.7	-14.7
of which: *Pay as you earn*	0.0	-0.7	-3.5	-6.8	-8.1	-9.2	-11.7
Self assessment	0.0	-0.8	-1.3	-1.1	-1.7	-2.0	-2.5
National insurance contributions	0.0	0.2	-0.6	0.2	-0.4	-1.5	-2.3
Value added tax	0.0	0.2	0.0	-0.1	0.1	0.0	-0.3
Corporation tax[2]	0.0	-0.2	-1.3	-3.8	-1.8	7.5	3.7
of which: *Onshore*	0.0	0.2	-0.8	-3.3	-1.3	8.0	4.3
Offshore	0.0	-0.4	-0.5	-0.5	-0.5	-0.5	-0.6
Petroleum revenue tax	0.0	0.2	-0.6	-0.7	-0.6	-0.7	-0.6
Fuel duties	0.0	0.1	0.1	-0.2	-0.3	-0.4	-0.4
Business rates	0.2	0.0	0.2	-1.4	-1.6	-1.6	-2.0
Council tax	0.2	0.1	0.3	0.5	0.6	0.7	0.8
VAT refunds	0.0	0.1	0.2	0.3	0.4	0.2	0.0
Capital gains tax	0.0	0.6	0.3	-0.4	-0.4	-0.3	-0.5
Inheritance tax	0.0	0.2	0.2	0.1	0.0	0.0	0.0
Stamp duty land tax[3]	0.0	-0.5	-0.1	0.0	-0.2	-0.3	-0.4
Stamp taxes on shares	0.0	0.3	0.0	0.0	-0.1	-0.1	-0.1
Tobacco duties	0.0	0.0	0.1	0.1	0.2	0.2	0.2
Spirits duties	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Wine duties	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Beer and cider duties	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Air passenger duty	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Insurance premium tax	0.0	0.1	-0.1	0.1	0.0	0.0	0.0
Climate change levy	0.0	-0.3	-0.4	-0.2	-0.2	0.2	0.2
Other HMRC taxes[4]	0.0	0.2	0.1	0.2	0.2	0.2	0.1
Vehicle excise duties	0.0	0.2	0.2	0.1	0.1	0.1	0.1
Bank levy	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank surcharge	0.0	0.0	-0.1	-0.5	-0.5	0.2	0.2
Apprenticeship levy	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Licence fee receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Environmental levies	0.0	0.0	0.0	0.1	0.1	-0.3	-0.9
EU ETS auction receipts	0.0	0.0	0.0	-0.1	-0.2	-0.2	-0.2
Scottish taxes[5]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Diverted profits tax	0.0	0.0	-0.2	-0.3	-0.2	-0.2	-0.3
Soft drinks industry levy	0.0	0.0	0.0	0.0	0.5	0.5	0.5
Other taxes	0.2	0.0	0.3	0.0	-0.1	-0.1	0.0
National Accounts taxes	**0.7**	**-0.4**	**-6.1**	**-14.5**	**-14.2**	**-7.4**	**-17.1**
Less own resources contribution to EU	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Interest and dividends	0.0	0.1	-0.6	-1.9	-2.4	-2.2	-2.1
Gross operating surplus	-0.4	-0.3	-0.2	-0.5	-0.4	-0.5	-0.5
Other receipts	0.3	0.2	0.1	0.0	0.1	0.1	0.1
Current receipts	**0.5**	**-0.4**	**-6.9**	**-16.9**	**-17.0**	**-10.2**	**-19.8**
Memo: UK oil and gas revenues[6]	*0.0*	*-0.1*	*-1.1*	*-1.2*	*-1.1*	*-1.2*	*-1.2*

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

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

[3] Forecast for SDLT is for England, Wales and Northern Ireland from 2015-16.

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

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

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

Changes in the receipts forecast since November

4.28 We have revised our receipts forecast down in every year of the forecast, with the size of the revision increasing over time to reach £19.8 billion in 2020-21. As Table 4.8 shows, the main downward revisions are explained by:

- **PAYE income tax and national insurance contributions (NICs)**. Weaker earnings growth (due to our downward revision to underlying productivity growth) and updated assumptions about differential earnings growth (reflecting the latest ONS Annual Survey on Hours and Earnings) have reduced receipts significantly over the forecast;
- **VAT** receipts. Weaker consumer spending (also a consequence of weaker underlying productivity growth hitting incomes and therefore spending) is only partly offset by upward revisions to the standard rated share of spending;
- **corporation tax**. Weaker industrial and commercial profits (again productivity driven) reduce receipts in all years; and
- **stamp duty land tax (SDLT)**. A boost from stronger house price growth is more than offset by weak outturn receipts (pointing to underperformance of transactions in high priced properties) and changes to the modelling of the transaction distribution.

4.29 Over the forecast period as a whole, the effect of Budget tax measures is to lower receipts slightly (£0.7 billion a year on average) but the effect is very uneven across years (reducing receipts by £7.0 billion in 2017-18, but raising them by £6.3 billion in 2019-20). The indirect effects of Government decisions on receipts are slightly positive in the first half of the forecast, but negative by 2020-21, largely reflecting the overall decisions on the pace of fiscal tightening.

Table 4.8: Sources of change to the receipts forecast since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	682.2	723.4	762.7	796.5	831.1	871.9
March forecast	681.8	716.5	745.8	779.5	820.9	852.2
Change	**-0.4**	**-6.9**	**-16.9**	**-17.0**	**-10.2**	**-19.8**
	Underlying OBR forecast changes					
Total change to underlying forecast	**-0.4**	**-8.2**	**-10.5**	**-14.0**	**-16.3**	**-19.5**
of which:						
Income and expenditure	**-2.1**	**-6.8**	**-8.8**	**-11.0**	**-12.3**	**-13.8**
Average earnings	-2.1	-4.7	-5.6	-6.8	-7.6	-8.5
Employee numbers	0.4	-0.1	-0.5	-1.0	-1.1	-1.3
Non-financial company profits	-0.1	-0.9	-1.3	-1.5	-1.7	-1.9
Consumer expenditure	-0.2	-0.8	-1.1	-1.4	-1.5	-1.7
Investment	0.0	0.0	0.5	0.7	1.0	1.2
Other	-0.2	-0.3	-0.8	-1.0	-1.3	-1.6
North Sea	**0.3**	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Oil and gas prices	-0.1	-0.4	-0.5	-0.4	-0.4	-0.4
Production and expenditure	0.4	0.4	0.4	0.3	0.3	0.3
Property markets	**0.2**	**0.5**	**0.4**	**0.3**	**0.2**	**0.1**
Market-derived assumptions	**-0.1**	**-1.1**	**-2.4**	**-2.8**	**-3.2**	**-3.4**
Equity prices	-0.1	-0.8	-1.8	-1.9	-2.1	-2.3
Interest rates	0.0	-0.3	-0.6	-0.9	-1.1	-1.1
Prices	**0.0**	**-0.3**	**-0.3**	**-0.1**	**-0.1**	**0.0**
Other economic determinants	**0.2**	**-0.2**	**0.2**	**0.2**	**0.1**	**-0.1**
Other assumptions	**1.2**	**-0.3**	**0.4**	**-0.5**	**-0.9**	**-2.2**
IT and NICs receipts and modelling	0.1	0.0	0.6	0.7	0.5	0.1
SDLT receipts and modelling	-0.7	-0.9	-1.0	-1.1	-1.2	-1.4
Corporation tax receipts and modelling	0.4	-0.4	0.8	-0.3	0.1	-0.4
VAT receipts and modelling	0.5	0.4	0.1	-0.1	-0.1	0.1
Incorporations modelling	-0.1	-0.4	-0.7	-0.9	-1.3	-1.6
Other judgements and modelling	1.0	1.1	0.7	1.3	1.1	0.9
	Effect of Government decisions					
Total effect of Government decisions	**0.0**	**1.3**	**-6.4**	**-3.0**	**6.1**	**-0.2**
of which:						
Scorecard measures	0.0	0.6	-7.0	-4.3	6.3	0.8
Indirect effects	0.0	0.7	0.6	1.3	-0.2	-1.1
Memo: March forecast on a pre-measures basis	*681.8*	*715.1*	*752.2*	*782.6*	*814.8*	*852.4*

Receipts in 2015-16

4.30 In preparing this forecast, we had access to full ONS receipts data up to January 2016 and some administrative data for February. Central government receipts in January were up by £2.4 billion (3.4 per cent) on a year earlier, largely reflecting payments of SA income tax and capital gains tax (CGT) relating to 2014-15 liabilities.

4.31 Table 4.9 looks at receipts growth in the first ten months of 2015-16. It shows that we expect overall growth in National Accounts taxes in the final two months of 2015-16 to be considerably higher than in the first ten months. This reflects a number of factors:

- **stamp duty land tax** receipts are expected to be 16.5 per cent higher in February and March combined than in the same months last year, up from a 0.3 per cent increase year-to-date. This is due largely to the December 2014 introduction of a 'slice' system for residential properties. The giveaway associated with this change stopped depressing year-on-year growth in SDLT receipts in December. The expected pick-up in the growth of SDLT receipts remains despite a £0.5 billion downward revision to our forecast since November;

- stronger growth in **income tax and NICs receipts**, reflecting indications from HMRC administrative data for February. The Government's **marriage tax allowance** is also costing less than expected, thanks to IT problems for many people trying to claim it and a combination of lack of awareness and reluctance to attract the attention of HMRC among other potential recipients. That more than offsets the lower yield from the introduction of **Class 3A voluntary NICs**, where lack of awareness has also led to much lower take-up than expected;

- our forecast for **environmental levies** receipts (contained within the 'other' line of Table 4.9) is higher than would be suggested by receipts year to date. We are investigating differences in estimates between DECC and the ONS;

- **alcohol duties** grow more strongly in the final two months of the year, as we expect that reverse forestalling associated with cuts in duty rates last year will not be repeated;

- **stamp duty on shares** and **VAT** receipts will both be boosted by large payments made in February; and

- **insurance premium tax (IPT)** receipts will be boosted by the July Budget measure to increase the standard rate of IPT to 9.5 per cent from November 2015.

4.32 Weaker growth in corporation tax receipts (where timing effects boosted receipts at the end of 2014-15) partly offsets this growth. Our forecasts for the split of SA between income tax, CGT and NIC4 in 2015-16 are based on the latest estimates from HMRC. These estimates have been revised from the initial data used in the January ONS numbers.

Table 4.9: Receipts in 2015-16

	£ billion			Percentage change on 2014-15		
	Outturn	Forecast		Outturn	Forecast	
	Apr-Jan	Feb-Mar	Full year	Apr-Jan	Feb-Mar	Full year
Income tax and NICs	230.0	54.7	284.7	3.8	4.6	3.9
of which:						
PAYE and NICs	209.9	51.5	261.4	4.4	4.6	4.4
Self assessment	21.1	3.1	24.1	2.7	-3.0	2.0
Value added tax	96.4	19.4	115.8	3.6	6.6	4.1
Corporation tax	40.5	3.6	44.1	3.0	-1.4	2.6
Petroleum revenue tax	-0.3	-0.2	-0.5			
Fuel duties	23.1	4.4	27.5	1.5	-0.3	1.2
Capital gains tax	5.5	1.6	7.0	28.0	22.2	26.7
Inheritance tax	3.9	0.7	4.6	19.6	21.9	19.9
Stamp duties	12.1	2.3	14.4	1.5	21.5	4.2
Tobacco duties	7.0	2.2	9.2	-0.4	0.8	-0.1
Alcohol duties	9.1	1.8	10.9	2.6	14.9	4.5
Business rates	23.5	4.3	27.8	1.8	-1.2	1.3
Council tax	24.1	4.7	28.8	2.8	-0.2	2.2
Other[1]	44.4	10.0	54.4	4.8	19.7	7.3
National Accounts taxes[1]	**519.2**	**109.5**	**628.7**	**3.6**	**5.9**	**4.0**

[1] Forecast data have been adjusted to exclude feed-in-tariffs, the warm home discount and other items which were excluded in the January ONS Public Sector Finances release. Further detail on these items can be found in the fiscal supplementary tables on our website.

Tax-by-tax analysis

Income tax and NICs

4.33 Receipts of income tax and NICs are expected to be £1.7 billion lower in 2015-16 than we forecast in November. This reflects shortfalls in a number of tax streams – PAYE and NIC receipts on employment income are expected to be £0.5 billion lower, self-assessment (SA) income tax £0.8 billion lower, non-SA (largely PAYE) repayments £0.4 billion higher and the yield from the Budget 2014 measure on voluntary NICs just under £0.4 billion lower. Receipts from NICs on the self-employed (NIC4) were £0.4 billion higher than expected.

4.34 The shortfall in the pre-measures income tax and NICs forecast relative to November widens to £13.1 billion by 2020-21, with weaker earnings growth explaining £8.5 billion of the shortfall by then. Lower earnings growth in each year reflects our judgement in the economic forecast that trend productivity growth will be around 0.2 percentage points lower each year. This lowers real (and nominal) wage growth by a similar amount.

4.35 Earnings growth in the second half of 2015-16 has been weaker than we expected in November and more than explains the £0.5 billion shortfall in PAYE and NIC receipts on employment income. Lower earnings growth should have taken around £2.1 billion off the 2015-16 forecast since November, but has been partly offset by a higher effective tax rate on these earnings, particularly due to strong growth of receipts from the business services sector. In the light of initial receipts from bonuses and recent announcements about major banks' bonus pools, we have assumed a 5 per cent fall in financial sector bonuses in 2015-

16. With most bonuses paid in February and March (and associated tax received by HMRC in March and April), this judgement remains uncertain.

4.36 Receipts from PAYE and NICs are expected to rise by 0.5 per cent of GDP in 2016-17, with NICs accounting for the majority of the rise. This mainly reflects the Budget 2013 policy decision to abolish the NICs contracting-out rebate from April 2016. This is expected to raise NICs receipts by £5.6 billion, 0.3 per cent of GDP in 2016-17, with around 50 per cent of the extra burden falling on public sector employers in higher employer NICs. NIC receipts will also be boosted in 2016-17 by unchanged tax thresholds, since CPI inflation in September 2015 (the month used for uprating NIC thresholds for the following financial year) was -0.1 per cent. Growth in PAYE receipts will be slower reflecting the decision to raise the personal allowance to £11,000 and the higher rate threshold to £43,000 from April 2016.

4.37 In this Budget, further above-inflation rises in the personal allowance and higher rate thresholds in 2017-18 have been announced. We have not included the effect from the Government's commitment to raise the personal allowance to £12,500 for all taxpayers and raising the higher rate threshold to £50,000 by the end of the Parliament. Paragraph 4.9 provides an estimate of the additional cost of meeting these commitments in 2020-21.

4.38 We expect a further 0.4 percentage point rise in the income tax and NICs to GDP ratio in the final three years of the forecast, with earnings growth outpacing inflation-linked rises in thresholds and allowances. This will drag more income into higher tax brackets.

4.39 Our forecast for PAYE and NIC receipts depends on the shape of the income distribution. In particular PAYE income tax benefits from stronger growth at the top end, given its progressive structure. When calculating marginal and average tax rates to feed into the forecast, we allow for differential earnings growth for different parts of the income distribution. These are based on historical averages from the ONS's Annual Survey of Hours and Earnings (ASHE). In contrast to the pre-crisis period, when earnings growth at the top end was stronger than for the whole distribution, the latest 7-year average suggests that earnings growth at the top end is similar to the distribution as a whole. Including the latest information on the income distribution takes around £0.8 billion off the forecast by 2020-21 relative to our November forecast. We have also continued to allow for the effects of introducing the National Living Wage. With many of those on the minimum wage close to or below the personal allowance or the lower earnings limit for NICs, the effective tax rate on their higher earnings will be very low.

4.40 A number of policy measures came into effect in 2015-16:

- tax from pension withdrawals relating to the **pension flexibility measure** is expected to be around £0.9 billion for the whole of 2015-16, around £0.2 billion higher than assumed in the original costing;

- take-up of the **transferable marriage allowance** has been much lower than initially assumed. We have incorporated a take-up rate of 12 per cent for 2015-16 compared

with over 70 per cent in the original costing. We assume that take-up eventually rises to around 50 per cent by the end of the forecast period. Lower take-up is likely to reflect issues with HMRC's IT systems, a lack of awareness of the allowance (e.g. reflecting limited initial advertising) and possibly a reluctance by those eligible to engage with HMRC. The lower take-up rate has boosted receipts by £0.4 billion in 2015-16. The improvement in receipts is smaller in future years, because taxpayers will be able to claim for previous years as take-up increases; and

- the yield from the Budget 2014 measure on **voluntary NICs** has been much lower than anticipated. This measure enabled pensioners to acquire additional state pension in exchange for a lump sum National Insurance payment at an actuarially fair price. Take-up has been much lower than expected, although the average amount contributed has been higher. We now expect receipts of around £65 million in both 2015-16 and 2016-17, compared with original estimates of £435 million in both years.

4.41 We expect self-assessment (SA) income tax receipts in 2015-16 (which relate to 2014-15 liabilities) to be up 2 per cent on the previous year, which itself had been boosted by the deferral of income relating to the reduction in the additional rate of income tax to 45 per cent. Relative to our November forecast, receipts were £0.8 billion lower than expected. This is partly due to lower SA from the Construction Industry Scheme and may also reflect lower than expected receipts from the Budget 2013 and Autumn Statement 2013 measures on partnerships. Preliminary data from SA returns suggests partnership income did not grow as strongly as expected. We will look further at this measure in our analysis of anti-avoidance measures in our next *EFO*.

4.42 We expect SA income tax receipts to rise by just over £6 billion in 2016-17 (0.3 per cent of GDP), with forestalling ahead of the rise in dividend tax adding £2.5 billion. This estimate is informed by the 2010-11 introduction of the 50p additional rate of income tax for incomes over £150,000[6]. We also expect 2016-17 to be the peak year for yield from the accelerated payments measure. If our estimate of the yield is correct, this explains a further £0.9 billion of the rise in 2016-17 SA receipts. The unwinding of the forestalling in 2017-18 and 2018-19 will depress receipts in those years but we expect SA receipts to increase by 45 per cent between 2015-16 and 2020-21, almost double the 25 per cent rise in public sector current receipts as a whole. In addition to the rise in dividend tax, a number of other measures announced at recent Budgets and Autumn Statements will boost receipts. These include changes in non-domicile rules, HMRC compliance and 'making tax digital' measures, restrictions on residential landlords' deductions from taxable income and the savings tax reforms. Much of the remaining liabilities on savings income will now be collected via SA.

[6] The Survey of Personal Incomes released at the start of March indicated that tax liabilities from additional rate taxpayers rose by £8 billion between 2012-13 and 2013-14. Taxpayers shifting income between years to take advantage of the lower 45p rate is likely to be a major factor driving this increase. In Box 4.2 of the March 2012 EFO, we forecast that deferring income between the two years would reduce tax liabilities by £3.4 billion in 2012-13 and raise them by £3.3 billion in 2013-14. Underlying growth in self-employment and dividend income will also have increased tax liabilities. The March 2012 costing of the pre-announced reduction in the additional rate estimated the measure would reduce receipts by £0.1 billion in 2013-14. The extent of the income-shifting prompted by the pre-announcement means it will never be possible to estimate the true cost of reducing the rate with any confidence, but we believe the original costing remains a reasonable guide to its effect on receipts.

4.43 We have reduced the yield we expect from the Liechtenstein and Crown Dependencies disclosure facilities in light of lower than expected registrations when they closed at the end of 2015. Much of the yield was expected to come through via SA in 2016-17 and this has reduced SA receipts by £0.6 billion in that year. Annex A provides more detail on the re-costing of these measures.

4.44 Our forecasts for PAYE, SA, NICs and corporation tax have included an effect from the rising trend in incorporations. When individuals choose to form companies, there will be a tax saving given the lower tax rates faced by incorporated businesses. This will lower PAYE, SA and NIC receipts, but raise corporation tax receipts, with the net effect negative for receipts overall. We have re-assessed the trend in incorporations in light of continued strong growth in the number of one-director companies. Tax rate differentials will be one reason for this growth, but in sectors such as information technology and construction, incorporation is becoming an increasingly popular way of working. We have assumed that there will be stronger growth in incorporations over the forecast period. Compared with our November forecast, this takes £2.6 billion off PAYE, SA and NIC receipts by 2020-21, but adds £1.1 billion to corporation tax.

Table 4.10: Key changes to the income tax and NICs forecast since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	286.4	313.9	328.3	347.5	365.8	386.8
March forecast	284.7	308.6	320.0	337.1	352.6	369.8
Change	**-1.7**	**-5.3**	**-8.3**	**-10.5**	**-13.1**	**-17.0**
	Underlying OBR forecast changes					
Total	**-1.7**	**-5.9**	**-7.0**	**-9.0**	**-10.9**	**-13.1**
(by economic determinant)						
Average earnings	-2.1	-4.7	-5.6	-6.8	-7.6	-8.5
Employee numbers	0.4	-0.1	-0.5	-1.0	-1.1	-1.3
Inflation	0.0	-0.1	0.3	0.6	0.7	0.7
SA determinants	0.1	-0.2	-0.3	-0.5	-0.6	-0.7
Other economic determinants	0.0	-0.3	-0.4	-0.6	-0.7	-0.7
(by other category)						
Outturn IT and NICs receipts	1.0	0.8	0.7	0.7	0.8	0.8
Outturn SA receipts	-0.3	-0.4	-0.6	-0.6	-0.6	-0.6
Incorporations modelling	-0.1	-0.5	-1.0	-1.4	-2.0	-2.6
Income distribution modelling	-0.2	-0.1	-0.3	-0.3	-0.5	-0.8
Marriage tax allowance recosting	0.4	0.1	0.3	0.4	0.3	0.3
Offshore recostings	0.0	-0.6	-0.2	0.2	0.1	0.0
Voluntary NICs recosting	-0.4	-0.4	0.0	0.0	0.0	0.0
Other costing revisions	0.2	0.6	0.4	0.1	0.1	0.2
Other modelling and receipts changes	-0.6	-0.1	0.3	0.3	0.3	0.3
	Changes due to Government decisions					
Scorecard measures	**0.0**	**0.2**	**-1.8**	**-2.3**	**-1.7**	**-2.8**
Indirect effects of Government decisions	**0.0**	**0.4**	**0.5**	**0.9**	**-0.6**	**-1.0**

VAT

4.45 Accrued VAT receipts are expected to increase by 4.1per cent in 2015-16 from a year earlier and are £0.2 billion higher than our November forecast. Very weak growth in cash VAT receipts in April and May 2015 depressed 2014-15 accruals, boosting accrued receipts growth in 2015-16. The share of consumer spending subject to the standard rate of VAT is expected to rise by 0.3 percentage points in 2015 despite lower spending on standard-rated road fuels resulting from the sharp drop in the oil price. This has been offset by higher spending on new cars and on recreation and culture.

4.46 Compared with our November forecast, we expect accrued VAT receipts to be lower from 2016-17 onwards. Growth in nominal consumer spending has been revised down in each year reflecting our judgement that trend productivity growth will be weaker than previously assumed. This feeds into lower real wages and lower real (and nominal) consumer spending. This takes £1.6 billion off the VAT forecast by 2020-21. Partly offsetting this, the share of consumer spending subject to the standard rate of VAT is expected to be higher throughout the forecast. This reflects the higher 2015 starting point and our lower interest rate assumptions which mean less income will be spent on mortgage interest payments.

4.47 A key element of the VAT forecast is the assumption for the VAT gap – the difference between the theoretical level of VAT payments and actual amounts received by HMRC. In the absence of measures, we hold the underlying VAT gap flat at its 2015-16 level. After measures, we expect a fall in the VAT gap of just over 1 percentage point to 10.3 per cent by the end of the forecast period. The decline largely reflects the operational measures announced in the July 2015 Budget and the measures tackling overseas trader evasion and the reverse charge on electronic communication services announced in this Budget.

Table 4.11: Key changes to the VAT forecast since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	115.6	120.1	124.9	130.2	135.9	142.3
March forecast	115.8	120.1	124.8	130.3	135.9	142.0
Change	**0.2**	**0.0**	**-0.1**	**0.1**	**0.0**	**-0.3**
	Underlying OBR forecast changes					
Total	**0.2**	**-0.2**	**-0.4**	**-0.5**	**-0.7**	**-1.0**
of which:						
Household spending	-0.2	-0.8	-1.1	-1.3	-1.4	-1.6
Standard rated share	0.5	0.4	0.7	1.0	1.1	1.1
Other economic determinants	-0.1	0.1	0.1	0.1	-0.1	-0.4
Outturn receipts and modelling	0.0	0.1	-0.2	-0.3	-0.3	-0.1
	Changes due to Government decisions					
Scorecard measures	**0.0**	**0.1**	**0.2**	**0.2**	**0.4**	**0.4**
Indirect effects of Government decisions	**0.0**	**0.0**	**0.2**	**0.5**	**0.3**	**0.3**

Onshore corporation tax

4.48 We expect receipts from onshore corporation tax (CT) in 2015-16 to be up by 6.6 per cent from a year earlier, in light of strong growth in payments from the financial sector and from larger industrial and commercial companies. Strong growth in receipts from the financial sector is likely to be the result of the Autumn Statement 2014 measure to limit the use of trading losses by the financial sector. Growth in receipts from larger industrial and commercial companies was boosted by unusually high payments relating to previous years' liabilities. This helped offset the effect from the cut in the main rate of corporation tax to 20 per cent. In contrast, CT receipts from smaller industrial and commercial companies have fallen in 2015-16, partly reflecting the increase in the annual investment allowance to £500,000 until December 2015.

4.49 Growth in onshore CT slowed through 2015-16 and is expected to fall slightly in 2016-17. This reflects a combination of factors – the slowdown in profit growth evident in the latest National Accounts data, a return to a more usual pattern of payments relating to liabilities from previous years, the effect of lower equity prices on the profits of life assurance firms and that the accelerated payments measure has brought forward receipts into 2015-16 at the expense of lower yield in future years. We expect growth in receipts from smaller industrial and commercial companies to resume in 2016-17, helped by the rise in incorporations (particularly of one-director companies).

4.50 Compared with November, our pre-measures onshore CT forecast is lower in each year from 2016-17 onwards. Weaker growth in industrial and commercial company profits takes off £1.9 billion by 2020-21, but this is partly offset by weaker growth in investment (which means that fewer capital allowances are used to offset taxable profits) and an upward revision to the number of incorporations expected over the forecast period. This adds £1.1 billion to the forecast by 2020-21 (although the loss of PAYE, SA and NIC receipts more than offsets higher CT receipts).

4.51 The profile of onshore CT receipts over the forecast period – with a sharp rise in 2019-20 – largely reflects the measures announced in this Budget and the July 2015 Budget. In July, the Government decided to bring the CT payment date for larger companies forward by four months from April 2017 raising receipts by over £5 billion in 2017-18 and around £3 billion in 2018-19. In this Budget, the Government has delayed the start of this policy to April 2019 "to give business more time to prepare". This moves the boost to receipts back to 2019-20 and 2020-21. Of the £6.9 billion rise in onshore CT in 2019-20, around £5.8 billion is from the CT timing measure. Receipts are in effect being brought forward from later years, providing a one-off boost that is neither repeated nor subsequently reversed.

4.52 Abstracting from the CT timing measure, this Budget raises onshore CT receipts in each year of the forecast. Measures such as those on restricting the use of trading losses, the tax deductibility of corporate interest expenses, reducing evasion by offshore property developers and extending the scope of the hybrid mismatch rules raise over £2 billion in 2017-18 and 2018-19. The announcement that the rate of corporation tax will be reduced to 17 per cent in 2020-21 provides a partial offset at the end of the forecast period.

4.53 The Government announced the introduction of a diverted profits tax in Autumn Statement 2014. This is designed to target multinationals that use contrived tax arrangements and was expected to raise around £300 million a year from 2016-17 onwards. Our forecast assumes that overall yield from the measure will be close to that originally scored, but we now expect that around two-thirds of the yield will come through higher CT payments (as firms restructure their tax affairs) rather than via the diverted profits tax itself. Yield from multinationals using such tax arrangements is highly uncertain, so we will need to look again at the yield and the split between CT and diverted profits tax in future forecasts.

Table 4.12: Key changes to the onshore corporation tax forecast since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	43.4	44.2	49.2	47.4	44.9	46.1
March forecast	43.6	43.4	45.9	46.1	53.0	50.4
Change	**0.2**	**-0.8**	**-3.3**	**-1.3**	**8.0**	**4.3**
	Underlying OBR forecast changes					
Total	**0.3**	**-1.3**	**-0.2**	**-0.9**	**-0.2**	**-0.4**
of which:						
Industrial and commercial company profits	-0.1	-0.9	-1.3	-1.5	-1.7	-1.9
Industrial and commercial company investment	0.0	0.2	0.4	0.6	0.8	1.0
Other economic determinants	0.0	-0.3	-0.4	-0.3	-0.2	-0.2
Incorporations modelling	0.0	0.1	0.3	0.5	0.7	1.1
Other modelling and costings updates	-0.5	-0.1	0.8	-0.1	0.3	-0.2
Latest receipts data	0.9	-0.2	-0.1	-0.1	-0.2	-0.2
	Changes due to Government decisions					
Scorecard measures	**0.0**	**0.5**	**-3.1**	**-0.5**	**8.3**	**4.8**
Indirect effects of Government decisions	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-0.1**

UK oil and gas revenues

4.54 We expect UK oil and gas revenues to be slightly negative (-£10 million) in 2015-16, down from £2.2 billion in 2014-15 and almost £11 billion as recently as 2011-12. We have revised oil and gas revenues down by an average of £1.2 billion a year from 2016-17. Receipts are expected to be negative throughout the forecast period – with repayments around £1 billion higher than payments in each year.

4.55 A key element of the downward revision in oil and gas revenues since our November forecast is the further drop in oil and gas prices. Oil prices are projected using futures prices for the first two years and then held flat in nominal terms. This leaves them $18 a barrel lower in 2015 and $15 a barrel lower in the medium term than in our November forecast. The depreciation of sterling against the dollar in recent months means that the percentage fall in sterling oil prices has been smaller. Gas prices are expected to be 9.2p a therm lower in 2016 and then nearly 8p a therm lower over the rest of the forecast.

4.56 Oil production rose by 12.8 per cent in 2015, partly reflecting the lagged effects of high levels of investment in the North Sea in recent years and an unusually low level of both planned and unplanned outtages. Despite the lower oil price environment, we expect this

higher level of production to be sustained in the near term. In light of higher plans for capital expenditure that have already been sanctioned by the Oil and Gas Authority (OGA), we also expect higher capital expenditure in the near term. But given lower oil and gas prices, we have reduced our forecast for capital expenditure towards the end of the forecast as lower prices are expected to result in lower unit costs and fewer projects clearing investment hurdle rates. Operating expenditure fell by more than we expected in 2015 and this effect is pushed into the near-term forecast.

4.57 With oil and gas prices down on their 2015 levels, we expect a further decline in the profitability of the sector in 2016-17 with many firms making losses. Payments of offshore CT and petroleum revenue tax (PRT) will be lower and are likely to be dwarfed by repayments relating to decommissioning costs and the carry back of trading losses.

4.58 The Budget announced that the rate of PRT will be reduced from 35 per cent to zero and the supplementary charge reduced to 10 per cent. This lowers receipts by an average of £0.2 billion a year from 2016-17. The cost is small because there are only a few profitable firms in the sector. Lower tax rates will boost the post-tax returns on oil and gas production, but we have assumed only a modest behavioural response. As noted earlier, the low oil and gas price environment will make it difficult for projects to clear investment hurdles. This is likely to be the case even with lower tax rates.

4.59 This forecast remains subject to significant uncertainty, particularly the extent to which much lower oil and gas prices will affect production and expenditure. The forecast model that HMRC operates for us to produce this forecast implies big rises in aggregate losses across the forecast period, which, if it proved accurate, might lead to bigger changes in activity in the North Sea than are assumed in our central forecast.

Stamp duties

4.60 Stamp duty land tax (SDLT) receipts are forecast to increase from £10.7 billion in 2015-16 to £17.4 billion in 2020-21[7]. This strong rise reflects both tax base effects – rising prices and, to a lesser extent, transactions – as well as a rising effective tax rate, as rising house prices drag a greater proportion of the value of residential transactions into higher tax brackets. It also reflects announcements in Autumn Statement 2015 and in this Budget raising the stamp duty on second homes and buy-to-let properties and the move to a 'slice' system for SDLT on commercial property. These measures add around £1.1 billion to SDLT receipts in 2016-17, rising to £1.6 billion by the end of the forecast.

4.61 Compared with November, SDLT receipts in 2015-16 have been revised down by £0.5 billion. This is despite house prices being a little stronger than expected in recent months and property transactions close to forecast. The effective tax rate appears to have fallen, reflecting the weaker top end of the residential property market. Pushing the weaker 2015-16 receipts through the forecast (plus modelling changes) takes over £1 billion off receipts by 2020-21. In particular, SDLT receipts are weaker because transactions among properties

[7] SDLT is no longer paid in Scotland, where property transactions tax has been devolved and the Scottish Government introduced a land and buildings transactions tax (LBTT) in April 2015.

worth at least £2 million have fallen. While the 9 per cent year-on-year drop over the first ten months of 2015-16 represents only around 390 fewer transactions, each transaction pays a very large amount of SDLT. Assuming an average transaction price in this bracket of £4 million would imply a £150 million drop in receipts.

4.62 We have reduced our forecast for stamp duty on shares by £0.1 billion a year on average from 2016-17. This is more than explained by the lower path for equity prices. Stamp duty on shares is up £0.3 billion in 2015-16 compared with our November forecast reflecting a large one-off payment and a higher volume of stampable shares than previously assumed. The latter effect is pushed through the forecast.

Table 4.13: Key changes to the SDLT forecast since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	11.2	12.9	14.3	15.4	16.6	17.8
March forecast	10.7	12.9	14.2	15.2	16.3	17.4
Change	**-0.5**	**-0.1**	**0.0**	**-0.2**	**-0.3**	**-0.4**
	Underlying OBR forecast changes					
Total	**-0.5**	**-0.6**	**-0.7**	**-0.8**	**-1.0**	**-1.2**
of which:						
House prices	0.2	0.3	0.3	0.3	0.3	0.2
Residential property transactions	0.0	0.1	0.0	0.0	0.0	0.0
Commercial property market	0.0	0.0	0.0	-0.1	-0.1	-0.1
Other modelling and receipts outturns	-0.7	-0.9	-1.0	-1.1	-1.2	-1.4
	Changes due to Government decisions					
Indirect effects of Government decisions	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**
Scorecard measures	**0.0**	**0.5**	**0.6**	**0.6**	**0.7**	**0.7**

Taxes on capital

4.63 **Capital gains tax (CGT)** is currently 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 2015-16 reflect asset disposals in 2014-15. CGT receipts have risen from £5.6 billion in 2014-15 to £7.0 billion in 2015-16, a rise of 27 per cent. This is on top of a rise of 42 per cent in 2014-15, so that 2015-16 receipts are 80 per cent up on 2013-14. CGT receipts in 2015-16 were stronger than would have been suggested by growth in house and equity prices in 2014-15. Preliminary analysis suggests disposals of property (because CGT is payable on the gains from non-principal residences) and unlisted shares drove the rise in receipts.

4.64 Compared to our November forecast, CGT receipts are £0.6 billion higher in 2015-16 but weaker from 2017-18 onwards. Lower equity prices more than offset the effect of pushing the higher 2015-16 outturn through the forecast. CGT is highly geared to changes in equity prices, since around two-thirds of chargeable gains are related to financial assets and CGT is only charged on the gain rather than the disposal price. The profile for receipts over the forecast largely reflects the path of equity prices and the Autumn Statement 2015 measure that from 2019-20 CGT on residential property would be due 30 days after the disposal

rather than between 10 and 21 months after the sale. This brings around £0.9 billion of CGT receipts into 2019-20. As with the measures that bring forward CT payment dates, this represents a one-off increase in receipts that is neither repeated nor reversed in later years.

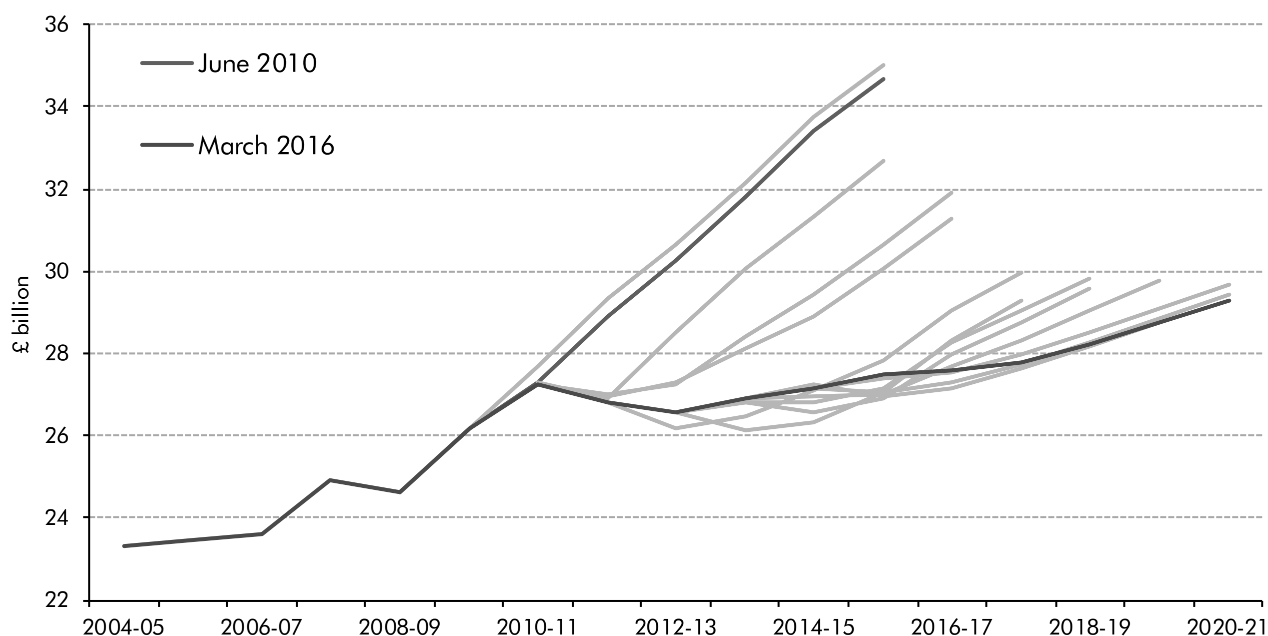
4.65 Receipts from **inheritance tax (IHT)** are expected to rise by around 20 per cent in 2015-16 and have been revised up by £0.2 billion from our estimate in November. Given the lags before IHT is paid, strong growth in house prices in 2014-15 is likely to be a key factor driving recent receipts growth. Housing assets account for around 50 per cent of the value of estates notified for probate. A higher number of deaths last winter and some exceptionally high-value estates have also boosted receipts this year. Further out, the effect from lower equity prices broadly offsets this higher starting point, meaning that IHT receipts are similar to our November forecast. The Government recently opened a consultation on proposals to change the fees payable for an application for a grant of probate. We would expect these changes to reduce IHT receipts if they go ahead, but since they are currently proposals subject to consultation no impact has been included in this forecast.

Fuel duties

4.66 Compared with November, we have revised fuel duty receipts up by £0.1 billion in 2015-16, leaving them up around 1 per cent on a year earlier. With duty rates frozen, this reflects a small rise in fuel clearances. These had fallen in every year between 2007-08 and 2012-13, reflecting improvements in fuel efficiency and the effects of the late 2000s recession on mileage. With fuel duty charged on a pence per litre basis, the drop in pump prices has helped raise the demand for fuel and boost receipts in the past three years. The further fall in oil prices since November provides a £0.2 to £0.3 billion a year boost to receipts, but there are offsets from our lower forecasts for both real GDP growth and RPI inflation.

4.67 The Budget announced that fuel duty would be frozen in April 2016 rather than being uprated in line with RPI inflation – the first freeze in this Parliament, following the five freezes and one cut that took place in the last Parliament. The Government maintains in its *Budget 2016 policy costings document* that its policy is to uprate duty rates with RPI inflation each year from April 2017. With improved fuel efficiency likely to reduce the demand for fuel from 2017-18 onwards, the £1.7 billion increase in receipts between 2016-17 and 2020-21 is more than explained by the implied duty rises. But this could be considered a source of policy risk to the forecast, given repeated decisions to cancel planned duty rises in recent years. Chart 4.3 shows our forecasts for fuel duty since June 2010, with the downward revisions dominated by these policy decisions.

Chart 4.4: Successive fuel duty forecasts since June 2010



Source: HMRC, OBR

Alcohol and tobacco duties

4.68 Alcohol duty is expected to rise from £10.9 billion in 2015-16 to £13.0 billion in 2020-21. Receipts from wine and spirits are expected to increase by £1.3 billion and £0.6 billion respectively, but we expect a rise of just £0.2 billion from beer and cider. We assume that the downward trend in beer clearances continues through the forecast. Our forecast for alcohol duties is little changed since November. It incorporates the Budget announcement that alcohol duties for beer, cider and spirits will be frozen in April 2016.

4.69 Tobacco receipts are expected to rise only slightly, from £9.2 billion in 2015-16 to £9.7 billion in 2020-21, despite RPI plus 2 per cent rises in duty each year. The effect of these duty rises is largely offset by the downward trend in cigarette clearances, 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. Our forecast is little changed since November. Receipts are £0.1 billion a year higher reflecting a lower euro/sterling exchange rate, which reduces the relative benefits of cross border shopping.

Other taxes

4.70 **Business rates** receipts are calculated by multiplying the rateable value of non-domestic property by the multiplier (which is uprated in line with RPI inflation). In the absence of measures, receipts would be down by around £0.2 billion by 2020-21, reflecting the downward revisions in our RPI forecasts. The Budget announced a package of measures on business rates which reduce receipts by between £1.4 and £1.9 billion a year from 2017-18. These include the permanent doubling of the small business rate relief and a widening in its eligibility criteria, as well as moving indexation of the multiplier to CPI rather than RPI

from 2020-21. The Government had previously extended the doubling of small business rate relief for one year every year since 2011.

4.71 Our business rates forecast is subject to some further policy-related uncertainty following the Government's announcement of its intention to localise all business rates and to provide some additional discretion to local authorities in setting business rates. However, the Government has told us that because this will be implemented as part of a wider package that it intends to be fiscally neutral, this element alone does not yet constitute firm Government policy. We have not therefore reflected it in this forecast (see Box 4.3).

4.72 Receipts from **council tax** are expected to be around £0.8 billion higher in 2020-21 than in our November 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 borrowing.

4.73 **Environmental levies** include levy-funded spending policies such as the renewables obligation (RO), contracts for difference (CfD), feed-in tariffs (FITs) and the warm homes discount. Environmental levy receipts also include receipts from the carbon reduction commitment, but not other DECC schemes that affect energy bills such as the energy company obligation. Our forecast shows environmental levy receipts are expected to rise from £6.2 billion in 2015-16 to £12.3 billion in 2020-21. This steep rise mainly reflects the expected rise in electricity generation from renewable sources.

4.74 Compared with November, our forecast is lower by £0.9 billion by 2020-21, although it would have been higher prior to policy announcements. This reflects higher assumptions on load factors for a variety of renewable technologies (leading to higher electricity generation) and the fact that lower electricity prices will raise spending through the CfD scheme. The December announcements on FITs (lower tariffs and a deployment cap) and closing the RO to small-scale solar PV from April 2016 reduce spending by 2020-21 by a little over £400 million and £60 million respectively. The Spending Review decision to remove the capital budget for the carbon capture and storage (CCS) competition means that we no longer expect the CCS demonstration projects to deploy. The associated CfD spending is reduced by £0.5 billion in 2020-21. All these policies have the same effect on both receipts and spending, so are neutral for borrowing. The abolition of the carbon reduction commitment reduces receipts by around £0.5 billion in 2020-21.

4.75 The environmental levies forecasts are produced for us by DECC using forecasting models that are relatively complex and that rely on commercially sensitive information. Both factors reduce the transparency of the forecasting process and our ability to scrutinise forecast changes in detail. This is an area that we hope to be able to improve over time, subject to the availability of analytical resources.

4.76 The Budget has announced that a **soft drinks industry levy** will be introduced from 2018-19 onwards. The liability to pay will be at the point beverages are packaged for sale and will rely on producers and importers to report volumes each quarterly accounting period. It will consist of two rates, based on the sugar content of these beverages. The levy will operate

with a specific revenue target of £500 million for the second year of implementation (2019-20). This currently implies levy rates of 18 pence and 24 pence per litre unit. These take into account a variety of behavioural effects which will affect the revenue raised.

4.77 The costing for this measure allows for several behavioural responses to the introduction of the levy. These include an initial 0.8 per cent reduction in demand for every 1 per cent rise in price, rising to 1 per cent. Producers are also assumed to reformulate their products to reduce sugar content or introduce sub-brands. We have assumed a 5 per cent a year drop in volumes subject to the higher rate and a 2 per cent a year rise in those subject to the lower rate. We also expect some initial forestalling ahead of the introduction of the tax, plus the emergence of a 'tax gap' given the incentive for increased cross-border shopping and illicit trade. From a pre-behavioural yield of over £900 million, the behavioural responses lower the yield to around £500 million a year. As a new tax likely to prompt a large behavioural response, these estimates are clearly subject to significant uncertainty.

4.78 Receipts from **insurance premium tax (IPT)** are expected to rise by over 50 per cent between 2014-15 and 2016-17, reflecting the July 2015 Budget measure to increase the standard rate of IPT from 6 to 9.5 per cent in November 2015 and the further rise to 10 per cent from September 2016 announced in the Budget. Abstracting from the increases in the IPT rate, growth in underlying IPT receipts in the forecast is expected to remain modest. We have continued to assume a small negative effect from reforms designed to reduce the cost of certain forms of road traffic personal injury claims.

4.79 **Air passenger duty** receipts are expected to rise from £3.1 billion in 2015-16 to £3.9 billion in 2020-21. This reflects duty rate rises and growth in passenger numbers. Our forecast is little changed since November.

4.80 **Vehicle excise duty (VED)** is levied annually on road vehicles and is expected to rise from £5.6 billion in 2015-16 to £6.2 billion in 2020-21, reflecting the uprating of duties in line with RPI inflation and measures announced in the July 2015 Budget. Relative to November, our forecast is higher by £0.1 to £0.2 billion a year, reflecting higher receipts so far this year that have been pushed through to the rest of the forecast.

4.81 Receipts from the **climate change levy (CCL)** are expected to be around £0.3 billion lower in 2015-16 than in our November forecast. This reflects lower than expected receipts from the carbon price floor (CPF) element of the CCL. The almost doubling of the carbon support rates in 2015-16 was expected to lead to a strong rise in CPF receipts this year. However, DECC data suggest that the switch away from coal-fired to gas-fired electricity generation (which has a lower tax rate) was much bigger than previously assumed, limiting the growth in CPF receipts. With CPF tax rates little changed until 2020-21 (when they rise in line with RPI inflation), the smaller tax base reduces receipts by at least £0.2 billion a year. In contrast to declining CPF receipts, we expect a rise in CCL receipts (excluding CPF), reflecting the July 2015 Budget decision to remove the CCL exemption from energy generated from renewable sources and the higher CCL rates from 2019-20 announced in the Budget to compensate for the loss of revenues from removing the carbon reduction commitment.

4.82 **Bank levy** receipts are expected to fall from £3.5 billion in 2015-16 to £2.2 billion in 2020-21. This mainly reflects the graduated cuts in the bank levy rate from 0.21 per cent to 0.1 per cent by 2021, which were announced in the July 2015 Budget. Our forecast is unchanged since November.

4.83 **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. Relative to November, our forecast is higher by around £0.2 billion a year, reflecting changes to overall central and local government spending.

Other receipts

4.84 **Interest and dividend** receipts include interest income on the government's stock of financial assets, which includes student loans and holdings related to financial sector interventions. Our forecast for interest and dividend receipts is significantly lower than in November, with receipts expected to be over £2 billion lower in each of the final three years of the forecast. The key driver is that interest rates are expected to remain lower for longer – with the direct effect of lower interest rates on the stock of central government assets (including foreign exchange reserves) and local authority assets over £1½ billion by 2020-21.

4.85 Lower interest rates also affect the accrued interest on the stock of some older student loans and the interest from the UK Asset Resolution mortgage book. The Budget announcement of a further large sale of mortgage assets in 2016-17 and 2017-18 will lower interest received by around £0.3 billion a year. With the sale of the Government's remaining stake in Lloyds delayed into 2016-17, we have factored in an additional dividend payment of £130 million before the sale has been completed.

4.86 Our forecast for **gross operating surplus (GOS)** comprises general government depreciation and public corporations' gross operation surplus (PCGOS), including the operating surpluses of housing associations. Our forecast for GOS has fallen by an average of £0.4 billion a year over the forecast period since November, largely because of the scorecard measure that makes pay to stay voluntary for housing associations, which is assumed to reduce additional rents from pay to stay by an average of £0.3 billion a year from 2017-18 onwards.

Public sector expenditure

Definitions and approach

4.87 This section explains our central forecast for public sector expenditure, which is 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. In our forecast, we combine these National Accounts aggregates with the two administrative aggregates used by the Treasury to manage public spending:

- **departmental expenditure limits (DELs)**[8] – mostly covering spending on public services, grants, administration and capital investment, which can be planned over extended periods. Our fiscal forecast therefore shows PSCE in resource DEL and PSGI in capital DEL. We typically assume (in line with historical experience) that departments will underspend the limits that the Treasury sets for them, so – unless otherwise stated – when we refer to PSCE in RDEL and PSGI in CDEL (or RDEL and CDEL for simplicity) we are referring to the net amount that we assume is actually spent; and

- **annually managed expenditure (AME)** – categories of spending less amenable to multi-year planning, such as social security spending and debt interest. Again, our fiscal forecast shows PSCE in current AME and PSGI in capital AME.

Summary of the expenditure forecast

4.88 Table 4.14 summarises our latest forecast for public spending. TME is expressed as a share of GDP, but not all of TME contributes directly to GDP – benefit payments, debt interest and other cash transfers merely transfer income from some individuals to others. The table also shows how TME is split between DEL spending and AME, and the main components of each. It shows that TME is expected to fall by 3.2 per cent of GDP over the four years of the latest Spending Review period up to 2019-20, and slightly further in 2020-21.

Table 4.14: TME split between DEL and AME

	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
TME	**40.8**	**40.2**	**39.7**	**38.8**	**38.0**	**37.0**	**36.9**
of which:							
TME in DEL[1]	**19.4**	**18.8**	**18.6**	**18.1**	**17.6**	**16.9**	**16.9**
of which:							
PSCE in RDEL	17.3	16.9	16.6	16.1	15.6	14.9	14.6
PSGI in CDEL	2.0	1.9	2.0	2.0	2.0	2.0	2.3
TME in AME[1]	**21.4**	**21.4**	**21.1**	**20.7**	**20.4**	**20.1**	**19.9**
of which:							
Welfare spending	11.7	11.5	11.2	10.8	10.5	10.2	10.1
Debt interest net of APF	1.8	1.8	1.8	1.9	2.0	2.0	1.9
Locally-financed current expenditure	2.0	2.2	2.1	2.1	2.1	2.1	2.1
Net public service pension payments	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Other PSCE in AME	3.3	3.3	3.4	3.3	3.4	3.5	3.5
PSGI in AME	2.0	2.0	2.0	1.9	1.7	1.6	1.7

[1] In relation to Table 4.15, 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).

4.89 Tables 4.15 and 4.16 detail our latest spending forecast and the changes since November.

[8] 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 and financial transactions, which are discussed later in this chapter.

Table 4.15: Total managed expenditure

	£ billion						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public sector current expenditure (PSCE)							
PSCE in RDEL	**317.6**	**316.1**	**321.7**	**325.3**	**327.7**	**327.1**	**333.7**
PSCE in AME	**355.7**	**365.1**	**372.5**	**380.8**	**394.9**	**404.3**	**416.2**
of which:							
Welfare spending	213.9	216.6	218.3	219.2	221.2	224.2	229.5
of which:							
Inside welfare cap	*119.3*	*120.4*	*119.8*	*118.0*	*116.4*	*116.2*	*118.1*
Outside welfare cap	*94.7*	*96.2*	*98.4*	*101.2*	*104.8*	*108.1*	*111.4*
Company and other tax credits	2.1	2.4	2.6	2.7	2.7	2.8	2.8
Net public service pension payments	12.3	11.5	11.2	12.1	13.7	13.2	14.7
National lottery current grants	1.4	1.4	1.4	1.4	1.5	1.5	1.5
BBC current expenditure	3.8	3.8	3.8	3.8	3.7	3.6	3.7
Network Rail other current expenditure[1]	1.0	0.8	0.8	0.3	-0.2	-0.1	-0.1
Other PSCE items in departmental AME	1.0	1.2	0.9	0.9	0.8	0.8	0.8
Expenditure transfers to EU institutions	10.4	10.5	11.8	9.4	11.2	11.6	11.9
Locally financed current expenditure	36.0	40.5	40.8	43.3	45.1	47.0	48.8
Central government gross debt interest	45.2	45.7	47.8	51.0	54.1	54.4	53.5
Reductions in debt interest due to APF	-12.4	-11.6	-12.4	-12.4	-11.7	-11.0	-10.1
Public corporations' debt interest	2.9	3.1	3.3	3.5	3.8	4.0	4.2
General government depreciation	28.5	29.4	31.1	32.8	34.5	36.1	37.8
Current VAT refunds	11.5	12.1	12.4	12.5	12.6	12.6	12.8
R&D expenditure	-7.2	-7.8	-7.9	-7.9	-8.0	-8.1	-8.4
Single use military expenditure	0.3	0.4	0.2	0.2	0.2	0.3	0.3
Environmental levies	3.2	5.9	7.3	8.7	10.7	12.4	13.4
Local authority imputed pensions	1.8	1.8	1.9	2.0	2.1	2.2	2.3
Other National Accounts adjustments	0.0	-2.7	-2.8	-2.9	-3.0	-3.2	-3.3
Total public sector current expenditure	**673.3**	**681.2**	**694.2**	**706.0**	**722.6**	**731.4**	**749.8**
Public sector gross investment (PSGI)							
PSGI in CDEL	**37.3**	**35.6**	**39.2**	**40.9**	**42.9**	**43.0**	**52.6**
PSGI in AME	**36.1**	**37.1**	**38.5**	**37.6**	**35.5**	**36.1**	**38.7**
of which:							
Tax litigation	0.0	0.0	0.9	1.2	1.5	1.8	1.9
Network Rail capital expenditure	6.2	6.3	6.9	6.1	5.1	5.0	5.3
Other PSGI items in departmental AME	0.8	0.2	1.1	1.5	1.7	2.0	2.4
Locally financed capital expenditure	6.9	7.3	6.9	7.3	5.8	6.4	6.6
Public corporations' capital expenditure	15.9	15.8	14.8	13.6	12.9	12.0	13.2
R&D expenditure	7.2	7.8	7.9	7.9	8.0	8.1	8.4
Other National Accounts adjustments	-0.8	-0.2	0.0	0.1	0.5	0.8	1.0
Total public sector gross investment	**73.4**	**72.7**	**77.8**	**78.6**	**78.4**	**79.1**	**91.3**
Less public sector depreciation	-38.6	-39.5	-41.4	-43.2	-45.1	-46.9	-48.9
Public sector net investment	**34.8**	**33.2**	**36.4**	**35.3**	**33.2**	**32.1**	**42.4**
Total managed expenditure	**746.7**	**753.9**	**771.9**	**784.6**	**801.0**	**810.4**	**841.1**

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

Table 4.16: Changes to total managed expenditure since November

	£ billion						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public sector current expenditure (PSCE)							
PSCE in RDEL	**0.0**	**0.7**	**0.6**	**2.1**	**2.2**	**-1.5**	**-7.8**
PSCE in AME	**0.0**	**-1.7**	**-2.4**	**-6.8**	**-5.1**	**-9.1**	**-9.4**
of which:							
Welfare spending	0.0	-0.6	0.4	-0.5	-0.3	0.1	0.1
of which:							
Inside welfare cap	*0.0*	*-0.5*	*0.6*	*0.3*	*0.6*	*0.9*	*1.1*
Outside welfare cap	*0.0*	*-0.1*	*-0.2*	*-0.8*	*-0.8*	*-0.7*	*-1.0*
Company and other tax credits	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Net public service pension payments	0.0	0.2	-0.3	-0.6	-0.6	-2.5	-2.0
National lottery current grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BBC current expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Network Rail other current expenditure[1]	-0.1	0.0	0.1	-0.1	-0.1	0.0	0.0
Other PSCE items in departmental AME	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Expenditure transfers to EU institutions	0.0	-1.2	1.1	-0.2	0.2	0.2	0.2
Locally financed current expenditure	-0.2	0.7	0.5	-0.1	-0.4	-0.9	-1.1
Central government gross debt interest	0.0	-0.8	-3.2	-3.2	-1.5	-3.0	-3.1
Reductions in debt interest due to APF	0.0	0.2	-0.8	-1.9	-2.5	-2.7	-2.6
Public corporations' debt interest	0.3	-0.1	0.0	0.0	0.0	0.0	0.0
General government depreciation	0.0	-0.2	-0.1	-0.1	0.1	0.1	0.0
Current VAT refunds	0.0	0.1	0.2	0.3	0.4	0.3	0.0
R&D expenditure	0.0	-0.3	-0.3	-0.3	-0.3	-0.3	-0.4
Single use military expenditure	0.0	0.2	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	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Other National Accounts adjustments	0.0	0.3	0.3	0.2	0.2	0.1	0.1
Total public sector current expenditure	**0.0**	**-1.1**	**-1.8**	**-4.7**	**-2.9**	**-10.6**	**-17.2**
Public sector gross investment (PSGI)							
PSGI in CDEL	**0.0**	**-0.2**	**0.3**	**0.8**	**1.3**	**-1.0**	**-0.2**
PSGI in AME	**-2.3**	**-0.5**	**0.1**	**1.0**	**1.4**	**1.1**	**1.3**
of which:							
Tax litigation	0.0	-0.2	0.2	0.0	0.0	0.0	0.0
Network Rail capital expenditure	0.0	-0.5	-0.5	0.5	0.7	0.0	0.0
Other PSGI items in departmental AME	0.0	-0.3	0.0	0.3	0.2	0.4	0.5
Locally financed capital expenditure	0.1	0.7	-0.2	-0.2	-0.1	0.2	0.5
Public corporations' capital expenditure	-0.1	0.1	0.4	0.0	0.1	-0.1	-0.2
R&D expenditure	0.0	0.3	0.3	0.3	0.3	0.3	0.4
Other National Accounts adjustments	-2.3	-0.6	-0.1	0.0	0.2	0.2	0.3
Total public sector gross investment	**-2.3**	**-0.7**	**0.4**	**1.8**	**2.7**	**0.1**	**1.1**
Less public sector depreciation	-0.1	0.3	0.2	0.1	-0.1	-0.1	-0.1
Public sector net investment	**-2.4**	**-0.4**	**0.6**	**1.9**	**2.6**	**0.0**	**1.0**
Total managed expenditure	**-2.3**	**-1.8**	**-1.4**	**-2.9**	**-0.2**	**-10.5**	**-16.1**

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

4.90 Table 4.17 summarises the sources of changes to our forecast since November. It shows that:

- **economy forecast driven changes** have reduced spending, with the main impact from lower inflation, which has reduced spending throughout the forecast, with reductions ranging from £2.0 billion in 2016-17 to £0.6 billion in 2020-21;
- **debt interest** spending has been revised down significantly, due to further falls in market interest rate expectations. Higher borrowing offsets some of that reduction;
- our **pre-measures forecast for other AME spending** is higher every year. Welfare spending has been revised up, thanks largely to higher-than-expected caseloads and average awards as disabled people are migrated from disability living allowance to the new personal independence payment. Spending by local authorities and public corporations has also been revised up. We have made smaller downward revisions to spending on state pensions, tax credits and public service pensions;
- the **direct effect of Government decisions** reduces AME in all years. However overall spending is increased for the three years up to 2018-19 because of scorecard measures that increase departments RDEL and CDEL spending. Thereafter, in 2019-20 and 2020-21, although some scorecard measures continue to increase RDEL (in both years) and CDEL (in 2019-20), these increases are outweighed by larger RDEL and CDEL cuts so that overall spending falls by £7.6 billion in 2019-20, and by £13.0 billion in 2020-21; and
- the **indirect effect of Government decisions** are mostly small, with the biggest effect a £1.0 billion increase in the accrued interest on index-linked gilts due to the effect on RPI inflation of the introduction of a soft drinks industry levy.

Table 4.17: Sources of changes to the spending forecast since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	755.7	773.3	787.5	801.2	821.0	857.2
March forecast	753.9	771.9	784.6	801.0	810.4	841.1
Change	**-1.8**	**-1.4**	**-2.9**	**-0.2**	**-10.5**	**-16.1**
	Forecast changes					
Forecast changes since November	**-1.7**	**-1.7**	**-3.3**	**-1.6**	**-2.9**	**-2.8**
of which:						
Economic determinants	**-0.5**	**-2.0**	**-1.8**	**-0.7**	**-0.9**	**-0.9**
of which:						
Inflation	-0.5	-2.0	-1.4	-0.7	-0.8	-0.6
Unemployment	0.0	-0.1	-0.1	0.0	0.1	0.1
Other determinants	0.0	0.1	-0.2	-0.1	-0.2	-0.3
Market assumptions: interest rates	**-0.1**	**-2.0**	**-3.9**	**-5.2**	**-6.0**	**-6.2**
Other assumptions and changes	**-1.1**	**2.3**	**2.5**	**4.3**	**4.0**	**4.2**
of which:						
Other welfare changes	-0.6	0.4	1.0	1.9	2.3	2.2
Locally financed and public corporations' capital expenditure forecast changes	0.8	0.5	0.8	0.8	0.8	0.8
Expenditure transfers to EU institutions changes	-1.2	1.1	-0.4	-0.1	-0.1	-0.2
Other debt interest forecast changes	0.0	0.1	0.2	0.5	0.8	1.1
DEL forecast changes	0.5	0.5	0.5	0.5	0.5	0.5
Locally financed current expenditure forecast changes	0.7	0.3	0.5	0.4	0.2	0.3
Public sector pensions forecast changes	0.2	-0.3	-0.5	-0.4	-0.4	-0.2
Network Rail current and capital expenditure changes	-0.6	-0.4	0.4	0.6	0.0	0.0
Other	-0.9	0.2	0.0	0.3	-0.1	-0.3
	Effect of Government decisions					
Total effect of Government decisions	**-0.1**	**0.3**	**0.4**	**1.4**	**-7.6**	**-13.3**
of which:						
AME scorecard measures	0.0	-0.1	-2.1	-2.6	-4.6	-4.5
RDEL changes[1]	0.4	0.3	1.8	1.9	-1.8	-8.1
CDEL changes[1]	-0.4	0.1	0.7	1.1	-1.2	-0.4
Indirect effects of Government decisions	-0.1	-0.1	0.0	1.0	0.0	-0.3

[1] Excludes changes to DELs that are forecast or classification changes.

Expenditure in 2015-16

4.91 We have revised down spending in 2015-16 by £1.8 billion since November. This includes £1.1 billion of spending that has been switched from 2015-16 to 2016-17, because some payments to the EU institutions that were expected to be paid at the start of 2016 are now being paid later in the year. Debt interest spending in 2015-16 is also £0.6 billion down since November due to lower RPI inflation affecting accrued interest payments on index-linked gilts. Other differences are largely offsetting. We have reduced the amount of underspending that we expect against departments' final RDEL plans, which increases

spending by £0.5 billion. But this is more than offset by a £0.6 billion reduction in our forecast for welfare spending, which mainly reflects a lower caseload on tax credits.

4.92 Monthly spending data are only available for central government spending. Table 4.18 compares the growth in central government spending over the first ten months of 2015-16 with our latest forecast for the full year. The latest official data for April to January report total central government spending 0.8 per cent higher than last year. Our forecast implies year-on-year falls in the remaining two months. That mainly reflects lower payments of current grants to local authorities and also lower capital spending. Current grants to local authorities are expected to be lower, because of changes in the profile of grant payments, including revenue support grant. Capital spending is expected to be lower because departments are forecasting a lower end year surge in capital spending, and because we still expect spending to fall below departments' own forecasts, as happens every year.

4.93 Within current central government spending, the lower February and March spending on current grants to local authorities is expected partly to be offset by higher payments of net social benefits and debt interest payments. Net social benefits are expected to be higher than last year partly because of the leap year effect. Debt interest payments are up year-on-year because RPI inflation, while lower than we expected in November, is still higher than last year. The EU payments and abatement receipts were actually known for February and March before this forecast closed, and so that provides a firm basis for our forecast that net current transfers abroad will be less negative over those months, compared to last year. The year-on-year comparison is complicated by the large historical adjustment payments that were made in December 2014. Growth in other current spending, largely PSCE in RDEL, is expected to be fairly steady to the end of the year.

Table 4.18: Central government expenditure in 2015-16

	Spending in 2015-16 (£ billion)			Percentage change on 2014-15		
	Outturn	Forecast[1]		Outturn	Forecast[1]	
	Apr-Jan	Feb-Mar	Full Year	Apr-Jan	Feb-Mar	Full Year
Total current expenditure	**547.5**	**105.8**	**653.3**	**0.7**	**-0.9**	**0.5**
of which:						
Net social benefits	171.0	33.1	204.0	0.7	3.6	1.2
Debt interest	40.8	4.9	45.7	0.8	4.0	1.1
Current grants to local authorities	99.7	18.1	117.8	-1.5	-15.3	-3.9
VAT and GNI based EU contributions	11.0	4.3	15.3	-3.6	-6.7	-4.5
Net current transfers abroad	3.3	-0.4	2.8	1.6	-34.8	11.4
Other current spending	221.7	45.9	267.6	2.0	2.3	2.0
Total (gross) capital spending	**41.7**	**10.3**	**52.0**	**1.9**	**-16.5**	**-2.4**
of which:						
Capital grants to local authorities	10.2	1.7	11.9	3.6	-19.0	-0.4
Other capital spending	31.5	8.6	40.1	1.3	-16.0	-3.0
Total central government expenditure in TME	**589.2**	**116.1**	**705.3**	**0.8**	**-2.5**	**0.2**

[1] Forecast data has been adjusted to be consistent with the latest National Accounts definitions of central government spending. One of our fiscal supplementary tables that are available on our website shows the items included in our forecasts that ONS have not yet included in outturn. The items shown in that table have been excluded from our forecast above, so that the above table compares outturn to date and our forecast for the full year on a comparable basis.

Spending within departmental expenditure limits (DELs)

DEL spending in 2015-16

4.94 Our latest forecasts for DEL spending in 2015-16 are shown in Table 4.15 above and changes since November in Table 4.16 below. These reflect departments' final plans published in *Supplementary Estimates 2015-16,* and the amount we expect departments to underspend against those plans.

4.95 Table 4.19 breaks down the changes in our forecasts for PSCE in RDEL and PSGI in CDEL (RDEL and CDEL hereafter) into three separate components:

- updated **forecasts for underspends** against the initial plans set out in *Public Expenditure Statistical Analyses* (PESA) 2015. In November we assumed that departments would underspend their PESA plans for RDEL and CDEL in 2015-16 by £1 billion and £2 billion respectively. We have not changed our CDEL underspend assumption, but have reduced our RDEL assumption to £0.5 billion. The evidence we considered in reaching these judgements is described more fully below;

- **classification changes** to reflect additional receipts that the ONS reclassified as negative spending in its February public sector finances release. This reflects ongoing work by the ONS and Treasury to reconcile accrued and cash measures of borrowing (described in Box 4.3 of our July *EFO*). It has reduced PSCE in RDEL by £0.2 billion and increased PSGI in CDEL by £0.2 billion (because the previous estimate of capital receipts was reduced). The Treasury has informed us that these further classification changes will also change the DEL plans set out in the Spending Review, so we have included these classification changes in our forecast from 2016-17 onwards; and

- the **effects of Government decisions**. For 2015-16, this includes changes to departments' detailed spending plans within their RDEL and CDEL limits, as reported in *Supplementary Estimates 2015-16*. These changes switched a net £0.4 billion of spending from CDEL to RDEL, which included £1 billion switched from CDEL to RDEL for the Department of Health to relieve some spending pressures current in the NHS.

4.96 Our underspend assumptions are measured against the plans set out in PESA 2015, net of Budget Exchange. Departments carry forward some spending headroom under the Treasury's Budget Exchange system, which presumes that they create similar headroom at the end of the year. So it also possible to look at our underspend estimates gross of Budget Exchange. Both figures are shown in Table 4.19.[9] It shows that:

- departments carried less spending forward under **Budget Exchange** this year than they did in 2014-15, with more in capital and less in resource budgets;

[9] 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.

- £2.4 billion of spending was surrendered in **Supplementary Estimates**, slightly more than last year. Surrenders were mostly on the capital side, with some spending switched from CDEL to RDEL;

- **departments' own 'forecast outturns'**, submitted to the Treasury in February, imply that both current and capital spending will be slightly lower than the final spending plans set in the Supplementary Estimates (as we would expect given the penalties that they would incur if spending limits were exceeded); and

- our **final underspend estimates** assume spending will fall further away from plans and 'forecast outturns', consistent with the pattern of previous years.

Table 4.19: DEL shortfalls against PESA plans for 2015-16

	£ billion					
	PSCE in RDEL		PSGI in CDEL		TME in DEL	
	Outturn	Forecast	Outturn	Forecast	Outturn	Forecast
	14-15	15-16	14-15	15-16	14-15	15-16
Budget Exchange brought into the year	2.2	0.5	1.0	1.6	3.2	2.1
Gross underspend	**-3.4**	**-1.0**	**-2.9**	**-3.6**	**-6.2**	**-4.6**
of which:						
Supplementary estimates (final plans)[1]	-1.6	0.0	-0.8	-2.4	-2.4	-2.4
Shortfall against final plans in departments' forecast outturn in February	-1.9	-0.3	-1.1	-0.3	-3.0	-0.6
OBR estimate of further shortfall	0.2	-0.7	-0.9	-0.9	-0.8	-1.6
Net underspend against PESA plans[2]	**-1.2**	**-0.5**	**-1.8**	**-2.0**	**-3.0**	**-2.5**

[1] Provisional estimates.

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

DEL spending from 2016-17 onwards

4.97 Table 4.20 shows our DEL forecasts for 2016-17 onwards. 'Actual spending' in this table reflects the plans that were set in November's Spending Review and the changes announced in this Budget, adjusted for expected underspending. Actual spending in 2020-21 reflects a mix of firm plans and policy assumptions set in the Spending Review and changes announced in the Budget, again adjusted for underspending.

4.98 The underspend assumption for CDEL in 2020-21 is much larger than the underspends we assume in the Spending Review years, due to the much faster rise in spending that the Government is assuming in that year. Experience suggests that actual spending falls further short of plans when the Government attempts to ramp up capital spending quickly.

4.99 We break down the changes in our forecast since November into underlying forecast changes (which reflect updates to our underspending assumptions excluding any consequences of Budget decisions), classification changes and the effect of Government decisions (which includes any implications for underspending). Table 4.20 shows that:

- we have reduced our **pre-measures forecast for underspending** against PSCE in RDEL by £0.5 billion a year. That reflects departments reporting higher 'non-fiscal' receipts (negative spending in the DEL control total). This does not directly affect PSNB, but some of the receipts have been used to raise 'fiscal' spending, which does affect PSNB. Given the upward trend in these non-fiscal receipts in recent years, and the upward revision in 2015-16 since our last forecast, we have assumed that this will feed through to lower underspending against PSCE in RDEL than we did in November. We will review this assumption after departmental plans have been set out in more detail in this summer's PESA publication. Our pre-measures forecast for underspending against PSGI in CDEL is unchanged;

- as noted above, the only **classification changes** relates to those in 2015-16, which the Treasury has informed us will be reflected in departments' plans for future years in due course;

- the Government's **Budget RDEL policy announcements** include scorecard measures that increase RDEL in every year except 2019-20, when the scorecard shows cuts that include £3.5 billion of as-yet unidentified cuts to be generated by an 'efficiency review' that will report in 2018. In 2019-20 and 2020-21, the Government has announced additional RDEL cuts that are not presented on its scorecard. In 2019-20 it has reduced overseas aid spending by £0.7 billion. In 2020-21, when departments' RDELs have not been fully allocated, it has cut the total RDEL envelope by £9.9 billion. We have reduced our RDEL underspend assumption by £0.5 billion in 2019-20 and 2020-21 to reflect these cuts and the additional pressure on budgets from higher employer contributions to public service pension schemes in those years, reflecting the Budget announcement that the Government will reduce the discount rate used in the forthcoming pensions revaluations (discussed in the public service pensions section below); and

- the Government's **Budget CDEL policy announcements** include scorecard measures that increase CDEL up until 2018-19, with the largest measure bringing forward £1.6 billion of capital spending from 2019-20 into 2017-18 and 2018-19. We have assumed that around 20 per cent of the CDEL spending that is brought forward will in reality slip into the following year, and have amended our assumptions for underspending to show that slippage. In 2019-20 and 2020-21 the scorecard measures reduce CDEL spending. The Government has also switched £0.2 billion of spending from fiscal CDEL to non-fiscal CDEL in 2020-21, reducing PSGI in CDEL.

Table 4.20: RDEL and CDEL spending and changes since November

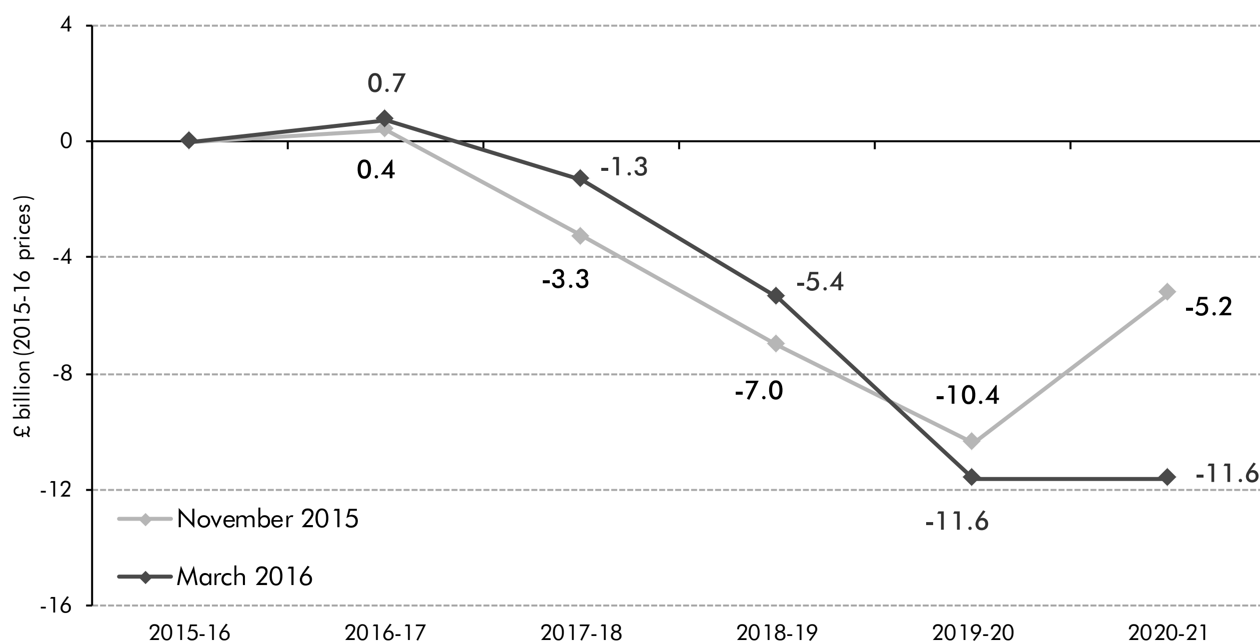
	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
PSCE in RDEL						
November forecast						
Actual spending	315.4	321.1	323.2	325.5	328.6	341.5
March forecast						
Limits	316.6	322.2	325.8	328.7	327.6	334.2
Assumed underspend[1]	-0.5	-0.5	-0.5	-1.0	-0.5	-0.5
Actual spending	316.1	321.7	325.3	327.7	327.1	333.7
Change	**0.7**	**0.6**	**2.1**	**2.2**	**-1.5**	**-7.8**
of which:						
Forecast changes	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**
Assumed underspend (forecast changes)	0.5	0.5	0.5	0.5	0.5	0.5
Classification changes	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Effect of government decisions	**0.4**	**0.3**	**1.8**	**1.9**	**-1.8**	**-8.1**
Assumed underspend (policy changes)	-	-	-	-	0.5	0.5
Scorecard measures	-	0.3	1.8	1.9	-1.6	1.3
Other changes to RDEL spending	0.4	-	-	-	-0.7	-9.9
PSGI in CDEL						
November forecast						
Actual spending	35.8	39.0	40.1	41.6	44.0	52.8
March forecast						
Limits	37.6	41.2	43.1	45.4	45.3	56.6
Assumed underspend[1]	-2.0	-2.0	-2.2	-2.5	-2.3	-4.0
Actual spending	35.6	39.2	40.9	42.9	43.0	52.6
Change	**-0.2**	**0.3**	**0.8**	**1.3**	**-1.0**	**-0.2**
of which:						
Forecast changes	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Assumed underspend (forecast changes)	-	-	-	-	-	-
Classification changes	0.2	0.2	0.2	0.2	0.2	0.2
Effect of government decisions	**-0.4**	**0.1**	**0.7**	**1.1**	**-1.2**	**-0.4**
Assumed underspend (policy changes)	-	-	-0.2	-	0.2	-
Scorecard measures	-	0.1	0.9	1.1	-1.4	-0.1
Other changes to CDEL spending	-0.4	-	-	-	-	-0.2
	Per cent of GDP					
PSCE in RDEL (actual spending)						
November forecast	16.6	16.2	15.7	15.1	14.6	14.5
March forecast	16.9	16.6	16.1	15.6	14.9	14.6
Change	**0.3**	**0.3**	**0.4**	**0.5**	**0.3**	**0.1**
PSGI in CDEL (actual spending)						
November forecast	1.9	2.0	1.9	1.9	2.0	2.2
March forecast	1.9	2.0	2.0	2.0	2.0	2.3
Change	**0.0**	**0.1**	**0.1**	**0.1**	**0.0**	**0.1**

[1] Underspends are measured against plans at the start of each year as set out in PESA, and are net of amounts carried forward from previous years under Budget Exchange. For 2016-17 onwards, underspends are measured against the intitial plans set out in the 2015 Spending Review and Autumn Statement, since plans for these years have not been set out in a PESA publication yet.

The path of resource and capital DEL spending over the forecast period

4.100 The Government set out detailed departmental spending plans up to 2019-20 in November's Spending Review, and set some departmental plans and its overall current and capital spending totals for 2020-21. It has adjusted those plans and totals in this Budget. As a result, real cuts in RDEL spending – day-to-day spending on public services, administration and grants – are set to be slightly greater over this Parliament and are no longer expected to start reversing in the first year of the next Parliament (Chart 4.5).

Chart 4.5: Change in real RDEL from 2015-16



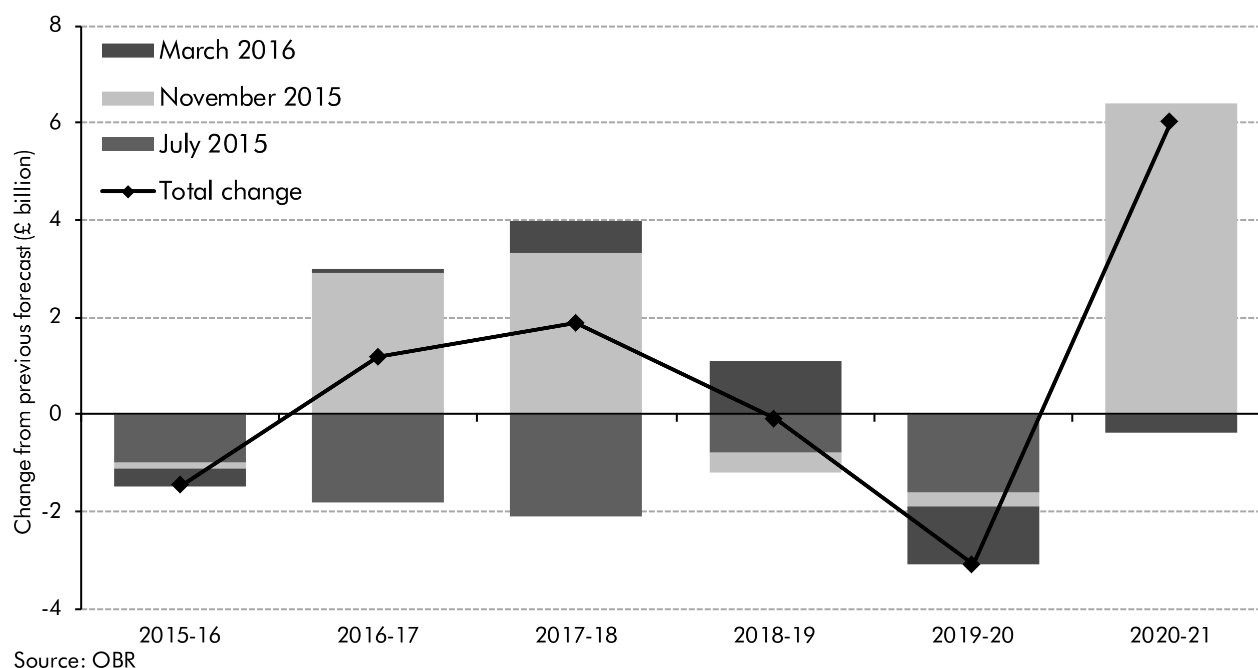
Source: OBR

4.101 The Government has also altered the planned path of CDEL spending – departmental spending on investment projects and capital grants – relative to the plans set out in November. It has brought forward some investment into 2017-18 and 2018-19, thereby cutting investment in 2019-20. Chart 4.6 shows how the Government has altered its investment plans in the three fiscal events since it took office in May last year:

- in the **July Budget**, it cut CDEL spending in every year relative to the totals that had been pencilled in by the Coalition Government in its final Budget in March;
- in the **November Spending Review**, it boosted CDEL spending in the next two years, then reduced it slightly in the subsequent two years before adding £6.4 billion (14.5 per cent) to CDEL spending in 2020-21;
- in **this Budget**, it has again boosted CDEL spending at the start of the forecast, before cutting it slightly in 2019-20; and
- across these three fiscal events, it has therefore **adjusted CDEL spending in different directions in most years**, while adding to it in 2020-21. The only year in which the

direction of its policy changes has been consistent is 2019-20 – the year in which the surplus target first bites. In that year the Government has chosen to cut CDEL spending in both Budgets and the November Spending Review.

Chart 4.6: Policy changes to CDEL spending since March 2015



Source: OBR

Annually managed expenditure (AME)

4.102 Table 4.15 sets out our latest central projection of AME spending to 2020-21, based on the economy forecast described in Chapter 3, the latest estimates of agreed policy commitments and the measures announced in this Budget.

Welfare cap and other spending

4.103 Total welfare spending in our forecast refers to AME spending on social security and tax credits – a subset of which is subject to the Government's 'welfare cap' (around 56 per cent in 2015-16). We have been tasked with assessing the Government's performance against the cap at each Autumn Statement.

4.104 Table 4.21 shows that total welfare spending is forecast to increase by 5.9 per cent over the forecast period, from £217 billion in 2015-16 to £230 billion in 2020-21. Over that period, spending on items subject to the cap (predominantly working-age welfare spending) is projected to fall by 1.9 per cent. By contrast, spending on items outside the cap (largely state pensions) is expected to rise by 15.7 per cent.

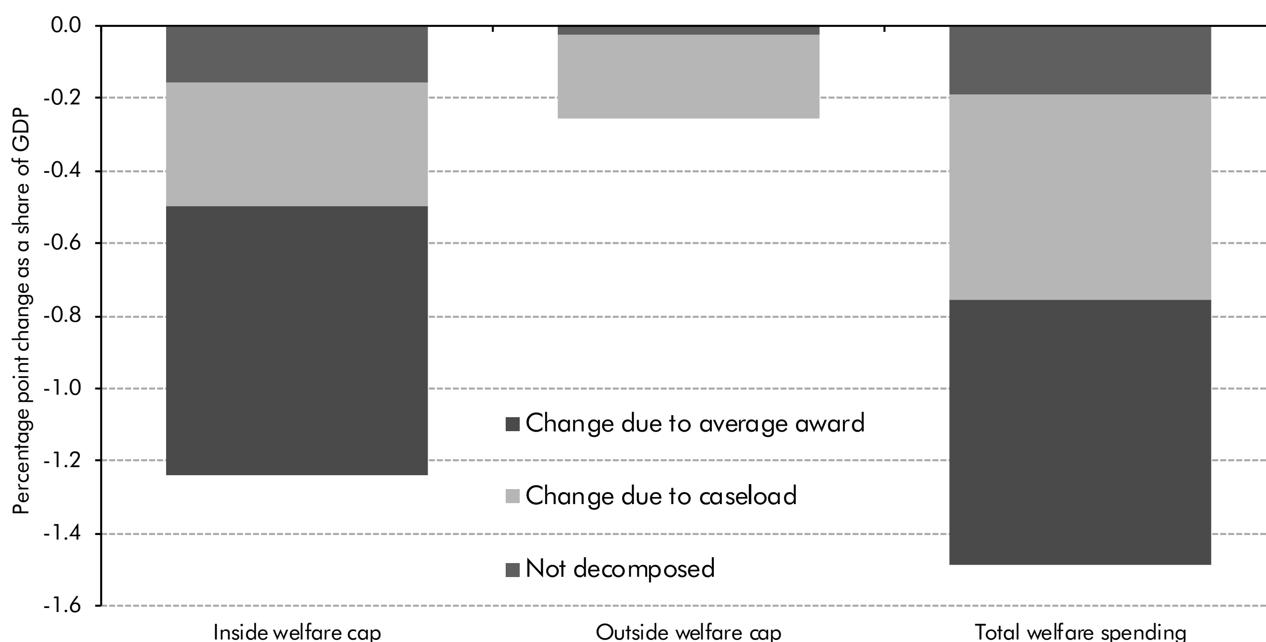
4.105 Relative to the size of the economy, welfare spending is forecast to fall by 1.5 per cent of GDP between 2015-16 and 2020-21 to its lowest share of GDP in 30 years, with spending inside the welfare cap falling by 1.2 per cent of GDP and spending outside the cap falling by 0.2 per cent of GDP.

Table 4.21: Welfare spending forecast overview

	Outturn	Forecast					
			Welfare cap period				
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
£ billion							
Total welfare spending	213.9	216.6	218.3	219.2	221.2	224.2	229.5
of which:							
Inside welfare cap	119.3	120.4	119.8	118.0	116.4	116.2	118.1
Outside welfare cap	94.7	96.2	98.4	101.2	104.8	108.1	111.4
Per cent of GDP							
Total welfare spending	11.7	11.5	11.2	10.8	10.5	10.2	10.1
of which:							
Inside welfare cap	6.5	6.4	6.2	5.8	5.5	5.3	5.2
Outside welfare cap	5.2	5.1	5.1	5.0	5.0	4.9	4.9

4.106 Chart 4.7 shows that of the 1.5 per cent of GDP fall in welfare spending that we expect between 2015-16 and 2020-21, around a third can be explained by trends in caseloads and around half by trends in average awards with drivers of the remainder not decomposed. The overwhelming majority of the reduction in spending (83 per cent) occurs on items that are subject to the Government's welfare cap. Lower welfare cap spending is mainly driven by falls in relative average awards but also caseloads, while the smaller fall in spending on items outside the cap is driven almost entirely by the caseload falling as a share of the total population.

Chart 4.7: Sources of changes to welfare spending (2015-16 to 2020-21)

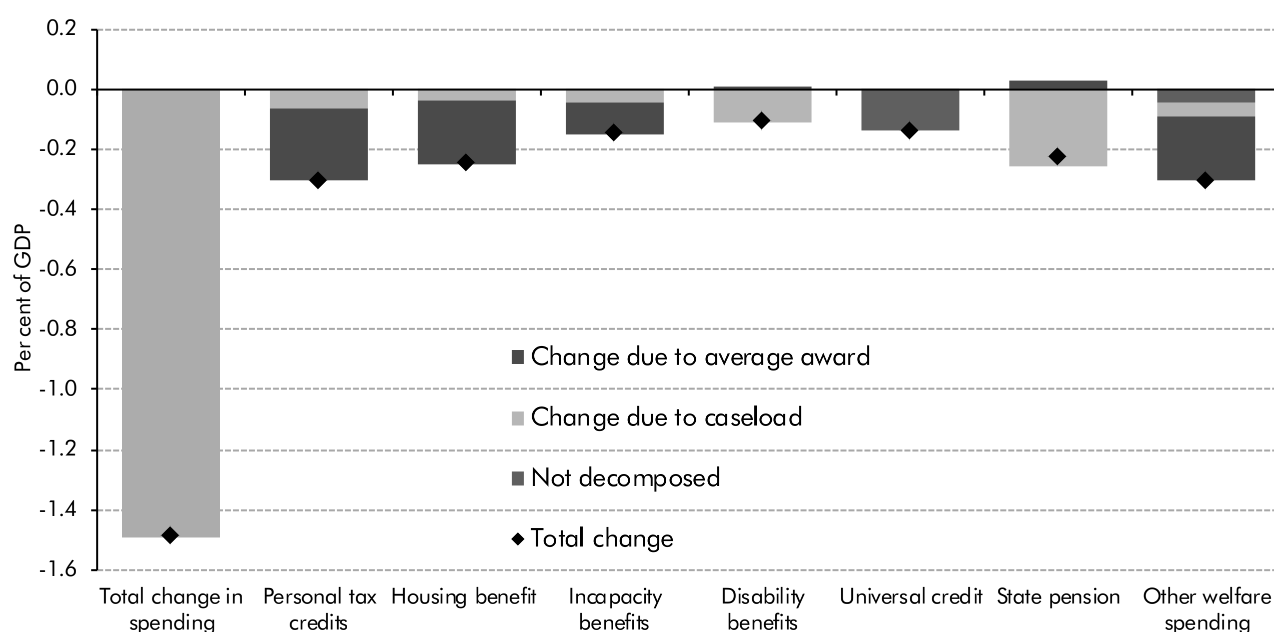


Source: OBR

4.107 Chart 4.8 splits the 1.5 per cent of GDP fall in welfare spending into its main components. These include:

- a fall in spending on **tax credits** (0.3 per cent of GDP). In particular, the uprating freeze between 2016-17 and 2019-20 means that average awards fall significantly relative to average earnings, reducing spending on tax credits as a share of GDP;
- a 0.2 per cent of GDP fall in spending on **housing benefit** (inside the cap). This is almost entirely driven by a reduction in average awards relative to average earnings. This largely reflects the July 2015 policy measures, including the freeze in working-age benefit uprating and the measure forcing social housing landlords to reduce rents by 1 per cent a year over four years;
- lower spending on **disability benefits** (0.1 per cent of GDP), due largely to the assumed drop in the caseload associated with the Budget measure on PIP aids and appliances. And lower spending on **incapacity benefits** (0.2 per cent of GDP), largely as average awards rise more slowly than average earnings. Awards outside the ESA 'support group' have been frozen for four years, like most working-age benefits; and
- a 0.2 per cent of GDP fall in spending on the **state pension**. This is driven entirely by the caseload rising more slowly than the total population as the state pension age rises. In contrast to working-age benefits, the basic state pension award is expected to rise mainly in line with earnings due to the triple lock on uprating, so average awards have little effect on state pension spending as a share of GDP. Indeed, with awards rising by 2.5 per cent in 2017-18 – higher than CPI inflation or average earnings – average awards push spending up slightly as a share of GDP.

Chart 4.8: Sources of changes to welfare spending (2015-16 to 2020-21)



Source: OBR

4.108 Table 4.22 sets out our detailed welfare spending forecasts for 2015-16 to 2020-21 on a pre-scorecard basis, plus the total effect on welfare spending of the Government's policy decisions announced in this Budget. A detailed post-measures forecast for each line is available in a supplementary fiscal table on our website.

Table 4.22: Welfare spending

	£ billion						
	Outturn	Forecast					
			Welfare cap period				
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare cap							
DWP social security	74.5	76.5	76.1	74.9	74.2	74.2	75.4
of which:							
Housing benefit (not on JSA)[1]	21.4	21.9	21.7	21.0	20.7	20.5	21.0
Disability living allowance and personal independence payments	15.4	16.2	16.4	16.7	17.1	17.7	18.2
Incapacity benefits[2]	14.2	15.1	14.9	14.7	14.6	14.8	15.1
Attendance allowance	5.4	5.5	5.5	5.6	5.8	6.0	6.4
Pension credit	6.6	6.1	5.8	5.5	5.3	5.3	5.3
Carer's allowance	2.3	2.6	2.7	2.9	3.1	3.3	3.5
Statutory maternity pay	2.3	2.3	2.4	2.4	2.5	2.6	2.7
Income support (non-incapacity)	2.5	2.4	2.4	2.1	2.0	2.0	2.1
Winter fuel payments	2.1	2.1	2.1	2.0	2.0	2.0	2.0
Universal credit[3]	0.0	0.0	-0.1	-0.5	-1.4	-2.5	-3.1
Other DWP in welfare cap	2.3	2.3	2.4	2.4	2.4	2.4	2.4
Personal tax credits	29.7	28.7	28.5	28.1	27.9	27.5	27.9
Child benefit	11.6	11.7	11.7	11.6	11.6	11.6	11.8
Tax free childcare	0.0	0.0	0.0	0.5	0.6	0.7	0.7
NI social security in welfare cap	3.4	3.4	3.5	3.4	3.4	3.5	3.6
Paternity pay	0.1	0.1	0.1	0.1	0.1	0.2	0.2
Budget measures		0.0	0.0	-0.7	-1.3	-1.5	-1.5
Indirect effects of Government decisions		0.0	0.0	-0.1	-0.1	0.0	0.0
Total welfare cap[4]	**119.3**	**120.4**	**119.8**	**118.0**	**116.4**	**116.2**	**118.1**
Welfare spending outside the welfare cap							
DWP social security	92.0	93.9	96.0	98.8	102.1	105.2	108.4
of which:							
State pension	86.5	89.3	91.7	94.1	97.2	100.1	103.2
Jobseeker's allowance	3.1	2.3	2.5	2.7	2.8	2.9	3.0
Housing benefit (on JSA)	2.4	1.8	1.8	2.0	2.1	2.2	2.2
Universal credit[3]	0.1	0.4					
NI social security outside welfare cap	2.2	2.4	2.4	2.5	2.6	2.7	2.8
War pensions[5]	0.8						
Budget measures		0.0	0.0	0.0	0.0	0.0	0.0
Indirect effects of Government decisions		0.0	0.0	0.0	0.0	0.2	0.2
Total welfare outside the welfare cap[4]	**94.7**	**96.2**	**98.4**	**101.2**	**104.8**	**108.1**	**111.4**
Total welfare[4]	**213.9**	**216.6**	**218.3**	**219.2**	**221.2**	**224.2**	**229.5**
Memo: welfare cap as proportion of total welfare	*55.7*	*55.6*	*54.9*	*53.8*	*52.6*	*51.8*	*51.5*

[1] 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.

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

[3] Universal credit actual spending for 2014-15 and 2015-16. Spending from 2016-17 onwards represents universal credit additional costs not already included against other benefits (i.e. UC payments that do not exist under current benefit structure).

[4] Total welfare outturn inside and outside of the welfare cap in 2014-15 is sourced from OSCAR, consistent with PESA 2015. For 2014-15 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 departmental expenditure limits.

4.109 Table 4.23 sets out the changes in our welfare spending forecast since November, distinguishing between those that flow from our updated economy forecast, those from other movements in the pre-measures forecast, and the effects of policies announced in the Budget. It shows that – prior to the Budget scorecard measures – we have revised spending down in 2015-16, but revised it up from 2016-17 onwards. The pre-measures forecast revision reaches £1.3 billion in 2020-21, with a £2.5 billion upward revision to welfare cap spending partly offset by a £1.1 billion downward revision to spending outside the cap.

4.110 The sources of the revisions are different across years. In summary:

- spending has been revised down by £0.6 billion in **2015-16**, with a caseload-driven fall in spending on tax credits the biggest factor. (Tax credits spending in the first ten months of 2015-16 is down 3.8 per cent on a year earlier.) Spending on housing benefit is also lower than expected, as the in-work caseload appears not to have risen as fast as recent employment growth would have suggested. Spending on incapacity and disability benefits has been revised up;

- we have revised up our pre-measures forecast for **spending subject to the welfare cap** by increasing amounts from 2016-17 to 2020-21. The biggest change has been to disability benefits (described below), with knock-on effects on incapacity benefits spending via disability premiums. We have also revised up spending on attendance allowance and carer's allowance (reflecting higher inflows) and on the marginal cost of universal credit (reflecting interactions between legacy benefits and universal credit in recent policy costings). That is largely offset by lower housing benefit spending, since the revision reallocates spending between the legacy system and universal credit. Lower earnings growth also raises spending on tax credits, but that is more than offset by the effect of lower-than-expected outturns this year;

- changes to **spending outside the welfare cap** are driven by our economy forecast revisions. In particular, lower expected earnings growth has reduced the forecast for spending on the state pension due to its effect on triple lock uprating. The triple lock implies 2.5 per cent uprating in 2017-18, so state pensions will rise in real terms and relative to earnings; and

- the Government's **policy decisions** reduce spending by the end of the forecast. The largest measure is the decision to reduce the number of points awarded for some 'aids and appliances' descriptors in the personal independence payment assessment. This is estimated to save £1.3 billion by 2020-21. Other measures are smaller.

Table 4.23: Key changes to welfare spending since November

	£ billion						
	Outturn	Forecast					
			Welfare cap period				
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare spending inside the welfare cap							
November forecast	119.3	120.9	119.2	117.7	115.9	115.3	117.1
March forecast	119.3	120.4	119.8	118.0	116.4	116.2	118.1
Change	**0.0**	**-0.5**	**0.6**	**0.3**	**0.6**	**0.9**	**1.1**
of which:							
Economic determinants	**0.0**	**0.0**	**0.1**	**0.0**	**0.0**	**0.1**	**0.2**
CPI inflation	0.0	0.0	0.0	-0.1	-0.3	-0.2	-0.1
Average earnings	0.0	0.0	0.1	0.2	0.2	0.2	0.3
Other	0.0	0.0	-0.1	0.0	0.1	0.1	0.0
Estimating/modelling changes	**0.0**	**-0.6**	**0.5**	**1.1**	**2.0**	**2.3**	**2.4**
Disability benefits[1]	0.0	0.1	0.3	0.8	1.4	1.6	1.5
Attendance/Carer's allowance	0.0	0.1	0.3	0.4	0.5	0.7	0.7
Incapacity benefits[2]	0.1	0.1	0.2	0.3	0.3	0.4	0.4
Personal tax credits	0.0	-0.5	-0.4	-0.5	-0.4	-0.4	-0.4
Other	-0.1	-0.3	0.2	0.1	0.2	0.2	0.1
Classification change	**0.0**	**0.0**	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Budget measures		**0.0**	**0.0**	**-0.7**	**-1.3**	**-1.5**	**-1.5**
Indirect effect of Government decisions		**0.0**	**0.0**	**-0.1**	**-0.1**	**0.0**	**0.0**
Welfare spending outside the welfare cap							
November forecast	94.7	96.3	98.6	102.0	105.6	108.8	112.3
March forecast	94.7	96.2	98.4	101.2	104.8	108.1	111.4
Change	**0.0**	**-0.1**	**-0.2**	**-0.8**	**-0.8**	**-0.7**	**-1.0**
of which:							
Economic determinants	**0.0**	**0.0**	**-0.1**	**-0.7**	**-0.8**	**-1.0**	**-1.1**
CPI inflation	0.0	0.0	0.0	-0.1	-0.2	-0.2	-0.2
Claimant count unemployment	0.0	0.0	-0.1	-0.1	0.0	0.1	0.1
Triple lock	0.0	0.0	0.0	-0.5	-0.7	-0.8	-1.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Estimating/modelling changes	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**0.0**	**0.0**
Budget measures	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Indirect effect of Government decisions	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.2**	**0.2**
Total welfare spending							
November forecast	213.9	217.2	217.8	219.8	221.5	224.1	229.4
March forecast	213.9	216.6	218.3	219.2	221.2	224.2	229.5
Change	**0.0**	**-0.6**	**0.4**	**-0.5**	**-0.3**	**0.1**	**0.1**
of which:							
Economic determinants	**0.0**	**0.0**	**0.0**	**-0.7**	**-0.8**	**-0.9**	**-0.9**
Estimating/modelling changes	**0.0**	**-0.6**	**0.4**	**1.0**	**1.9**	**2.3**	**2.3**
Classification change	**0.0**	**0.0**	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Budget measures	**0.0**	**0.0**	**0.0**	**-0.7**	**-1.3**	**-1.4**	**-1.4**
Indirect effect of Government decisions	**0.0**	**0.0**	**0.0**	**-0.1**	**0.0**	**0.2**	**0.2**

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

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

4.111 Once again we have needed to make significant upward revisions to our pre-measures forecast of spending on **disability benefits** (disability living allowance (DLA) and its replacement the personal independence payment (PIP)). As Table 4.24 shows, our pre-measures forecast in 2020-21 is £1.4 billion higher than in November. It is £3.0 billion higher than in July (the first time our forecasts extended to 2020-21).

4.112 Partly offsetting some of the increase in the pre-measures forecast, the Government has chosen to reduce the points awarded for some 'aids and appliances' descriptors in PIP, which we expect to save £1.3 billion by 2020-21. This includes knock-on reductions in spending on passported benefits, including carer's allowance and employment and support allowance. The change affects both caseloads and average awards for disabled claimants. The changes to the points awarded for 'aids and appliances' reduces our forecast of the PIP daily living caseload by around 290,000 in 2020-21 (accounting for £1.2 billion of the total saving) and reduces awards for an additional 80,000 who are expected to move from enhanced awards to standard awards (accounting for the remaining £0.1 billion).

Table 4.24: Key changes in disability benefits spending since November

	£ billion					
	Forecast					
		Welfare cap period				
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	16.2	16.1	15.9	15.8	16.2	16.7
March forecast	16.2	16.4	16.2	16.2	16.7	17.2
Change	**0.1**	**0.3**	**0.3**	**0.4**	**0.5**	**0.5**
of which:						
Forecasting changes	**0.1**	**0.3**	**0.8**	**1.3**	**1.5**	**1.4**
Average PIP reassessment awards	0.0	0.2	0.6	0.9	1.0	1.0
PIP reassessment success rates	0.0	0.2	0.5	0.8	0.8	0.7
PIP new claims	0.0	-0.1	-0.2	-0.2	-0.2	-0.2
Other forecast changes	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Budget policy measures	**0.0**	**0.0**	**-0.5**	**-0.9**	**-1.0**	**-1.0**
Indirect effects of Government decisions	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

4.113 Not for the first time, we have revised up our forecast for spending on disability benefits because the transition from DLA to PIP has saved less money than expected. DLA reforms were initially factored into the first OBR forecast in June 2010 on the assumption of a flat success rate of 80 per cent (i.e. 20 per cent of claims reassessed would stop receiving the benefit). Average awards were assumed to be unchanged, so the 20 per cent of cases not succeeding at reassessment resulted in 20 per cent savings, which increased to around £1.5 billion in 2015-16. There was little evidence on which to base this costing, which in essence reflected the Government's desire to reduce spending on disability benefits by 20 per cent. It was described in the Government's *Budget 2010 policy costings* document as "*Drawing on the evidence of the impact of the WCA [work capability assessment], the central assumption for this policy is that it will result in a 20 per cent reduction in caseload and expenditure once fully rolled out. It is assumed that existing claimants would be reassessed over three years, with 25 per cent of the caseload reassessed in [2013-14], 75 per cent by the end of [2014-*

15] and 100 per cent by the end of [2015-16]."[10] We would no longer certify costings where detail on policy design and delivery is so sparse.

4.114 In December 2012, we revised the assumed success rates down to 74 per cent based on the results of DWP analysis of 900 existing DLA cases. We also adjusted average awards in line with the outcomes of these 900 cases. In that forecast, 1.8 million reassessments – both 'natural' (when a claimant's award came to an end, circumstances changed or they reached 16) and managed (at DWP's behest) – were scheduled to be completed by 2018-19. The reassessments were expected to reduce spending by £3.0 billion in 2017-18.

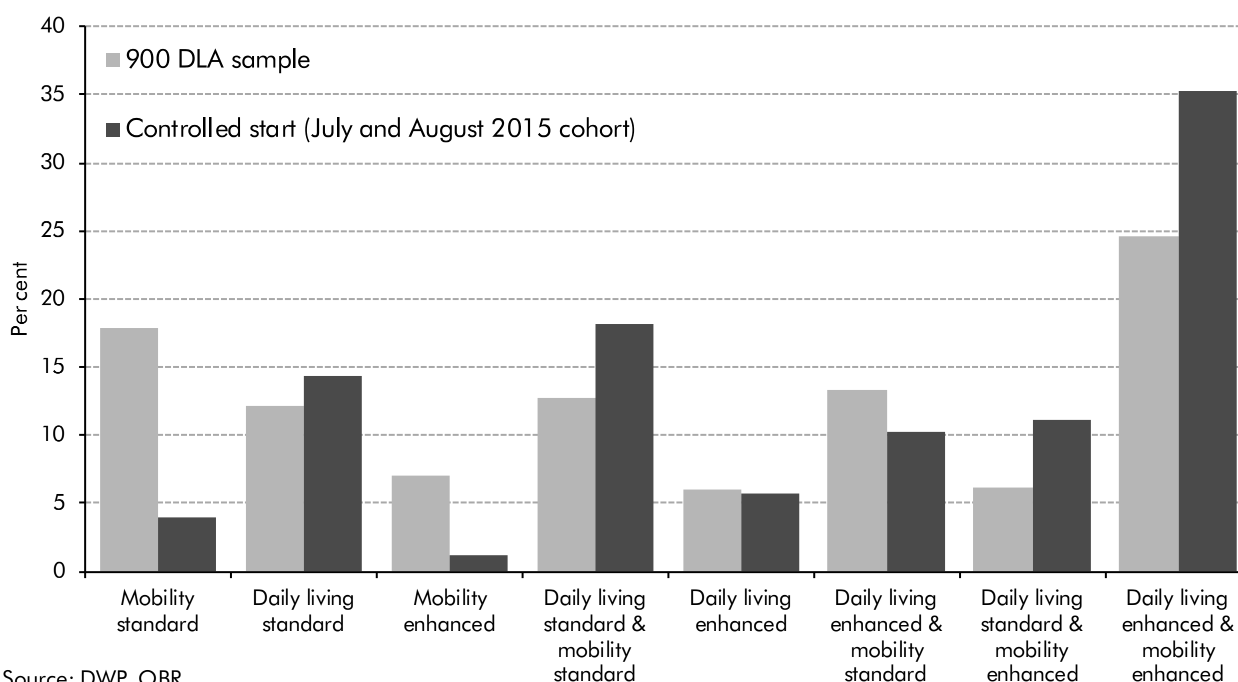
4.115 In this *EFO* we have made further changes to two key assumptions:

- **the probability of a DLA claim going through the managed reassessment process being successful for the claimant has been revised up from 74 to 83 per cent**, raising the PIP caseload. DWP now has evidence from 7,300 actual reassessment cases that are currently being processed through the 'controlled start' programme. It shows an initial claim success rate of 76 per cent, which we assume will rise to a final success rate of 83 per cent after mandatory reconsiderations and appeals. These assumptions remain subject to significant uncertainty since 7,300 cases represent less than 0.5 per cent of the 1.5 million managed reassessments expected to take place over the next three years, only some of which have yet completed the mandatory reconsideration and appeals processes. The new assumption added between £0.5 and £0.8 billion a year to our pre-measures forecast from 2017-18 onwards; and

- **average awards have been revised up by 16 per cent to £100 a week**. PIP awards had been assumed to be £86 a week (rising with CPI-linked uprating each year), again based on the distribution of expected successful cases from DWP's analysis of 900 DLA claims. The latest evidence points to a significantly higher proportion of claims being awarded the enhanced daily living and mobility payments (Chart 4.9). This change added £1.0 billion a year to our pre-measures forecast by 2020-21. Again, this assumption is subject to considerable uncertainty.

[10] See page 36 of *Budget 2010 policy costings*, HM Treasury and HM Revenue and Customs, June 2010.

Chart 4.9: Assumed composition of PIP caseloads after reassessments

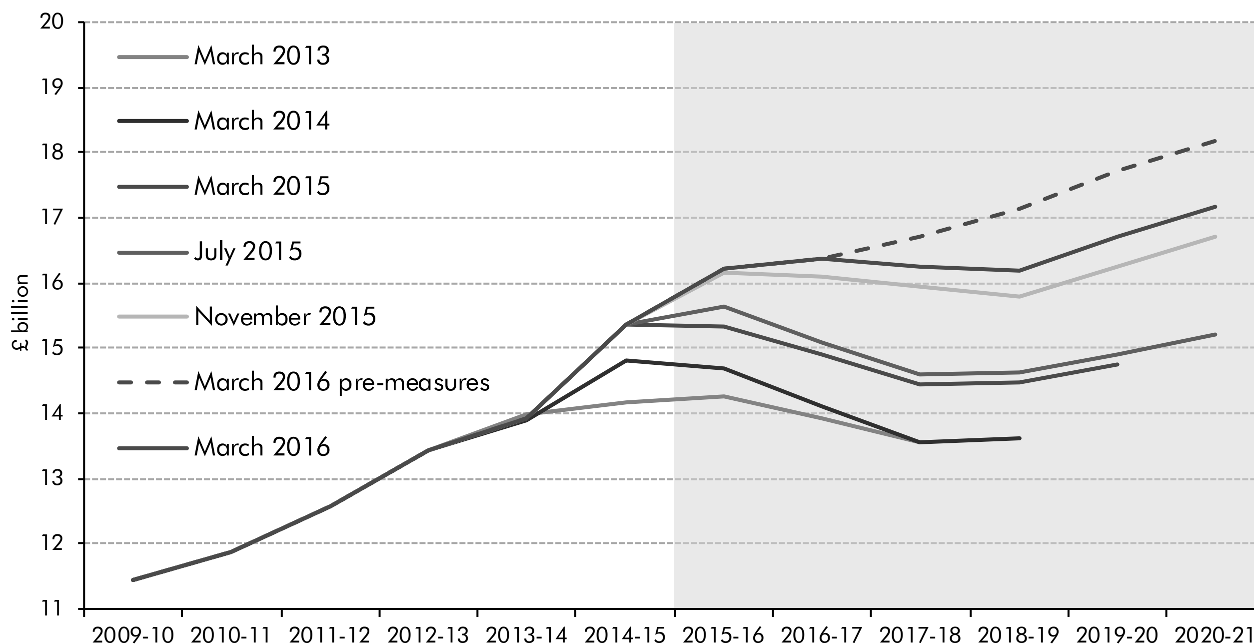


Source: DWP, OBR

4.116 As Chart 4.10 shows, in the absence of further policy measures in the Budget, this would have been the latest in a series of often substantial upward revisions to disability benefits spending. As noted above, our December 2012 forecast incorporated an assumed saving of £3.0 billion by 2017-18 from the introduction of PIP. If that costing had factored in the success rates and average awards assumed in this forecast, the saving would have been almost 90 per cent lower at £0.4 billion. This implies that the original 20 per cent saving sought by the Government looks more like 5 per cent in our pre-measures forecast, with the decisions announced in the Budget increasing that back towards the original target.

4.117 We have attempted to apply the lessons of the shortfall in PIP savings to date in scrutinising the aids and appliances policy costing included in this forecast. But the experience of recent years illustrates the uncertainty that surrounds such estimates. As reported in Annex A, we have assigned a 'medium-high' uncertainty rating to this costing.

Chart 4.10: Successive forecasts for spending on disability benefits



Source: DWP, OBR

4.118 Successive large revisions to our forecasts for incapacity and disability benefits spending have resulted from the results of the real-world rollout disappointing relative to the assumptions on which our forecasts have been based. The Treasury had similar problems forecasting tax credits spending as the system was reformed and expanded in the 2000s. Over the coming years, our forecast includes the effects of an even bigger reform of the welfare system: the introduction of **universal credit** (UC).

4.119 Forecasting the effects of any new system is difficult, not least because it takes time before the forecast can be informed by outturn data. With UC, the incorporation of tax credits recipients (administered by HMRC) into universal credit (administered by DWP) poses even greater challenges. In order to base our forecast as far as possible on actual data, UC is factored in as a marginal cost relative to the legacy benefits it replaces. This comprises a number of gross costs and gross savings, as shown in Table 4.25. The forecast is therefore more akin to a policy costing than a typical AME forecast. This adds greater uncertainty.

4.120 One specific source of uncertainty is that the costs are estimated from caseload forecasts generated by DWP's integrated forecasting model (INFORM), which models flows onto, between, and off different benefits. But DWP no longer uses INFORM to process our legacy benefit forecasts, with most now produced using separate stock-flow models where interactions between benefits are processed manually rather than integrated into the model.

4.121 The next key assumption underpinning the UC caseload forecast is the pace at which the system is rolled out to replace the legacy systems. We currently expect natural migration to progress in accordance with DWP's plans, but managed migration to start six months later than those plans. We have pushed our rollout assumption back on a number of occasions and it remains subject to uncertainty.

4.122 Table 4.25 shows that the main gross costs and savings associated with UC include:

- on a like-for-like basis spending on UC is expected to be higher than on the legacy benefits due to **higher take-up of benefits for claimants who would be eligible to multiple legacy benefits, but who do not claim them all**. They will receive their equivalent automatically under the single UC payment. We also assume that the UC design encourages slightly higher take-up for some claimants who are currently not claiming the legacy benefits to which they are entitled. This leads to a gross marginal UC cost of £0.8 billion on average, rising to £1.6 billion in 2020-21;

- the **average change in entitlement** for each legacy benefit is calculated using DWP's policy (micro-)simulation model (PSM). Policy in a steady-state UC world is compared to policy in a legacy-benefit world, with the difference generating a marginal UC cost or saving per case. These are then multiplied by the UC caseloads to generate gross UC marginal costs or savings. A number of policies are modelled outside the PSM and the resulting impact on expenditure added to the UC marginal costs off-model. This leads to a gross marginal UC cost of £1.5 billion on average, rising to £2.7 billion in 2020-21, where entitlement is estimated to be higher under UC;

- claimants that stand to lose when 'manage-migrated' will receive **transitional protection** until they either have a significant change in the circumstances or until the protection is eroded through increases in UC. Our estimate of the impact of transitional protection is derived mainly from the PSM: a gross marginal UC cost of £0.1 billion on average, rising to £0.5 billion in 2020-21. With a large number of policies modelled outside the PSM, and the UC and legacy policy comparisons being set in steady-state in the PSM, the transitional protection calculation is probably the most uncertain part of this forecast;

- the **gross marginal UC saving** of £2.5 billion on average, rising to £5.0 billion in 2020-21 **where entitlement is estimated to be lower under UC**;

- there are three **other large gross UC marginal savings**: abolishing the income disregards in tax credits (saving £0.6 billion by 2020-21); elements of UC design that reduce error and fraud (saving £1.1 billion by 2020-21); and the introduction of the minimum income floor for the self-employed (saving £0.8 billion by 2020-21). The marginal impact of these elements of our UC forecast all depend on changes in policy in the legacy benefits – primarily tax credits. These are estimated off-model, so rely on HMRC and DWP data-sharing procedures as policy continues to evolve; and

- a series of **off-model adjustments** that are necessary to reach a final estimate of the marginal cost of UC. Together these amount to £0.3 billion of additional net savings.

Table 4.25: The marginal cost of universal credit and its component parts

	£ billion				
	Forecast				
	Welfare cap period				
	2016-17	2017-18	2018-19	2019-20	2020-21
Marginal cost (pre-measures)	**-0.1**	**-0.5**	**-1.4**	**-2.5**	**-3.1**
of which:					
Gross cost	**0.3**	**1.2**	**2.7**	**3.7**	**4.7**
Gross cost of higher take-up[1]	0.1	0.4	0.9	1.3	1.6
Gross cost where entitlement is higher[2]	0.2	0.8	1.7	2.3	2.7
Transitional protection where entitlement is lower	0.0	0.0	0.0	0.2	0.5
Gross saving	**-0.4**	**-1.7**	**-4.1**	**-6.3**	**-7.7**
Gross saving where entitlement is lower[3]	-0.1	-0.8	-2.5	-4.0	-5.0
Gross saving of abolishing the disregards	0.0	-0.2	-0.4	-0.5	-0.6
Gross saving from reductions in error and fraud	0.0	-0.2	-0.5	-0.9	-1.1
Gross saving from the minimum income floor	0.0	-0.1	-0.4	-0.6	-0.8
Gross saving from other factors	-0.3	-0.3	-0.3	-0.3	-0.3
	Proportion of caseload migrated to UC (per cent)				
Jobseeker's allowance	32	61	90	99	100
Employment and support allowance	2	15	39	66	89
Income support (non-incapacity)	4	28	61	82	93
Tax credits	1	16	44	66	80
Housing benefit	7	28	65	88	99
All	5	21	50	72	87

[1] Includes both the change in entitlement and take-up for groups where take-up has increased.

[2] Entitlement for those who fully take-up their entitlement in the legacy system.

[3] Net entitlement and take-up impacts from those households who have lower entitlements.

4.123 Given the errors that have been identified when incorporating the effects of recent large policy measures, we have devoted considerable time to scrutinising the affected forecasts. That process has revealed new sources of significant concern with our UC marginal costs forecast. In particular, the model on which it is produced has not been able to keep pace with recent policy changes and has become even less transparent than was previously the case due to the increasing use of off-model adjustments. We will continue to work with DWP to try to resolve these issues and will report on progress in our next *Welfare trends report*.

Public service pensions

4.124 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.[11] A breakdown of spending and income for the major schemes covered by our forecast is included in the supplementary fiscal tables on our website.

4.125 Table 4.26 details the changes to our public service pensions forecast since November. It shows that net expenditure has fallen by £1.0 billion a year on average over the forecast

[11] 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.

period. That is made up of a £0.4 billion a year downward revision in our pre-measures forecast and bigger falls in 2019-20 and 2020-21 as a result of decisions announced in the Budget. At the component level:

- **gross expenditure** has fallen, due largely to lower CPI inflation and a change in the forecast methodology for how pensions in payment and lump sums for new retirees are uprated in the NHS pension scheme. With evidence that those approaching retirement tend to earn close to the top of their pay range, we now uprate the annual awards and lump sums of new retirees by settlement growth only, since pay drift is not possible when an employee is at the top end of a given pay scale;

- **NHS receipts** have been revised down to reflect lower expected workforce growth than we had assumed in November (when we linked pensionable paybill growth to the growth in the NHS's RDEL budget). We now expect a higher proportion of additional NHS funding announced at the Spending Review to be spent on other, non-workforce areas, such as meeting existing pressures and delivering new policy commitments around mental health and access to cancer treatment;

- we have revised up a number of **other workforce assumptions**. Teachers' pension scheme (TPS) receipts are higher as workforce growth is higher than we assumed in November. (The number of teachers is predicated on the forecast number of pupils.) Scottish scheme receipts (NHS and teachers') are higher, as we now assume that the respective schemes' pensionable paybills will grow at the same rate as the England and Wales NHS and TPS schemes. Police scheme receipts are also higher, reflecting smaller workforce reductions as a result of the real terms budget protection announced in the Spending Review, which had not been factored into our November forecast;

- we have removed our centrally applied adjustment the **abolition of contracting out** from the years in the forecast in which firm plans now exist (up to 2019-20 for all schemes and 2020-21 for the armed forces and NHS schemes) as the impact should now be in individual scheme returns. The abolition of the contracting out rebate represents a departmental RDEL cost pressure, which we would expect, in part, to reduce workforce (and therefore pensionable paybill) growth. It is not possible to isolate the contributions effect of this on a scheme-by-scheme basis, as departments tend to consider all such pressures together. In practice, we expect that any estimated impact would roughly offset our previous central adjustment. We continue to adjust 2020-21 receipts for schemes that are not yet based on firm plans; and

- **Government decisions** reduce spending. The Budget announced that the Government will reduce the discount rate used in the forthcoming pensions revaluations from 3.0 to 2.8 per cent, which will lead to higher employer contributions. Absent any response from public sector employers, that would reduce net spending by around £2.5 billion a year from 2019-20 onwards. However, we expect the additional pressure on departmental budgets to prompt lower workforce growth, offsetting part of the saving. The effect of the policy therefore reduces net spending by £2.0 billion a year. We

assume that other RDEL cuts announced in the Budget will also lead to lower workforce growth, reducing contributions and raising net spending by £0.4 billion in 2020-21.

4.126 Our public service pensions forecast has not been adjusted for the recent ruling in the GAD-Milne court case, which will lead to compensation payments associated with past underpayment in the firefighters' and police pension schemes. The latest information we have suggests that these payments will be treated as capital AME. The latest data on payments that have been made and those due to be made in 2015-16 closely aligns with our previous forecast, leading to negligible changes in estimated payments (and the associated tax charges, which are directly offset in the receipts forecast).

Table 4.26: Key changes to public service pensions since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Net public service pensions						
November forecast	11.4	11.5	12.7	14.3	15.7	16.7
March forecast	11.5	11.2	12.1	13.7	13.2	14.7
Change	**0.2**	**-0.3**	**-0.6**	**-0.6**	**-2.5**	**-2.0**
Expenditure						
November forecast	39.4	40.0	41.5	43.4	45.2	47.2
March forecast	39.5	40.0	41.3	43.1	44.9	46.9
Change	**0.0**	**0.0**	**-0.2**	**-0.3**	**-0.3**	**-0.3**
of which:						
CPI inflation	0.0	0.0	-0.1	-0.2	-0.1	-0.2
NHS pay drift assumption	0.0	0.0	-0.1	-0.2	-0.2	-0.3
Other	0.0	0.0	0.0	0.0	0.1	0.1
Income						
November forecast	-28.1	-28.5	-28.8	-29.1	-29.5	-30.5
March forecast	-27.9	-28.8	-29.2	-29.4	-31.8	-32.2
Change	**0.1**	**-0.3**	**-0.4**	**-0.3**	**-2.2**	**-1.7**
of which:						
NHS paybill growth	-0.1	0.0	0.2	0.4	0.7	0.8
TPS paybill growth	0.0	0.0	0.0	-0.1	-0.1	-0.2
Scottish schemes' paybill growth	0.0	-0.1	-0.1	-0.2	-0.3	-0.2
Police paybill growth	0.0	0.0	0.0	-0.1	-0.1	-0.1
Contracting out adjustments	0.0	-0.3	-0.3	-0.3	-0.3	-0.2
Other forecast changes	0.1	0.1	0.0	-0.1	-0.1	-0.1
Scorecard measure	0.0	0.0	0.0	0.0	-2.0	-2.0
Indirect effects of Government RDEL decisions	0.0	0.0	0.0	0.0	0.0	0.4

EU contributions

4.127 Exchange rate movements have increased our forecast for EU contributions over most of the forecast period, but this effect has mostly been offset by reductions in the UK share of EU GNI and VAT bases. Our latest forecast also includes some large changes associated with the profile of spending in 2016. This has no effect on total spending in the calendar year, but moves it from 2015-16 to 2016-17 in fiscal year terms. Table 4.27 summarises the main changes to our forecast since November, which include:

- **sterling depreciation** since November, which we assume will persist, has increased spending by £0.4 billion a year from 2018-19 onwards. The effect of weaker sterling on the UK's contributions is not straightforward. It reduces the UK's share in euro-denominated GNI and VAT bases, but it also increases the sterling value of euro-denominated payments, abatements and receipts;

- the downward revision to our **UK productivity forecast** has fed through to a lower assumed share of EU GNI and VAT bases, reducing spending by £0.4 billion in 2016-17 and £0.1 billion to £0.2 billion a year from 2018-19 onwards. The UK's GNI and VAT payments for 2016 were set initially in May 2015. We have revised our forecast for these payments down by £0.4 billion to anticipate revisions that will be made when the latest estimates for the EU GNI and VAT bases become available in May 2016;

- we have anticipated additional GNI and VAT adjustments being levied in late 2016 as a result of forthcoming **upward revisions to UK GNI estimates relating to 2010 to 2014**, which we have calibrated on the basis of two recent ONS articles about foreign direct investment earnings data and previewing Blue Book 2016. That has added £0.5 billion to spending in 2016-17, but subtracted £0.4 billion in 2017-18 due to the associated abatement. We also assume that these adjustment payments will add to surplus EU funds that will be returned to Member States in proportion to their financing shares. Given this estimate is based on only preliminary UK estimates, there is considerable scope for it to change in light of final Blue Book revisions and any upward or downward revisions to other Member States' historical GNI and VAT bases over the summer;

- a revised estimate of the **effects of the VAT and GNI adjustments that were applied in 2015**, on the UK rebate received in 2016. The estimated impact has been revised up by £0.2 billion, increasing the rebate, reflecting new information on the profile of other Member States' adjustments;

- two relatively large **timing effects within 2016** have together moved £1.1 billion of spending from late 2015-16 to 2016-17. First, in contrast to recent years, the Commission's first quarter payment demand was less than the maximum 5-month draw-forward (at 4.3 months, it moved £0.7 billion to later in 2016). Second, the payments that we assume will result from implementing the 2014 Own Resources Directive following ratification by all Member States has been allocated entirely to 2016-17. When we closed this forecast, several Member States were yet to ratify, with all expected to complete the process by the end of 2016;[12] and

- **other factors** have generally been small and partly offsetting. For example, we have attempted to anticipate the forthcoming recalculation of structural funds payments

[12] The 2014 own resources decision (ORD) was agreed ahead of the 2014-2020 Multiannual Financial Framework (MFF). In our December 2013 *EFO* we explained that our forecast assumed that this would come into effect in 2016, two years after the start of the MFF. This reduced our forecast for payments in 2013-14 and 2014-15, but increased them in 2015-16 and 2016-17, as we forecast retrospective payments would be made to correct for the lag in the implementation. There is still some uncertainty over the precise impact of the retrospective adjustment, but, as many of the payments are abatable, any changes to our forecast should be small, and contained in 2016-17 and 2017-18.

across Member States, which the Commission is expected to publish in May. The net effect on our forecast has been small. It will affect payments for the next seven years, starting in 2016-17. There remains some uncertainty over the timing of the payments.

4.128 Further details of our forecast for expenditure transfers to EU institutions are contained in supplementary fiscal tables on our website. They show our latest assumptions for the levels of EU budget expenditure and transactions broken down into the GNI and VAT contributions and rebate, with details of adjustments for historic years.

4.129 Our forecast only covers the effect of transactions on the public sector finances, reflecting definitions that are set out in the National Accounts, under the European System of Accounts 2010. It does not cover the wider effect of EU transactions on the whole of the UK, including the private sector. For instance, our forecast does not include most customs duties, which are deemed to be collected on behalf of the EU. Nor does it include public sector or private sector receipts from the EU.

Table 4.27: Key changes to expenditure transfers to EU institutions since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	11.7	10.7	9.7	10.9	11.4	11.7
March forecast	10.5	11.8	9.4	11.2	11.6	11.9
Change	**-1.2**	**1.1**	**-0.2**	**0.2**	**0.2**	**0.2**
of which:						
Exchange rate assumptions	0.0	0.0	0.1	0.4	0.4	0.4
UK share of EU GNI and VAT bases[1,2]	0.0	-0.4	0.0	-0.1	-0.1	-0.2
2016 adjustment for historical GNI changes[2,3]	-	0.5	-0.4	-	-	-
Change to rebate in respect of GNI and VAT adjustments in 2015[2]	-	-0.2	-	-	-	-
Change in payments drawn forward into 2015-16	-0.7	0.7	-	-	-	-
Re-profiling of ORD14 impact	-0.4	0.4	-	-	-	-

[1] Reflects OBR forecasts of UK GNI and VAT, and IMF forecasts for other member states. This mainly includes an adjustment to anticipate revisions to the UK payments during 2016 that will be required when the latest estimates for the EU GNI and VAT bases are agreed in the ACOR figures in May 2016. This also includes revisions to the forecasts of the GNI and VAT adjustments that will be applied in 2016 in respect of estimated outturns in 2015.

[2] All the forecast adjustments to the GNI and VAT payments and the rebate are shown in detail in the supplementary fiscal table on our website.

[3] Adjustment for historical GNI changes in respect of 2010 to 2014.

Locally financed current expenditure

4.130 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 through additions to or withdrawals 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. Table 4.28 below focuses on LASFE, while further detail on all aspects of local authority spending in our forecast is available in supplementary tables on our website.

4.131 There are currently a number of important uncertainties affecting this forecast:

- **financing from central government** comes from a variety of sources that have been affected by November's Spending Review. While funding from the Department for Communities and Local Government (CLG), including the local government settlement for 2016-17, is either known or can be estimated with reasonable confidence, there is more uncertainty over other sources. Perhaps the most important of these is the split of Dedicated Schools Grant (DSG) funding between payments to local authorities (for schools) and payments made directly to academies, which are classified as part of central government in the National Accounts. The Government's proposals about academies in *Intervening in failing, underperforming and coasting schools* last year and further announcements in this Budget add to this uncertainty. We have based our forecast on recent trends in the rate at which schools are converting to academies. This assumption affects total funding and spending by local authorities, but not LASFE; and

- **local sources of financing** are dominated by council tax and business rates. We expect council tax to rise by 14 per cent in real terms over the forecast period, in part due to the Autumn Statement announcements helping some local authorities to increase council tax more quickly to meet some of the costs associated with adult social care and policing. The biggest source of uncertainty, though, relates to business rates, where the Government has announced that local authorities will retain 100 per cent of business rates by the end of the Parliament (up from 50 per cent at present). The potential implications of that announcement – and the unspecified spending responsibilities that will be transferred at the same time – are described in Box 4.3 at the end of this section.

4.132 These uncertainties could affect the overall level of local authority spending and the split of financing between central government and local sources. One effect on our forecast for current LASFE is that we assume that they will cause local authorities to add more to their reserves in 2016-17, with additions tapering to zero over four years as pressures on local authority budgets intensify.

4.133 The latest in-year data on local authorities' current spending – which CLG have been improving to deal with some recent quality concerns – suggest that local authorities in England may spend more this year than we assumed in November. Table 4.28 shows that we have increased our forecast in 2015-16 by £0.7 billion, and reduced our forecast for local authorities' net additions to their reserves by £0.4 billion (implying a small net drawdown).[13] We still expect English local authorities to underspend their budgets this year, largely because those budgets assumed that they would draw down their reserves by £1.8 billion. Our forecast implies an underspend of £2.6 billion on their net current expenditure, which would be slightly higher than last year.

[13] This revision has prompted us to reduce our forecast for net additions to reserves in future years. We now assume additions of £0.9 billion in 2016-17, declining steadily to zero by 2019-20.

4.134 From 2016-17 onwards, our current LASFE forecast is largely driven by our forecasts for council tax and business rates. We have assumed that council tax increases in England will average 3.4 per cent. This assumes an average increase of 1.9 per cent for all local authorities, just below the referendum cap of 2 per cent[14] and an additional 1.5 per cent in respect of those local authorities allowed to increase council tax by up to a further 2 per cent, in large part to help fund spending on adult social care, the cost of which is expected to rise due to the introduction of the National Living Wage. We expect that 95 per cent of eligible local authorities take the opportunity to raise their council tax to the 3.99 per cent limit. We have also increased our forecast of growth in the council tax base. We continue to assume that council tax levels in Scotland will rise in line with CPI inflation from 2016-17, and that Welsh council tax will increase in line with a three-year historical average.

4.135 Table 4.28 summarises the main changes to our current LASFE forecast. As well as those described above, they include:

- revisions to our forecast for **revenue used to finance capital expenditure (CERA)**, which we have increased slightly in 2015-16, but then revised down in later years. This reflects the uncertainty over levels of local authority funding, which has led us to assume an unchanged level of CERA from 2017-18 onwards. Compared to our previous forecast, this switches more forecast spending from current to capital LASFE;

- lower **spending financed by interest receipts**, due to lower interest rates;

- **other changes to the pre-measures forecast** include a small increase in current LASFE for local authorities in Scotland, which reflects increases seen in the final outturn for 2014-15. In 2016-17 this is offset by a £0.2 billion reduction in the forecast for retained business rates, which reflects more income being retained in the business rates collection fund in case it is needed to settle increases seen in the level of appeals; and

- **scorecard measures** that include three separate measures that reduce the amounts of business rates, and also a measure to allow local authorities to spend proceeds from sales of some specific assets on some specific elements of current spending. Local authorities will receive additional RDEL grants to offset the reduction in business rate income, where the additional RDEL for those grants is included in RDEL scorecard measures discussed above.

[14] Larger authorities and other bodies, such as police and crime commissioners, have to hold a referendum if they want a rise of 2 per cent or more, or would raise bills by £5 a year per household.

Table 4.28: Key changes to locally financed expenditure and public corporations expenditure since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Locally financed current expenditure						
November forecast	39.8	40.3	43.4	45.6	48.0	49.9
March forecast	40.5	40.8	43.3	45.1	47.0	48.8
Change	**0.7**	**0.5**	**-0.1**	**-0.4**	**-0.9**	**-1.1**
of which, changes in local finance:						
Council tax	0.0	0.2	0.4	0.5	0.6	0.6
Revenue used to finance capital expenditure (CERA)	0.1	0.0	-0.1	-0.2	-0.3	-0.3
Net use of current reserves	0.4	0.3	0.2	0.1	0.0	0.0
Interest receipts	0.0	-0.1	-0.2	-0.2	-0.2	-0.2
Other changes in local finance	0.2	-0.1	0.2	0.1	0.2	0.1
Scorecard measures	0.0	0.1	-0.6	-0.8	-1.1	-1.4
Locally financed and public corporations' capital expenditure						
November forecast	22.2	21.4	21.1	18.8	18.3	19.6
March forecast	23.1	21.7	20.9	18.7	18.4	19.8
Change	**0.8**	**0.2**	**-0.2**	**0.0**	**0.1**	**0.2**
of which:						
Housing associations' capital spending	-0.4	0.4	0.6	0.6	0.6	0.6
Local authority capital expenditure financed from the revenue account (CERA)	-0.1	0.0	0.1	0.2	0.3	0.3
Additional financial transactions to align with in-year quarterly outturns[1]	0.5	0.0	0.0	0.0	0.0	0.0
Other changes to capital LASFE and public corporations' capital expenditure	0.8	0.0	0.0	0.1	-0.1	-0.1
Scorecard measures	0.0	-0.2	-1.0	-0.9	-0.7	-0.6

[1] These financial transactions are not included in PSGI, and so are removed elsewhere within our accounting adjustments included in PSGI in AME. The adjustment to remove financial transactions and all the other main accounting adjustments are detailed in a supplementary fiscal table available on our website.

Locally financed and public corporations capital expenditure

4.136 Our latest forecasts for locally financed capital expenditure (capital LASFE) and public corporations' capital spending are shown in Table 4.28 above. These forecasts are net of asset sales, forecasts for which are shown in the supplementary tables on our website. Capital LASFE is measured net of capital spending by local authorities' Housing Revenue Accounts (HRAs) and the Transport for London (TfL) subsidiaries that are treated as public corporations in the National Accounts.[15] 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. We therefore look at changes for LASFE

[15] These TfL transport subsidiaries trade under the company name 'Transport Trading Ltd' (TTL). Previously the ONS classified all the TTL subsidiaries as public corporations apart from Crossrail, which was classified as part of the local authority sector. However, the ONS has recently reclassified two 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 are waiting for further details of how the ONS has implemented those reclassifications in the outturn data before we reflect them in our forecast.

and public corporations capital spending together, so that any changes to the switches net out and do not obscure the changes that affect TME.

4.137 In November we included provisional forecasts for housing associations, following the ONS's announcement that they would be reclassified to the public sector. The ONS has now implemented that reclassification. Its estimate of housing associations' capital spending in 2014-15 was lower than we had expected, so we have revised down our forecast for 2015-16. From 2016-17 onwards, we have revised capital spending up due to a higher forecast of rental income, which we assume housing associations will use to finance borrowing for housebuilding. Our housing association forecast is described in more detail in Box 4.2.

4.138 The remaining changes to our forecasts mainly reflect:

- the revision to **CERA** described in the section on current LASFE;
- increases in our forecast for capital spending financed by the **community infrastructure levy (CIL)**, which we have assumed are largely offset by reductions in capital spending financed by contributions from private developers;[16] and
- other changes to our forecast of capital LASFE to reflect the latest **quarterly in-year information**. This suggests that local authorities in England will underspend their capital budgets by £4.4 billion. This is a little lower than the average of £5.3 billion underspending over the previous two years;[17] and
- the effects of several **scorecard measures** that include additional asset sales to finance specific current spending, as detailed above, and measures to defer the downrating of social rents by a year, and change pay to stay to include a taper, and make the pay to stay policy voluntary for housing associations, and also a measure to pilot right to buy for housing associations. Table 4.28 shows the total effect of all these measures on capital LASFE and the capital spending by HRAs and housing associations.

Box 4.3: Local authorities' retention of business rates

The Government announced in Autumn Statement 2015 that it will let English local authorities retain 100 per cent of business rates by the end of the Parliament. It has stated that the reform is intended to be fiscally neutral: as part of these reforms, the main local government grant will be phased out and additional spending responsibilities devolved to local authorities. These details have not yet been confirmed. The reforms are subject to a number of rounds of engagement and consultation over the next two years and will require primary legislation. The final policy package is therefore not expected to be agreed until at least early 2017. The Government announced in the Budget that it is piloting this, but we were not informed in time to factor this into our forecast.

[16] Both CIL and the contributions from private developers are offset elsewhere in the public finances account and so are neutral for borrowing overall.

[17] The measure of local authority capital spending in England that we use in our forecast is the main measure of capital spending, net of asset sales, which CLG use in their local authority data collection and statistical releases. These include financial transactions that are not included in PSGI or PSNB in the National Accounts, and which are therefore removed in the accounting adjustments in capital AME.

Business rates are currently classified as a central government tax, but they are levied on non-domestic properties by local authorities and raise around £26 billion a year in England. The tax is levied as a proportion ('the multiplier') of the market rateable value as estimated by the Valuation Office Agency; the multiplier is currently increased in line with RPI inflation each year. The Budget announced that indexation would switch to CPI inflation from April 2020. From 2013, local authorities have retained around 50 per cent of receipts from business rates. The new reforms will mean that the remaining 50 per cent of business rates would also be retained. Local authorities will also be given powers to cut business rates, while mayoral authorities will be given the power to increase business rates to fund infrastructure projects, provided that they have the support of the local business community via an agreed process. As in the current business rates system, there will also be a need for redistribution via a top-up and tariff system.

Since the Autumn Statement, CLG has issued a consultation on *The provisional Local Government Finance Settlement 2016-17 and an offer to councils for future years.* This set out some examples of grants and responsibilities that might be devolved, including:

- the main local government grant;
- the responsibility for funding the administration of housing benefit for pensioners;
- Transport for London's capital grant;
- the public health grant; and
- additional responsibilities to provide support for older people with disabilities or care needs, who would currently be supported via attendance allowance.

These items are subject to further consultation, so do not represent firm Government policy. Once the proposed transfer of grants and responsibilities is known, we will scrutinise all parts of the proposed package in detail to consider any direct and indirect effects. The latest information that the Treasury has given us suggests that formal consultation will commence in summer 2016, with primary legislation to follow as soon as possible. That would suggest the final package will not be firm enough to incorporate in our forecasts until Budget 2017, at the earliest.

The channels by which these changes could affect our forecast would include:

- if the package was completely fiscally neutral, public sector current receipts and total managed expenditure would be unchanged – it would just be the balance between central and local government that would change;
- spending on items funded by the main local government grants, other components of local government DEL, the housing benefit administrative subsidy, and the public health grant would shift from RDEL (which would be lower) to current LASFE in our AME forecast (which would be higher);
- the Transport for London capital grant would move from CDEL to capital LASFE; and
- spending on attendance allowance (AA) in England would move from welfare spending to current LASFE within our AME forecast (at the Great Britain level, we forecast AA will rise to £6.4 billion by 2020-21 (see Table 4.22) – in 2014-15, 84 per cent of AA spending was in England).

Central government debt interest

4.139 Central government debt interest payments (net of the effect of the Bank of England's Asset Purchase Facility (APF) holdings of gilts) are forecast by applying interest rates to the stocks of different liabilities. These interest rates are derived from financial market expectations and our inflation forecast (for index-linked gilts).[18]

4.140 Table 4.29 shows a significant downward revision to debt interest spending, net of the saving from financing some debt at Bank Rate through the APF, averaging £4.9 billion a year from 2016-17 onwards. The cumulative saving over the next five years relative to our November forecast is £24.5 billion. This comes on top of significant downward revisions in three of our last four forecasts. Debt interest spending (net of the APF) in 2018-19 is now forecast to be £42.4 billion, down more than 40 per cent since our March 2014 forecast, before market interest rate expectations began falling again. Box 4.4 discusses the evolution of our recent debt interest forecasts and the risks to which our latest forecast may be subject.

4.141 There have been significant changes to both elements of the forecast – the gross debt interest paid by central government (including that paid to the APF) and the amount that is netted off because the APF is part of the public sector. The table therefore shows the sources of changes to both elements. These include the effect of:

- **lower gilt yields**, which have fallen further since November, reducing spending by rising amounts over the forecast period as lower gilt yields reduce gross debt interest payments on new issues of conventional gilts;

- **market expectations of Bank Rate have fallen** even more significantly since November. Market expectations are below the current rate of 0.5 per cent for the next two years, do not reach 0.75 per cent until 2019 (a full decade after Bank Rate was initially cut to 0.5 per cent) and only reach 1.1 per cent by the end of our 5-year forecast period. As we have used market expectations throughout the forecast period, our forecast is consistent with Bank Rate being reduced below 0.5 per cent for some of the next two years. That is consistent with the Bank of England's published guidance on the possibility of Bank Rate cuts if the Monetary Policy Committee considered that necessary in the context of setting policy to meet its inflation target.[19] Lower Bank Rate reduces the cost of financing the Bank of England reserves created to fund the APF's gilt purchases;

[18] Our forecasting approach was explained in Box 4.4 of our March 2015 *EFO*. We publish a supplementary fiscal table on our website that presents the different stocks, flows and effective interest rates that make up our debt interest forecast.

[19] For example, the February 2015 *Inflation Report* stated that "*…there are risks to the inflation outlook in both directions. Were downside risks to materialise, market expectations of the future path of interest rates could adjust to reflect an even more gradual and limited path for Bank Rate increases than is currently priced. The Committee could also decide to expand the Asset Purchase Facility or to cut Bank Rate further towards zero from its current level of 0.5%. The scope for prospective downward adjustments in Bank Rate reflects, in part, the fact that the United Kingdom's banking sector is operating with substantially more capital now than it did in the immediate aftermath of the crisis. Reductions in Bank Rate are therefore less likely to have undesirable effects on the supply of credit to the UK economy than previously judged by the MPC. Were upside risks to materialise, it would be appropriate for Bank Rate to increase more quickly than embodied in current market yields but the likelihood is that those increases would still be more gradual and limited than in previous tightening cycles. The MPC stands ready to take whatever action is needed, as events unfold, to ensure inflation remains likely to return to target in a timely fashion.*"

- **lower RPI inflation** – excluding the knock-on effects of Budget measures – has reduced debt interest costs on index-linked gilts. This saving is greatest in the initial years of the forecast, reflecting lower oil prices and other factors;
- **changes to the pre-measures financing requirement** due to higher borrowing have offset some of these debt interest savings; and
- the **indirect effects of Government decisions** are uneven across the forecast period. The effect of duty measures on RPI inflation pushes up the accrued cost of servicing index-linked gilts, with the effect particularly large in 2018-19 when the soft drinks industry levy is introduced. Offsetting that, UKAR asset sales reduce the financing requirement from 2016-17 onwards and fiscal tightening reduces it further from 2019-20.

Table 4.29: Key changes to central government debt interest since November

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast (net of APF)	34.7	39.5	43.7	46.4	49.0	49.1
March forecast (net of APF)	34.1	35.4	38.6	42.4	43.4	43.4
Change	**-0.6**	**-4.0**	**-5.1**	**-4.0**	**-5.6**	**-5.7**
November forecast (gross of APF)	46.5	51.0	54.2	55.7	57.3	56.6
March forecast (gross of APF)	45.7	47.8	51.0	54.1	54.4	53.5
Change	**-0.8**	**-3.2**	**-3.2**	**-1.5**	**-3.0**	**-3.1**
of which:						
Interest rates	-0.1	-1.0	-1.9	-2.5	-3.0	-3.3
Inflation	-0.5	-2.0	-1.1	-0.1	-0.2	-0.2
Financing	0.0	0.0	-0.1	0.1	0.5	1.0
Other factors (including outturn)	-0.2	0.0	0.1	0.2	0.1	-0.2
Indirect effects of Government decisions	0.0	-0.1	-0.2	0.8	-0.3	-0.5
of which:						
Inflation	0.0	0.1	0.1	1.0	0.1	0.2
Other	0.0	-0.2	-0.3	-0.3	-0.4	-0.6
Changes from the Asset Purchase Facility						
November forecast	-11.7	-11.5	-10.6	-9.3	-8.3	-7.6
March forecast	-11.6	-12.4	-12.4	-11.7	-11.0	-10.1
Change	**0.2**	**-0.8**	**-1.9**	**-2.5**	**-2.7**	**-2.6**
of which:						
Interest rates	0.0	-1.0	-2.0	-2.7	-3.0	-2.8
Other factors (including outturn)	0.2	0.1	0.2	0.2	0.3	0.3

Box 4.4: Debt interest spending and the yield curve

In several recent forecasts we have revised down debt interest spending as market expectations of the interest rates at which the Government can borrow and service its debt have moved progressively lower and as inflation has fallen.

Since March 2014 our forecast for the budget balance in 2018-19 (the final year of that forecast) has deteriorated by £22.6 billion from a small surplus to a deficit of £21.5 billion in

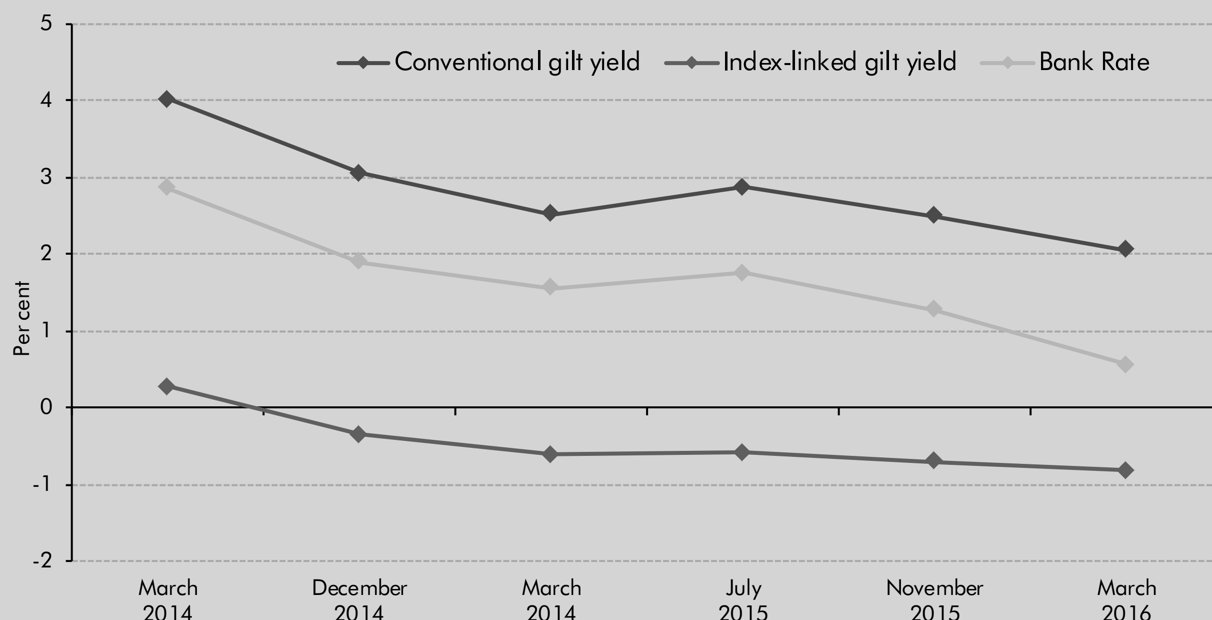
this forecast. That has occurred despite a £33.0 billion reduction in expected debt interest spending in that year. As Table C shows, lower interest rates (conventional and real gilt yields and short-term rates) explain the majority of the change, with lower RPI inflation and other factors (e.g. updated assumptions about gilt holdings in the APF) contributing smaller amounts.

Table C: Sources of changes to debt interest spending since March 2014

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
March 2014 (post-PSF review basis)	50.1	60.4	69.7	75.4		
March 2016	34.1	35.4	38.6	42.4	43.4	43.4
Change	**-16.0**	**-25.0**	**-31.1**	**-33.0**		
of which:						
Interest rates	-5.4	-14.1	-20.3	-24.1		
RPI inflation	-9.4	-7.8	-5.9	-5.0		
Other factors	-1.2	-3.1	-4.9	-3.9		

Chart C shows how market expectations for the 2018-19 level of the key interest rates that drive our debt interest forecast have fallen since March 2014. Bank Rate expectations have fallen from around 3 per cent in March 2014 to only just above ½ per cent now. Expectations of yields on conventional and index linked gilts have also fallen significantly.

Chart C: Successive market expectations for interest rates in 2018-19



Source: OBR

Given how low the market yield curve has fallen – and the extent to which lower interest rates have cushioned the effects of other forecast changes – the rest of this box reviews the sensitivity of debt interest spending to changes in various factors and what might drive them.

What could cause market expectations of interest rates to rise?

When considering the possible implications of higher interest rates, it is important to think about

the underlying drivers of any change. In broad terms:

- if market expectations move higher because **strengthening growth prospects** mean that markets expect monetary policy to be tightened, the upward pressure on borrowing from higher interest rates via debt interest spending would be offset by the effects of a stronger economy in boosting receipts and reducing some welfare spending; but
- if interest rate expectations move higher due to **higher risk premia** (e.g. due to greater uncertainty about inflation prospects or the outlook for the economy and public finances) those offsetting factors could be absent or could even exacerbate the direct effect of higher debt interest spending. Yields on UK government bonds have typically been very closely correlated with those on US government bonds, so it would also be possible for developments in the US economy and markets to cause gilt yields to rise, which might also be associated with smaller offsetting effects on UK borrowing.

What would be the effect on the fiscal position of a sudden increase in interest rates?

Debt interest payments are very sensitive 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 quantifies these sensitivities. Table D contains the ready reckoners consistent with this forecast. The overall effect on net borrowing would, as described above, depend on what had driven any change to these determinants of the forecast. Looking just at the direct effect on debt interest spending, the table shows that:

- the effect of a persistent increase in **conventional gilt rates** would build only gradually over time, as higher rates only apply to new debt issuance, and UK conventional gilts have a relatively long average maturity;
- higher **short-term interest 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 D: Debt interest ready reckoner

	£ billion				
	Forecast				
	2016-17	2017-18	2018-19	2019-20	2020-21
1 per cent increase in gilt rates	0.5	1.4	2.2	3.0	3.8
1 per cent increase in short rates	4.9	4.9	4.9	4.9	4.9
1 per cent increase in inflation	3.6	4.2	4.7	5.4	5.7
£5bn increase in CGNCR	0.0	0.1	0.3	0.4	0.5

Note: all increases are assumed to take effect at the beginning of 2016-17 and continue throughout the forecast.

Other AME spending

4.142 Our forecasts of **BBC** spending and licence fee income are little changed since November. Further detail can be found in the supplementary fiscal tables on our website.

4.143 Our RDEL forecast includes spending on **research & development (R&D)**, but this is classified in the National Accounts as capital spending. In order to move this spending from current to capital in our forecast, current AME includes a negative R&D accounting adjustment and capital AME includes an offsetting positive entry. Our latest forecast includes revisions to 2015-16 that reflect the latest in-year departmental outturn data. Spending from 2016-17 onwards is assumed to grow in line with RDEL, so reflects movements in the 2015-16 baseline as well as the changes the Government has made to RDEL totals in this forecast.

4.144 **Other PSCE in departmental AME** is little changed. The movement in **other PSGI items in departmental AME** is largely explained by three factors (all treated as capital grants):[20]

- spending attributable to the bonus shares element that will be part of the forthcoming **Lloyds retail share offering** (see paragraph 4.158) has been pushed back a year due to the delayed sale;
- we have revised down our forecast for payments on the **Help to Buy ISA** by between £0.1 billion and £0.4 billion due to the effect of lower interest rates and a methodological change to capture the effect of rising house prices on the proportion of first-time buyer property transactions that will be below the scheme caps (which are fixed in cash terms); and
- the Budget announcement of a **lifetime ISA.** This introduces an individual savings account (ISA) that individuals can save into and receive a 25 per cent contribution match from the Government. There is an option to withdraw the full amount for first-time homebuyers, but individuals cannot use this ISA in combination with the Help to Buy ISA. We expect this measure to cost £0.8 billion by 2019-20.

4.145 **Environmental levies** include spending on DECC levy-funded policies such as the renewables obligation, feed-in tariffs and the warm homes discount. Most are neutral for borrowing as they are directly offset by receipts. These forecasts and the downward revision since November are explained in the receipts section.

4.146 **VAT refunds** expenditure is neutral for borrowing, as it is directly offset within receipts. The upward revisions to the forecast are also explained in the receipts section.

4.147 Our forecast for **HMRC tax litigation** spending is unchanged on average over the forecast period. There has been a slight change to the profile, as the £0.2 billion of spending that we forecast for 2015-16 in November has now been delayed a year, increasing 2016-17 spending by that amount in this forecast.

[20] The spending in these categories is detailed in the supplementary fiscal tables on our website.

4.148 Our forecast for **Network Rail** spending has been revised by only small amounts over the whole forecast period, with current spending down by £0.2 billion and with around £1 billion of capital spending pushed back from 2015-16 and 2016-17 into 2017-18 and 2018-19.

4.149 The AME forecast includes other **National Accounts adjustments**, which are included in the definitions for PSCE and PSGI. Revisions to current National Accounts adjustments reflect broadly offsetting revisions to a number of local authority current accounting adjustments. The revision to capital National Accounts adjustments in 2014-15 reflects improved alignment of the residual adjustment between our estimated sum of the detailed components of spending and the latest outturns for PSGI published by the ONS. The revision in 2015-16 largely reflects a £0.6 billion upward revision to local authority financial transactions, which are removed from central government spending totals (thus reducing spending – this offsets an increase in capital LASFE, noted above). Revisions in later years mostly reflect downward revisions to our forecast for an adjustment to reflect ONS outturn data for local authorities' receipts of capital grants from the private sector (thus increasing spending). Further details of our forecasts for all the other National Accounts adjustments are included in the supplementary tables on our website. Explanations and the background to National Accounts adjustments are given in Annex D to PESA 2015.[21]

Loans and other financial transactions

4.150 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, such as loans and repayments between government and the private sector, and the sale of financial assets to 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.

4.151 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 instruments including treasury bills, gilt issues and NS&I products.

4.152 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;
- **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

[21] See HM Treasury, July 2015, *Public Expenditure Statistical Analyses 2015*.
[22] Consistent with the measures of debt and deficit used in this forecast, PSNCR excludes the public sector banks.

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 to which they relate. In contrast, PSNCR is a cash measure in which spending and receipts are attributed to the year in which the cash flow takes place. These timing differences need to be adjusted for;
- UK Asset Resolution: we separately identify transactions relating to UKAR holdings, including asset sales and the natural rundown of loan books that the Government acquired during the late 2000s financial crisis; and
- other factors affecting the central government net cash requirement: these include Network Rail and some other adjustments that do not fall into the categories above.

Table 4.30: Reconciliation of PSNB and PSNCR

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public sector net borrowing	**72.2**	**55.5**	**38.8**	**21.4**	**-10.4**	**-11.0**
Loans and repayments	**14.4**	**18.6**	**20.8**	**21.8**	**21.6**	**21.7**
of which:						
Student loans[1,2]	11.1	12.7	14.7	16.8	18.4	19.5
DFID	0.0	0.8	1.2	0.8	1.0	1.2
Green Investment Bank	0.4	0.6	0.2	0.2	0.1	0.0
Business Bank/Partnership	0.4	0.3	0.3	-0.1	0.0	0.0
Help to Buy	1.5	1.5	1.5	1.4	1.3	1.2
UK Export Finance	0.1	0.4	0.8	1.0	0.9	0.0
Ireland	0.0	0.0	0.0	0.0	-1.6	-1.6
Other lending	1.3	3.1	2.9	2.7	2.5	2.5
Allowance for shortfall	-0.3	-0.8	-0.8	-1.0	-1.0	-1.0
Transactions in financial assets	**-13.7**	**-11.7**	**-7.9**	**-7.9**	**-7.8**	**-2.4**
of which:						
Student loan book	0.0	-2.4	-2.4	-2.4	-2.4	-2.4
Royal Mail pension asset disposal	-0.5	-0.3	-0.2	-0.1	-0.1	-0.1
Lloyds Banking Group share sales	-7.4	-3.6	0.0	0.0	0.0	0.0
Royal Bank of Scotland share sales	-2.1	-5.4	-5.4	-5.4	-5.3	0.0
Other	-3.6	-0.1	0.0	0.0	0.0	0.0
Accruals adjustments	**8.0**	**10.1**	**2.8**	**-4.1**	**-2.3**	**7.1**
of which:						
Student loan interest[1,2]	1.9	2.1	2.8	3.9	5.3	6.5
PAYE income tax and NICs	2.2	2.0	2.0	1.6	1.9	2.2
Indirect taxes	1.6	1.3	0.9	1.0	1.0	0.8
Other receipts	2.4	2.5	2.5	2.7	2.8	2.7
Index-linked gilts[3]	-4.5	1.5	-7.2	-14.6	-13.9	-5.5
All gilts	3.3	3.4	4.6	4.2	3.7	3.5
Other expenditure	1.1	-2.6	-2.8	-2.8	-3.0	-3.2
Other factors	**-18.6**	**-14.4**	**-14.0**	**-1.1**	**-1.3**	**-0.8**
of which:						
UKAR alignment and asset sales	-18.6	-14.3	-13.3	-1.3	-1.3	-1.1
Network Rail	0.8	0.8	0.1	1.0	0.8	1.1
Alignment adjustment	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Public sector net cash requirement	**62.3**	**58.1**	**40.5**	**30.1**	**-0.3**	**14.6**

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

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Cash spending on new loans	13.2	15.2	17.3	19.5	21.3	22.7
Cash repayments	2.1	2.5	2.6	2.6	2.9	3.2

[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.

Table 4.31: Changes in the reconciliation of PSNB and PSNCR

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public sector net borrowing	**-1.3**	**5.5**	**14.0**	**16.8**	**-0.3**	**3.7**
Loans and repayments	**-1.6**	**0.3**	**0.6**	**1.4**	**-0.8**	**-1.2**
of which:						
Student loans[1,2]	-0.1	-0.1	-0.1	0.0	-0.3	-0.1
DFID[3]	-	-	-	-	-	-
Green Investment Bank[3]	-	-	-	-	-	-
Business Bank/Partnership[3]	-	-	-	-	-	-
Help to Buy[3]	-	-	-	-	-	-
UK Export Finance[3]	-	-	-	-	-	-
Ireland	0.0	0.0	0.0	0.4	-1.6	-1.6
Other lending [3]	-	-	-	-	-	-
Allowance for shortfall	-0.3	0.0	0.0	0.0	0.0	0.0
Transactions in financial assets	**3.6**	**-2.0**	**0.5**	**0.5**	**0.4**	**5.8**
of which:						
Student loan book	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Royal Mail pension asset disposal	0.0	0.2	0.2	0.2	0.0	0.1
Lloyds Banking Group share sales	4.7	-3.6	0.0	0.0	0.0	0.0
Royal Bank of Scotland share sales	0.0	0.4	0.4	0.4	0.5	5.8
Other	-1.1	1.1	0.0	0.0	0.0	0.0
Accruals adjustments	**0.8**	**2.7**	**0.7**	**-1.4**	**0.3**	**0.0**
of which:						
Student loan interest[1,2]	0.0	-0.1	-0.4	-0.4	-0.1	0.0
PAYE income tax and NICs	0.5	0.5	0.0	-0.4	0.0	0.0
Indirect taxes	-0.2	0.1	0.0	0.1	0.0	-0.1
Other receipts	0.0	0.1	0.0	0.1	0.2	0.0
Index-linked gilts[3]	0.6	2.0	1.1	-0.9	0.1	0.0
All gilts	-0.2	0.0	0.0	0.0	0.1	0.1
Other expenditure	0.0	0.1	-0.1	0.0	0.0	0.0
Other factors	**-0.2**	**-8.3**	**-8.6**	**4.1**	**3.1**	**1.2**
of which:						
UKAR alignment and asset sales	-0.7	-8.8	-8.2	3.8	3.2	0.9
Network Rail	0.2	0.2	-0.7	0.0	-0.4	0.0
Alignment adjustment	0.3	0.3	0.3	0.3	0.3	0.3
Public sector net cash requirement	**1.3**	**-1.7**	**7.2**	**21.4**	**2.6**	**9.4**

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

Cash spending on new loans	-0.2	-0.2	-0.3	-0.3	-0.2	-0.2
Cash repayments	0.0	-0.1	-0.2	-0.3	0.0	-0.1

[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] In November, we were not provided with individual forecasts but only for total lending as the Spending Review was completed.

Loans and repayments

Student loans

4.153 Net lending by the public sector to the private sector, in particular for student loans, raises the net cash requirement relative to net borrowing in each year of our forecast. The recent student loan reforms have increased the size of the upfront loans, with repayments being made over a longer period. In our 2015 *Fiscal sustainability report*, on the policy settings that were current at the time, we estimated that student loans would increase PSND by 8.8 per cent of GDP by the late 2030s before falling to 8.0 per cent of GDP in 2064-65.

4.154 We have made small revisions to our forecast for student numbers in England. Our estimate for 2015-16 is unchanged, but beyond that we have made small upward revisions, as the latest UCAS data show slightly higher acceptance and application rates, which more than offset lower population growth than we expected in November. Details of our student numbers forecast are available in a supplementary fiscal table on our website.

4.155 All else equal, higher student numbers would translate into higher spending, but we have revised down our forecast for student loan outlays due to the bigger effect of lower RPI inflation than assumed in November. We have revised our repayment forecast down slightly due to lower earnings growth and a lower Bank Rate assumption than in November.

4.156 The Government has announced the establishment of doctoral income contingent loans that will provide a new loan of £25,000 to eligible students who enrol in any doctoral programme at eligible UK institutions from academic year 2018-19. This is expected to increase outlays by £0.3 billion by 2020-21, but to have no effects on repayments within the forecast horizon. The Government has also decided to extend the availability of the Master's loan further to include 3 year part-time Master's courses. This policy increases outlays of about £30 million by 2020-21. Our forecast also takes account of the changes to higher education funding and student support announced in November. Those include:

- the **freeze of the repayment threshold** at £21,000 for five years from 2016-17 for post-2012 student loans;
- **converting maintenance grants into loans** for students in certain health-related courses; and
- **other changes** that expand the number of student eligible for loans from government.

Other lending

4.157 Other lending covers a range of Government schemes. In order to inform our estimate for the current year, we ask the Government to provide us with details of the planned lending by each institution or scheme. In light of new information provided by the Treasury, we have included a £0.3 billion under-lending assumption in 2015-16 to reflect the fact that the latest in-year plans appear slightly optimistic when compared with available outturn data. This forecast includes the 2015-16 final repayment of £0.7 billion to the Financial Services

Compensation Scheme (FSCS), completing recovery of the cost of compensating UK Icesave depositors in 2008.

4.158 For 2016-17 onwards, the Government has now provided us with an estimate of the planned lending by each institution or scheme, having provided only totals in November as the Spending Review was completed. That has allowed us to scrutinise the figures in greater detail. Table 4.30 splits out the major lending schemes, but we are not able to report changes since November in Table 4.31. One change since November that can be quantified relates to the size and timing of repayments on the loan to Ireland, aligning our forecast to the latest agreement, which reduces our lending forecast by £1.6 billion in both 2019-20 and 2020-21.

Transactions in other financial assets

4.159 We only include the impact of financial asset sales and purchases in our forecasts when firm details are available that allow the effects to be quantified with reasonable accuracy and allocated to a specific year. There are a number of asset sales that currently meet these criteria. The scale of these sales is illustrated in the top panel of Chart 4.11, while the extent to which our forecast has changed is shown in the bottom panel. Our latest forecast and changes since November reflect:

- in Autumn Statement 2013, the Government announced its plan to sell part of the **student loan book**, which it expected would raise around £12 billion over five years from 2015-16. In November, the Treasury informed us that they expected the first loan sale in 2016-17, one year later than originally thought. And they have confirmed for this forecast that that remains the case. We continue to believe that this is a central assumption, although last year's delay shows that it remains uncertain. Selling the loan book changes the years in which payments are received by government, with more recorded upfront as sales proceeds, but less in future years, because future loan repayments will flow to the private sector rather than the Exchequer;

- as in November, we have made a neutral assumption that loan book sales will be evenly spread across the five years, starting in 2016-17. The total proceeds have been revised up by £0.5 billion because we have now aligned the accounting treatment for repayments, interest and write-offs to the way in which we expect them to be treated in the National Accounts. This is largely a timing effect, since the information on which the sales will take place will be based on the last known balances, but after that point the Government will have received repayments and interest, and carried out write-offs, that will in effect have been on behalf of the buyer. Those effects were not captured in our previous forecasts. The sale of the loan book is expected to reduce the flow of repayments to the Exchequer by around £1.5 billion by 2020-21;

- our forecast in November included the Government's planned sales of £12.1 billion of **Lloyds Banking Group** shares in 2015-16. We have revised that down to £7.4 billion, reflecting the total proceeds in the year-to-date. On 28 January, the Chancellor announced that the remaining sales of Lloyds shares in 2015-16 would be delayed

due to turbulence in financial markets. The Budget confirms that the Government remains committed to selling its remaining stake in Lloyds during 2016-17, including via a retail offer that will include some gift elements. Based on the share price assumption underpinning our forecast (the 10-day average to 25 February), we expect Lloyds share sales to raise £3.6 billion in 2016-17;

- our November forecast incorporated the Government's commitment to sell over £25 billion of **Royal Bank of Scotland (RBS)** shares over the course of this Parliament (announced in July) and a further £5.8 billion in 2020-21 (announced in November). The sharp fall in the RBS share price since then means we expect sales of RBS shares to raise considerably less in this forecast. The Budget confirms that the Government will continue to seek further opportunities to dispose of its holding in RBS, following the August 2015 sale that raised £2.1 billion. But, based on the share price assumption underpinning this forecast, we expect proceeds to total £21.5 billion between 2016-17 and 2019-20, with nothing in 2020-21. This forecast will remain sensitive to movements in the RBS share price and decisions about the specific timing of sales;

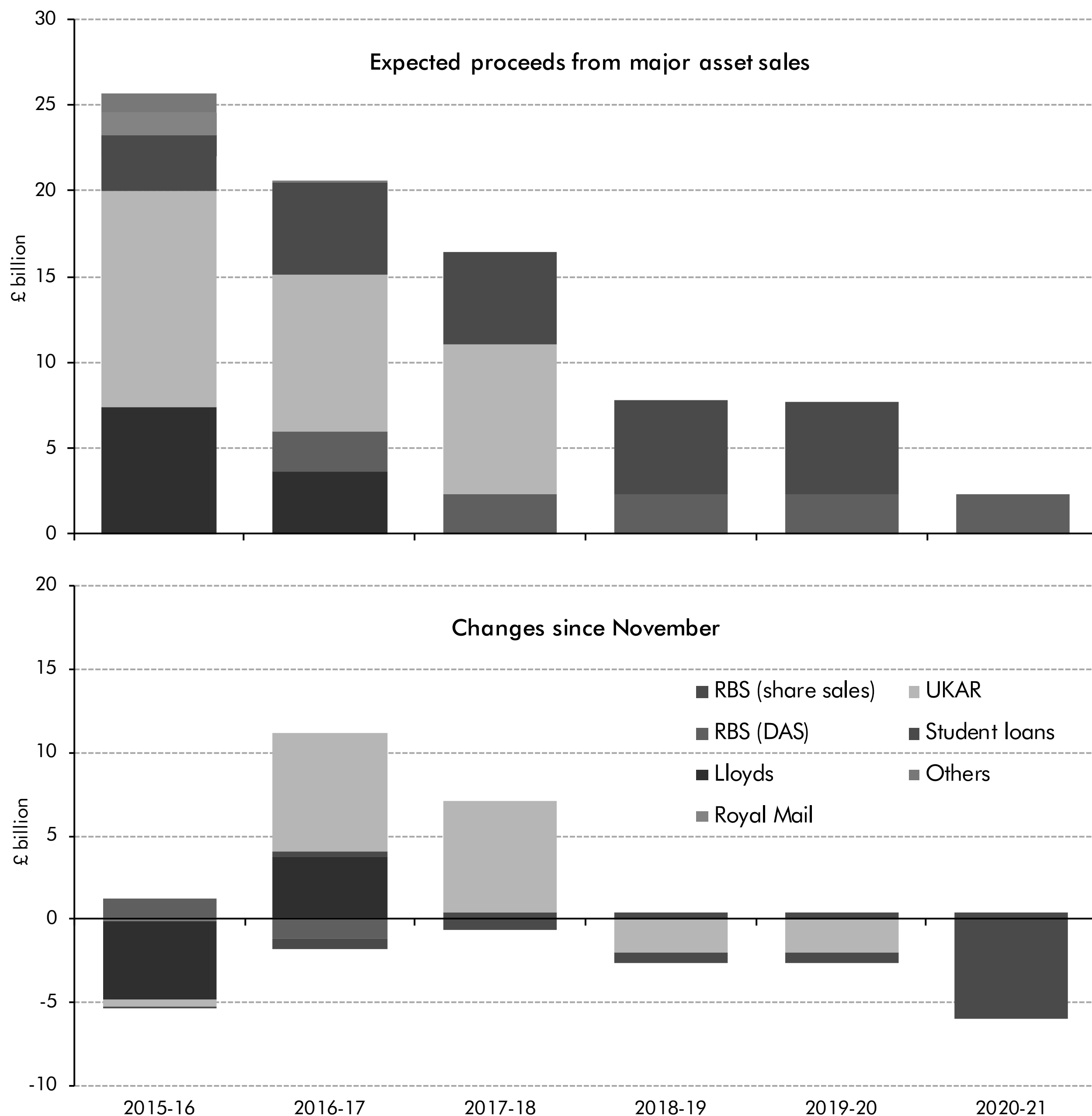
- we have revised the expected timing of when the Government will receive the remaining payment from RBS of about £1.2 billion to retire the **dividend access share** (DAS). It is now expected in 2015-16, consistent with the announcement made by RBS in its February 2016 results, rather than 2016-17, subject to regulatory approval; and

- a further significant sale of **UK Asset Resolution's** (UKAR) assets, in addition to the natural rundown of the loan book. These are discussed in the UKAR section below.

4.160 The Government has confirmed that it still intends to include a gift element to the Lloyds retail share offering in 2016-17 – allocating bonus shares to small investors and assuming that shares will be sold at a small discount to the prevailing market price. We estimate that will add £0.1 billion to public spending in 2016-17 and £0.2 billion in 2017-18, as the gift element is treated as a capital grant to the private sector in the National Accounts.

4.161 We expect the proceeds of these major asset sales to total £25½ billion in 2015-16 (all of which has been completed). A further £52 billion is expected over the remainder of this Parliament to 2019-20, and £2½ billion in 2020-21. Relative to our November forecast, we expect the Government to receive about £4 billion less in 2015-16, reflecting the net effect of the postponed Lloyds share sales and the earlier receipt of the RBS DAS payment. We then forecast that the Government will receive about £11 billion more over the rest of the Parliament, with the additional UKAR sale more than offsetting the effect of the lower RBS share price.

Chart 4.11: Proceeds from major asset sales and changes since November



Source: HMT, OBR

Accruals adjustments

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

4.163 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, but cash repayments are not received until the point at which former students earn sufficient income. This part of the forecast is lower than in November, reflecting the effects

of lower Bank Rate and RPI inflation on the interest rate applied to these loans. Our forecast includes student interest payments related to Scotland, Wales and Northern Ireland.

4.164 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 uneven profile of redemptions from year to year. Positive RPI inflation raises the amount the government will have to pay on index-linked gilts when they are redeemed. This commitment is recognised in PSNB as debt interest payments each year, but the actual cash payments do not occur until redemption, which may be many years in the future. Since November, the downward revision to RPI inflation, especially in the first half of the forecast, has reduced accrued debt interest, with a largely offsetting change in the accrual adjustment.

4.165 Since our last forecast, HMRC has made significant interim payments in relation to tax litigation cases. These payments do not necessarily affect accrued spending immediately. These interim payments have been recorded in the public finances as financial transactions, while any associated spending will only be recorded when the relevant court proceedings have been finalised. We have therefore include accruals adjustments associated with all tax litigation payments so far in 2015-16 equal to £1.5 billion.

UK Asset Resolution

4.166 The rundown of UKAR's Bradford & Bingley and NRAM plc (B&B and NRAM) loan books directly reduces the net cash requirement, in addition to those loans generating net interest that also reduces net borrowing. As well as this rundown, our November forecast reflected the £13 billion sale of the Granite securitisation vehicle and some related assets, the vast majority of which was paid in 2015-16 with the remainder (about £0.5 billion) expected early in 2016-17. In November, the Government announced that UKAR will undertake further asset sales totalling £7.5 billion over the course of this Parliament to 2019-20.

4.167 In this Budget, the Government has announced that it expects UKAR to begin a major sale programme of Bradford & Bingley mortgages. We have assumed that this will raise sufficient proceeds for B&B to repay its £15.7 billion liability to the FSCS, and for the FSCS to repay its corresponding loan from the Treasury. The Government expects the proceeds from this programme of sales to be delivered in 2016-17 and 2017-18, and to have concluded in full by the end of 2017-18. We consider the information that the Government has provided us in relation to this announcement to be sufficiently firm for the effect to be included in our forecast and have assumed that the gross proceeds will be spread evenly across 2016-17 and 2017-18. As with any major asset sale, it is subject to uncertainty. We have assumed that there will be sufficient private-sector demand for the sale to take place and at a sufficiently attractive price for the transaction to go ahead. There will be effects from foregone mortgage repayments associated with the sale. These reduce interest receipts (affecting both PSNB and PSND) and principal repayments (affecting only PSND).

Central government net cash requirement

4.168 The central government net cash requirement (CGNCR) is the main determinant of government's net financing requirement. Table 4.32 reconciles CGNCR with PSNCR and Table 4.33 sets out the changes in this reconciliation since November. The CGNCR is derived by adding or removing transactions associated with local authorities and public corporations to the PSNCR.

4.169 Cash flows are usually 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.[23]

4.170 In November, we included a £1.4 billion a year 'alignment adjustment' for factors that we expected to persist. Since November, the Treasury and ONS have continued their work on reconciling PSNB and PSNCR. This has uncovered a number of additional small receipts lines that were affecting PSNCR but not PSNB. They amount to around £0.3 billion a year and have now been added to our receipts and spending forecasts (where some score as negative spending). We have therefore subtracted £0.3 billion a year from the alignment adjustment we make between the PSNB and PSNCR forecasts.

4.171 The classification of 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.[24] This has three effects:

- the **banks' own cash requirements are included in the headline CGNCR**. Running down the banks' loan books (including through asset sales) reduces the CGNCR by almost £18.6 billion in 2015-16, falling to around £1 billion by 2020-21, but this does not directly affect the Exchequer (this forecast is shown towards the bottom of Table 4.32);

- **interactions between the Exchequer and these bodies net off** within the headline measure. The banks' loan repayments to the Exchequer vary from around £1 billion to £6 billion a year; and

- the Treasury will finance **Network Rail**'s new and maturing debt in future, for which Network Rail will pay a fee. Refinancing needs are projected at £3 billion in 2015-16, but decline over time.

[23] In See Box 4.3 of our July 2015 *EFO* for a discussion of a number of changes we had made to our forecast as we explored the reasons for this discrepancy.
[24] The Government is publishing a revised financing remit for 2015-16 and 2016-17 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 4.32: Reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public sector net cash requirement (NCR)	**62**	**58**	**40**	**30**	**0**	**15**
of which:						
Local authorities and public corporations NCR	3	3	1	-1	-3	-1
Central government (CG) NCR own account	59	55	40	31	3	16
CGNCR own account	59	55	40	31	3	16
Net lending within the public sector	1	1	1	1	1	1
CG net cash requirement	**60**	**56**	**41**	**32**	**3**	**17**
B&B and NRAM adjustment	13	4	0	0	1	1
Network Rail adjustment	3	2	1	1	-1	0
CGNCR ex. B&B, NRAM and Network Rail	**76**	**62**	**41**	**32**	**3**	**17**

Table 4.33: Changes in the reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public sector net cash requirement (NCR)	**1**	**-2**	**7**	**21**	**3**	**9**
of which:						
Local authorities and public corporations NCR	1	1	0	0	-1	-1
Central government (CG) NCR own account	0	-3	7	21	3	10
CGNCR own account	0	-3	7	21	3	10
Net lending within the public sector	-2	-1	-1	-1	-1	-1
CG net cash requirement	**-2**	**-3**	**7**	**21**	**3**	**10**
B&B and NRAM adjustment	2	2	2	-2	0	0
Network Rail adjustment	0	0	0	0	0	0
CGNCR ex. B&B, NRAM and Network Rail	**0**	**-2**	**9**	**19**	**3**	**10**

Key fiscal aggregates

4.172 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 five 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. We focus on it when explaining the reasons for changes since the previous forecast. It is the target measure for the Government's fiscal mandate;
- **cyclically adjusted net borrowing:** public sector net borrowing adjusted to reflect the estimated impact of fluctuations in the economic cycle. It represents an estimate of underlying or 'structural' net borrowing, in other words borrowing we would expect to see if the output gap was zero;
- the **current budget deficit**: the difference between receipts and public sector current expenditure each year. In effect, this is public sector net borrowing excluding borrowing to finance investment;
- the **cyclically adjusted current budget deficit**: the current budget adjusted to reflect the estimated impact of fluctuations in the economic cycle. It was the target measure for the Coalition Government's fiscal mandate in the last Parliament; 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 target (and was also targeted by the Coalition Government in the last Parliament).

4.173 In our November forecast, we anticipated the effect on these fiscal aggregates of the ONS decision to reclassify housing associations to the public sector.[25] In February, the ONS implemented that reclassification decision in the official statistics. All forecasts and changes since November discussed in this section are therefore presented on that basis.

Public sector net borrowing

Expected borrowing in 2015-16

4.174 We expect borrowing to fall to £72.2 billion this year, down £19.7 billion or 21.4 per from 2014-15. That is a bigger drop than would be implied by the data for the first 10 months of the year, which showed borrowing down £10.6 billion or 13.7 per cent on 2014-15. So it is not surprising that outside analysts tend to have higher forecasts.

[25] Strictly speaking, it is 'private registered providers' of social housing in England that have been reclassified. These include most housing associations as well as some for-profit housing bodies. We refer to 'housing associations' for simplicity.

4.175 We have revised down our receipts forecast since November (although it still implies stronger year-on-year growth in the final two months of the year than in the first ten). But this has been more than offset by downward revisions to spending.

4.176 As ever, it is important to stress the uncertainty that remains around in-year borrowing, even at this late stage in the year. It is also important to remember that we are forecasting the level at which the budget deficit will settle when all the relevant data have been gathered over the coming months. History suggests that this will not be the level initially reported by the ONS when it publishes its first estimate next month. This will necessarily be based on provisional data that will be revised as final outturn data are received.

4.177 The main factors that are likely to explain the difference between our latest forecast for borrowing in 2015-16 and the gloomier outside expectations include:

- we expect stronger growth in **income tax and NICs receipts**, reflecting indications from HMRC administrative data for February. The Government's **marriage tax allowance** is also costing less than expected, thanks to IT problems for many people trying to claim it and a combination of lack of awareness and reluctance to attract the attention of HMRC among other potential recipients. That more than offsets the lower yield from the introduction of **Class 3A voluntary NICs**, where lack of awareness has also led to much lower take-up than expected;

- we expect **stamp duty land tax** to rise by 16.5 per cent in the year to February and March combined, up from 0.3 per cent year-to-date, due largely to the timing of the 2014 reform. That pick-up remains despite a £0.5 billion downward revision to our forecast since November. We also expect **stamp duty on shares** to be boosted by a large payment made in February as a result of a recent corporate takeover;

- **VAT** is also expected to be stronger over the remaining two months, reflecting February administrative data. We also forecast stronger receipts from **environmental levies** (where we are investigating differences between DECC and the ONS estimates) and **alcohol duties** (where we expect timing effects associated with cuts in duty rates last year not to be repeated);

- a £0.7 billion downward revision to **housing associations**' net borrowing, informed by the £1.0 billion lower-than-expected ONS estimate for their borrowing in 2014-15. The latest public finances data for 2015-16 are based on our November 2015 housing associations forecast, so our new forecast will be reflected in the official data until the ONS can replace it with firm data from housing associations; and

- we have revised down spending on **EU contributions** in 2015-16 by £1.2 billion, largely due to a lower-than-expected demand from the European Commission for a contribution in March.

Forecast for borrowing from 2016-17 onwards

4.178 Table 4.34 shows how changes to our underlying forecast judgements and the Government's policy decisions have affected our forecast for public sector net borrowing:

- we have revised down our **pre-measures receipts forecast** significantly (which increases borrowing and therefore shows up as positive figures in the table). Weaker productivity growth implies weaker nominal GDP growth and this reduces growth in all the main tax bases (wages and salaries, consumer spending and corporate profits). Lower share prices have also reduced receipts from capital taxes, while lower market expectations of interest rates have reduced interest and dividend receipts. Updated modelling of stamp duty land tax has also contributed to the downward revision;

- lower market expectations of Bank Rate and gilt yields, plus downward revisions to our RPI inflation forecast, have prompted a further large downward revision to **debt interest spending**, net of the saving associated with financing part of the debt at Bank Rate through the Asset Purchase Facility (APF). This is the third time in our last four forecasts that changes in market expectations have led to a large downward revision to debt interest spending (as set out in Box 4.4 in Chapter 4). Higher interest rates clearly pose an upside risk to our spending, although recent experience shows that even at very low interest rates it is possible for them to fall further;

- our **pre-measures forecast for other AME spending** is higher every year. Welfare spending has been revised up, thanks largely to higher-than-expected caseloads and average awards as disabled people are migrated from disability living allowance to the new personal independence payment. Spending by local authorities and public corporations has also been revised up. We have made smaller downward revisions to spending on state pensions, tax credits and public service pensions;

- the **direct effect of the Government's policy decisions** has been to increase the deficit in 2017-18 and 2018-19, but then to turn our pre-policy-measures forecasts of deficits in 2019-20 and 2020-21 into surpluses. The year-on-year fiscal tightening in 2019-20 implied by this uneven profile is striking – a £18.2 billion or 0.8 per cent of GDP turnaround relative to the small giveaway in 2018-19. In part that reflects the Government's decision to delay the July Budget measure that brings forward the timing of large firms' quarterly corporation tax payments. That measure gives a one-off boost to receipts that is neither repeated nor reversed in later years. The biggest boost has been shifted from 2017-18 to the surplus target year of 2019-20; and

- the net **indirect effects** on the public finances of the Government's decisions have been relatively small. In most years, they reflect the knock-on effects of how the Government has altered the pace of fiscal tightening. In 2018-19, the effect on RPI inflation of the introduction of a soft drinks industry levy has added around £1 billion to accrued interest payments on index-linked gilts.

Table 4.34: Public sector net borrowing since November

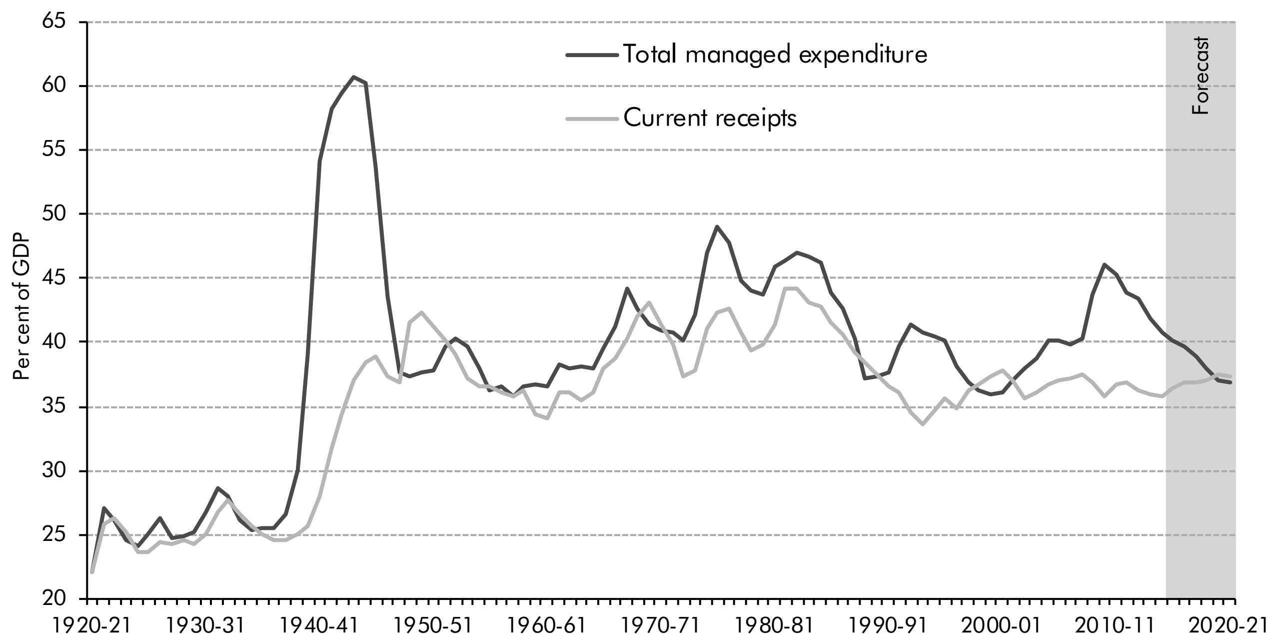
	£ billion						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	**94.7**	**73.5**	**49.9**	**24.8**	**4.6**	**-10.1**	**-14.7**
Total forecast changes	**-2.8**	**-1.3**	**6.6**	**7.2**	**12.3**	**13.4**	**16.7**
of which:							
Receipts	-0.5	0.4	8.2	10.5	14.0	16.3	19.5
Debt interest spending	0.0	-0.6	-3.9	-4.9	-4.8	-5.4	-5.2
Non-interest AME spending	-2.3	-1.5	1.8	1.1	2.7	2.0	2.0
Revisions to DEL spending	0.0	0.5	0.5	0.5	0.5	0.5	0.5
March forecast pre-policy decisions	**91.9**	**72.2**	**56.5**	**32.0**	**17.0**	**3.2**	**2.0**
Total effect of Government decisions		**-0.1**	**-1.0**	**6.7**	**4.5**	**-13.7**	**-13.1**
of which:							
Scorecard receipts measures		0.0	-0.6	7.0	4.3	-6.3	-0.8
Scorecard AME spending measures		0.0	-0.1	-2.1	-2.6	-4.6	-4.5
Changes to RDEL spending		0.4	0.3	1.8	1.9	-1.8	-8.1
Changes to CDEL spending		-0.4	0.1	0.7	1.1	-1.2	-0.4
Indirect effect of Government decisions		-0.1	-0.7	-0.6	-0.3	0.2	0.7
March forecast post-policy decisions	**91.9**	**72.2**	**55.5**	**38.8**	**21.4**	**-10.4**	**-11.0**
Overall change since November	**-2.8**	**-1.3**	**5.5**	**14.0**	**16.8**	**-0.3**	**3.7**

Note: This table uses the convention that a negative figure means a reduction in PSNB, i.e. an increase in receipts or a reduction in spending will have a negative effect on PSNB.

4.179 Between 2009-10 and 2019-20, the budget balance is forecast to move from a post-war record deficit of 10.3 per cent of GDP to a small surplus of 0.5 per cent – a turnaround of 10.8 per cent of GDP (£202 billion in today's terms). By 2015-16, around 60 per cent of that planned reduction – 6.4 per cent of GDP (£121 billion) – will have been completed.

4.180 Chart 4.12 shows current receipts and total managed expenditure as a share of GDP since 1920-21 using Bank of England and ONS data. Total spending falls to 36.9 per cent of GDP in by the end of the forecast period, which is the lowest since 2000-01. Current receipts as a share of GDP are forecast to peak at 37.5 per cent in 2019-20, then fall back to 37.4 per cent in 2020-21. Receipts have not been higher than 37 per cent of GDP in any year since 2007-08.

Chart 4.12: Total public sector spending and receipts



Source: Bank of England, ONS, OBR

Cyclically adjusted net borrowing (the structural fiscal position)

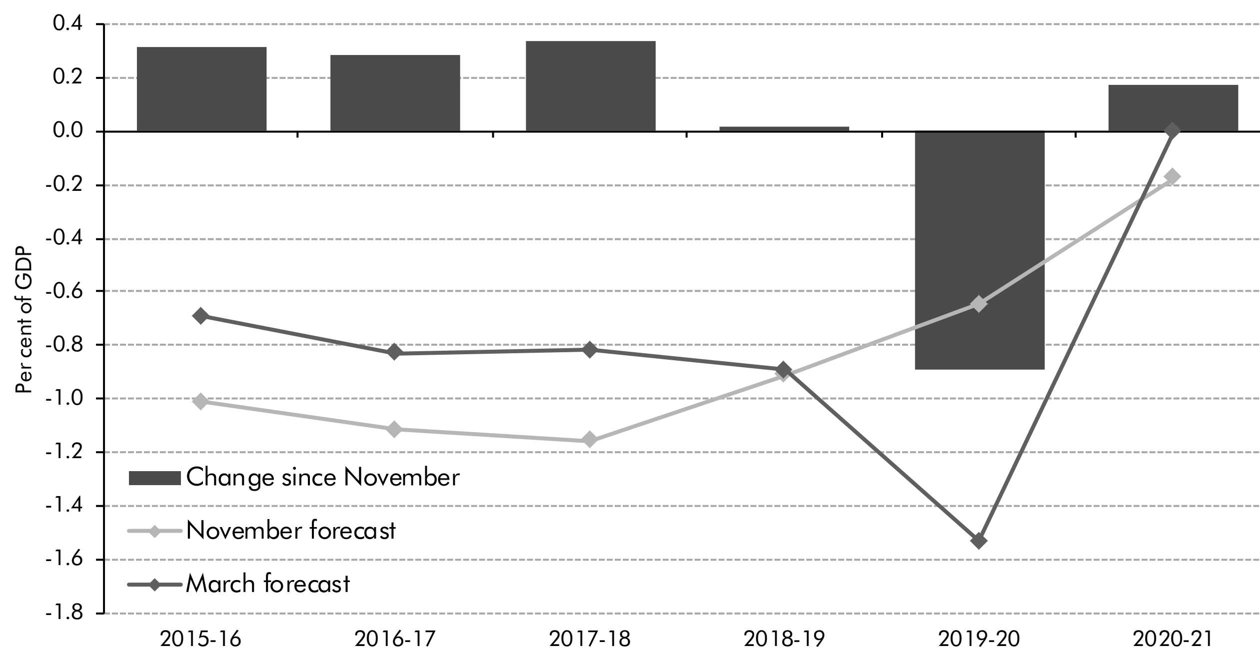
4.181 Our estimate of the margin of spare capacity in the economy is small in 2015-16 at just 0.3 per cent of potential output – slightly narrower than we estimated in November – and we expect the output gap to be very close to zero from 2016-17 onwards. This means that more of the deficit in 2015-16 is considered structural than was the case in November, but the path of structural borrowing is similar to that of headline borrowing described above.

4.182 The year-on-year change in the structural budget deficit – public sector net borrowing adjusted for the size of the output gap – is a common measure of the pace of fiscal consolidation. It has drawbacks when estimates of potential output change significantly, but is more useful when potential output growth is more stable. Chart 4.13 shows that:

- **in November's Spending Review and Autumn Statement**, the Government set a path for the structural deficit that saw the pace of tightening pick up slightly in 2016-17 and 2017-18 and then diminish year by year as the budget moved into surplus; but

- **in this Budget**, thanks to tax and spending policy changes that have uneven effects on borrowing across the forecast, the Government has charted a course that sees the pace of tightening pick up gradually up to 2018-19, then dramatically in 2019-20 (the year in which its surplus target first applies), before slowing abruptly in 2020-21. The 1.5 per cent of GDP tightening of the structural fiscal position in 2019-20 would be the sharpest since 2010-11.

Chart 4.13: Year-on-year changes in cyclically adjusted net borrowing



Source: OBR

Current budget

4.183 We estimate that the current budget deficit, which excludes borrowing to finance net investment spending, will have been £39.0 billion in 2015-16, down from a peak of £103.2 billion in 2009-10. Our latest forecast shows the current budget moving into surplus in 2018-19 (a year later than in our November forecast) and the surplus increasing thereafter to reach £53.4 billion in 2020-21.

Cyclically adjusted current budget

4.184 We expect the cyclically adjusted current budget (CACB) to move from a deficit of 1.8 per cent of GDP in 2015-16 to a surplus of 0.5 per cent in 2018-19, also a year later than in our November forecast. The surplus rises to 2.4 per cent of GDP in 2020-21.

Public sector net debt

4.185 In November we forecast that public sector net debt (PSND) would fall as a share of GDP in 2015-16 and in each subsequent year of the forecast. But despite revising down the cash level of net debt this year, we now expect it to rise as a share of GDP in 2015-16 before declining from 2016-17 onwards. This reflects revisions to the nominal GDP forecast.

4.186 PSND is now forecast to come in at 83.7 per cent of GDP this year, falling to 74.7 per cent of GDP in 2020-21. Table 4.35 shows that we have revised up the debt-to-GDP ratio by increasing amounts across the forecast period since November. That is because:

- lower **nominal GDP growth** in the near term has raised the debt-to-GDP ratio significantly. In particular, the sharp slowdown in the year to the final quarter of 2015

– up just 1.9 per cent, compared with the 3.9 per cent we forecast in November – has fed through to the denominator for the 2015-16 debt-to-GDP ratio calculation (see Box 4.1). This has pushed the ratio up significantly compared to 2014-15. From 2016-17 onwards, smaller downward revisions to our nominal GDP growth forecast, due to a lower estimate of underlying productivity growth, push the ratio up a little further;

- **cumulative borrowing** across the forecast has been revised up significantly. As described above, that reflects a large upward revision to our pre-policy-measures forecast, partly offset by the impact of the Government's policy decisions;

- the depreciation of the pound has increased the sterling value of the UK's **foreign currency reserves**, as measured in the PSND calculation.[26] In reality, the reserves are largely hedged against currency movements to reduce the Exchequer's exposure to currency risk, but Eurostat's *Manual on government deficit and debt* stipulates that derivative instruments must not be counted in EDP measures of debt (even though they are counted in the full National Accounts). The ONS follows this Eurostat guidance for its PSND calculations. The result is that the sharp drop in the value of sterling this year has raised the sterling value of the official reserves, which net off PSND. The effect was worth £6.3 billion in January alone and we estimate it will subtract £10 billion from PSND by the end of the year. This is a feature of the PSND calculation rather than a true reflection of the public sector's net worth;

- the pace at which **UK Asset Resolution's assets** are sold or run down has increased, reducing PSND. UKAR's mortgage book has been running down slightly faster than expected as its customers take advantage of lower mortgage rates currently offered by other lenders. UKAR is then planning a further large sale of mortgage assets – following last year's £13 billion sale of the Granite securitisation and other assets. That brings forward around £17½ billion of sales into 2016-17 and 2017-18, while reducing the amount of mortgages that would otherwise have run down naturally later in the forecast period. Taken together, the reduction in PSND relative to our last forecast peaks in 2017-18 then declines in subsequent years;

- lower proceeds from **other financial asset sales** across the forecast period. Sales of the Government's remaining stake in Lloyds have been pushed back from 2015-16 to 2016-17, with proceeds also lower due to the fall in the share price since November. (The Government still plans to give some shares away to retail investors, so while this sale reduces PSND it would worsen a broader measure of public sector net worth.) More significantly, the expected proceeds from RBS share sales between 2016-17 and 2020-21 have fallen by 26 per cent to £21.5 billion, more than explained by the sharp fall in the share price;

[26] The ONS has introduced a new table in its public sector finances bulletin that details how to reconcile changes in the central government net cash requirement and changes in central government net debt, of which these effects on the foreign exchange reserves are one element. Thanks to this greater transparency, we will be able to forecast its elements directly rather than treating it as an unexplained residual in the PSND calculation.

- **APF balance sheet effects** have been revised up slightly, due to the difference between the amount the Bank pays for the gilts held in the APF and their nominal value at redemption. Lower market expectations of gilt yields mean that when the APF replaces gilts that reach their redemption date the new gilts will be purchased at a greater premium to the nominal values at which they are valued for PSND. As a result, over the coming five years we expect that the APF will need to purchase gilts with a market value of £138½ billion to replace gilts of the same value that are redeemed, but that the nominal value of those gilts will be £115½ billion compared with the redeemed gilts' nominal value of £124½ billion. That £9 billion difference by 2020-21 is around £4 billion higher than assumed in November; and

- movements in expected **gilt premia** push PSND down in every year of the forecast and **other factors** are generally smaller and partly offsetting.

Table 4.35: Changes in public sector net debt since November

	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	83.1	82.5	81.7	79.9	77.3	74.3	71.3
March forecast	83.3	83.7	82.6	81.3	79.9	77.2	74.7
Change	**0.2**	**1.3**	**0.9**	**1.4**	**2.6**	**2.9**	**3.4**
of which:							
Change in nominal GDP[1]	0.2	1.7	1.6	1.8	2.0	2.2	2.3
Change in cash level of net debt	0.1	-0.5	-0.7	-0.4	0.6	0.7	1.1
	£ billion						
November forecast	1546	1599	1652	1685	1702	1708	1715
March forecast	1547	1591	1638	1677	1715	1725	1740
Change in cash level of net debt	**1**	**-9**	**-14**	**-8**	**14**	**16**	**25**
of which:							
Pre-measures borrowing	0	-1	5	13	25	38	55
Policy effects on borrowing	0	0	-1	6	10	-4	-17
Foreign currency reserves	0	-10	-10	-10	-10	-11	-11
UKAR asset sales and rundown	0	-1	-9	-18	-14	-11	-10
Other financial asset sales	0	4	2	2	3	3	9
Gilt premia	0	-2	-4	-4	-6	-6	-7
APF balance sheet effects	0	0	1	1	2	3	4
Other factors	1	1	3	3	4	3	2

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

Table 4.36: Fiscal aggregates

	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Receipts and expenditure							
Public sector current receipts (a)	35.7	36.3	36.9	36.9	37.0	37.5	37.4
Total managed expenditure (b)	40.8	40.2	39.7	38.8	38.0	37.0	36.9
of which:							
Public sector current expenditure (c)	36.8	36.3	35.7	34.9	34.3	33.4	32.9
Public sector net investment (d)	1.9	1.8	1.9	1.7	1.6	1.5	1.9
Depreciation (e)	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Deficit							
Current budget deficit (c+e-a)	3.1	2.1	1.0	0.2	-0.6	-1.9	-2.3
Cyclically adjusted current budget deficit	2.4	1.8	0.9	0.2	-0.5	-2.0	-2.4
Cyclically adjusted net borrowing	4.3	3.6	2.7	1.9	1.0	-0.5	-0.5
Primary balance	-3.4	-2.2	-1.1	-0.1	0.9	2.2	2.1
Cyclically adjusted primary balance	-2.6	-1.9	-1.0	-0.1	0.8	2.3	2.1
Fiscal mandate and supplementary target							
Public sector net borrowing (b-a)	5.0	3.8	2.9	1.9	1.0	-0.5	-0.5
Public sector net debt[1]	83.3	83.7	82.6	81.3	79.9	77.2	74.7
Financing							
Central government net cash requirement	4.6	3.2	2.9	2.0	1.5	0.2	0.7
Public sector net cash requirement	4.2	3.3	3.0	2.0	1.4	0.0	0.6
Stability and Growth Pact							
Treaty deficit[2]	5.0	3.9	2.9	2.0	1.1	-0.3	-0.4
Cyclically adjusted Treaty deficit	4.2	3.6	2.7	2.0	1.1	-0.3	-0.4
Treaty debt ratio[3]	87.4	88.9	88.3	87.1	85.6	83.0	80.3
	£ billion						
Public sector net borrowing	91.9	72.2	55.5	38.8	21.4	-10.4	-11.0
Current budget deficit	57.0	39.0	19.1	3.5	-11.8	-42.6	-53.4
Cyclically adjusted net borrowing	78.1	67.0	53.3	39.0	21.8	-10.9	-11.3
Cyclically adjusted current budget deficit	43.3	33.8	17.0	3.6	-11.4	-43.0	-53.7
Public sector net debt	1547	1591	1638	1677	1715	1725	1740
Memo: Output gap (per cent of GDP)	*-0.7*	*-0.3*	*-0.1*	*0.1*	*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

4.187 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**, including the outlook for productivity growth in the UK, the implications of lower growth in China and uncertainty associated with the forthcoming EU referendum (paragraph 3.118);

- uncertainties associated with the **delivery of reforms to the welfare system**, particularly in relation to disability benefits (from paragraph 4.113) and universal credit (from paragraph 4.118);
- **higher interest rates** clearly pose an upside risk to our spending forecast, although recent experience shows that even at very low interest rates it is possible for them to fall further (from Box 4.4);
- ongoing uncertainties around the large **financial asset sales** that are planned to take place over this Parliament (from paragraph 4.159); and
- the Government has set out a number of **ambitions or intentions** that have not yet been confirmed as firm policy decisions, but which remain a source of risk to the forecast (paragraph 4.9).

International comparisons

4.188 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 4.37 and 4.38 present our UK forecasts on a basis that is comparable with that used by these international organisations. 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 simply weighting our financial year forecasts.

Table 4.37: Comparison with European Commission forecasts

	Per cent of GDP					
	Treaty deficit[1]			Treaty debt[2]		
	2015	2016	2017	2015	2016	2017
UK (March *EFO*)	**4.4**	**3.1**	**2.2**	**89.3**	**88.6**	**87.4**
UK (EC)	4.4	3.1	2.1	88.6	89.1	88.2
Germany	-0.5	-0.1	0.0	71.6	69.2	66.8
France	3.7	3.4	3.2	96.2	96.8	97.1
Italy	2.6	2.5	1.5	132.8	132.4	130.6
Spain	4.8	3.6	2.6	100.7	101.2	100.1
Euro area	2.2	1.9	1.6	93.5	92.7	91.3

[1] General government net borrowing.
[2] General government gross debt.
Source: European Commission, *European Economic Forecast Winter 2016,* OBR

Table 4.38: Comparison with IMF forecasts

	Per cent of GDP					
	General government net borrowing			General government net debt		
	2015	2016	2020	2015	2016	2020
UK (March *EFO*)	4.4	3.1	-0.4	80.7	79.6	72.2
UK (IMF)	4.2	2.8	-0.1	80.3	79.5	69.3
Germany	-0.5	-0.3	-1.0	48.4	46.4	38.1
France	3.8	3.4	0.7	89.4	90.3	85.4
Italy	2.7	2.0	0.2	113.5	112.8	104.8
Japan	5.9	4.5	4.1	126.0	128.1	132.1
U.S	3.8	3.6	4.2	79.9	80.7	81.2

Source: IMF, *World Economic Outlook,* October 2015, OBR

5 Performance against the Government's fiscal targets

Introduction

5.1 This chapter:

- sets out the Government's **medium-term fiscal targets** (from paragraph 5.2);
- examines whether the Government has a better than 50 per cent **chance of meeting them** on current policy, given our central forecast (from paragraph 5.7); 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 5.31).

The Government's fiscal targets

5.2 The *Charter for Budget Responsibility* requires the OBR to judge whether the Government has a greater than 50 per cent chance of hitting its fiscal targets under current policy. The latest version of the *Charter* (approved by Parliament in October 2015 and available on our website) sets out two targets that are formally in place for this forecast:

- the Government's fiscal mandate requires a surplus on **public sector net borrowing** by the end of 2019-20 and in each subsequent year; and
- it is supplemented by a target for **public sector net debt** to fall as a percentage of GDP in each year to 2019-20 (after which it would continue to do so if the mandate is met).

5.3 The *Charter* states that "*These targets apply unless and until the Office for Budget Responsibility (OBR) assess, as part of their economic and fiscal forecast, that there is a significant negative shock to the UK. A significant negative shock is defined as real GDP growth of less than 1% on a rolling 4 quarter-on-4 quarter basis.*" We will make this assessment in each *Economic and fiscal outlook (EFO)*, at the same time as we carry out our assessment of performance against the fiscal targets.

5.4 The current fiscal mandate replaced the Coalition Government's target of achieving cyclically adjusted current balance by the end of the third year of the forecast period. The current supplementary target requires public sector net debt as a percentage of GDP to be falling in each year rather than at a fixed date in 2016-17 as was the case previously. Both

targets were amended in the last Parliament, with the fiscal mandate initially applying to the final year of the five-year forecast period and the debt target to 2015-16.

5.5 The fiscal mandate is further supplemented by:

- a cap on a subset of **welfare spending**, at cash levels set out by the Treasury for each year from 2016-17 to 2020-21 in the July 2015 Budget.

5.6 In this chapter, we assess the Government's performance against the current targets and provide an update on how our central forecast compares with the requirements of the targets that preceded them. As we are tasked with assessing the Government's performance against the welfare cap formally only once a year alongside the Autumn Statement, we provide only an update in this *EFO*. On our central forecast, the Government is on course to meet its fiscal mandate but to miss its supplementary target. The previous fiscal mandate and supplementary target would have been met. Welfare cap spending is forecast to exceed the formal ceiling in every year, and by more than the 2 per cent forecast margin in all years. We would therefore not change our November 2015 assessment that the terms of the welfare cap have been breached.

The implications of our central forecast

5.7 Table 5.1 shows our central forecasts for the fiscal aggregates relevant to the current and previous fiscal targets: public sector net borrowing (PSNB); public sector net debt (PSND); spending subject to the welfare cap; and the cyclically adjusted current budget deficit (CACB). These forecasts are described in detail in Chapter 4. They are median forecasts, so we believe it is equally likely that outturns will come in above them as below them.

Table 5.1: Fiscal aggregates relevant to the Government's fiscal targets

	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Fiscal mandate: Public sector net borrowing							
November forecast	5.2	3.9	2.5	1.2	0.2	-0.5	-0.6
March forecast	5.0	3.8	2.9	1.9	1.0	-0.5	-0.5
Supplementary target: Public sector net debt							
November forecast	83.1	82.5	81.7	79.9	77.3	74.3	71.3
March forecast	83.3	83.7	82.6	81.3	79.9	77.2	74.7
Spending subject to the welfare cap (£ billion)							
November forecast	119.3	120.9	119.2	117.7	115.9	115.3	117.1
March forecast	119.3	120.4	119.8	118.0	116.4	116.2	118.1
Previous fiscal mandate: Cyclically adjusted current budget deficit							
November forecast	2.4	1.6	0.5	-0.5	-1.2	-1.9	-2.4
March forecast	2.4	1.8	0.9	0.2	-0.5	-2.0	-2.4

The fiscal mandate

5.8 The Government's fiscal mandate requires it to achieve an overall budget surplus (in other words, that PSNB must be negative) in 2019-20 and each year thereafter. In the absence of any policy measures in this Budget, the Government would have been on course for small deficits in 2019-20 (£3.2 billion) and 2020-21 (£2.0 billion), breaching the fiscal mandate.

5.9 But the Government's Budget policy measures raise £13.7 billion in 2019-20 and £13.1 billion in 2020-21, broadly offsetting the deterioration in the underlying forecast and putting it back on course to meet the surplus target by £10.4 billion and £11.0 billion respectively. We therefore judge that the Government is more likely than not to meet its target on existing policy, but with a margin that is small in comparison with the uncertainty that surrounds our fiscal forecast at that horizon.

5.10 How has the Government maintained its surplus in 2019-20? Chart 5.1 shows that it has:

- cut its limit on **departmental current spending** by £2.3 billion (which we estimate would translate into an actual spending cut of £1.8 billion as departments underspend their budgets by less). The Government says that this £2.3 billion gross cut – together with £1.9 billion of new spending commitments in areas such as lengthening the school day, full 'academisation' of state schools and improving flood defences – will be funded from a £0.7 billion cut in overseas aid and £3.5 billion of as-yet unidentified cuts to be generated by an 'efficiency review' that will report in 2018;

- the Government has also placed an additional £2.0 billion a year squeeze on departments in that year by raising planned **public service pension contributions**, in line with a lower discount rate, but not compensating them for the additional costs they will face. This reduces borrowing by displacing other departmental spending within existing expenditure limits, while reducing net spending on public service pensions;

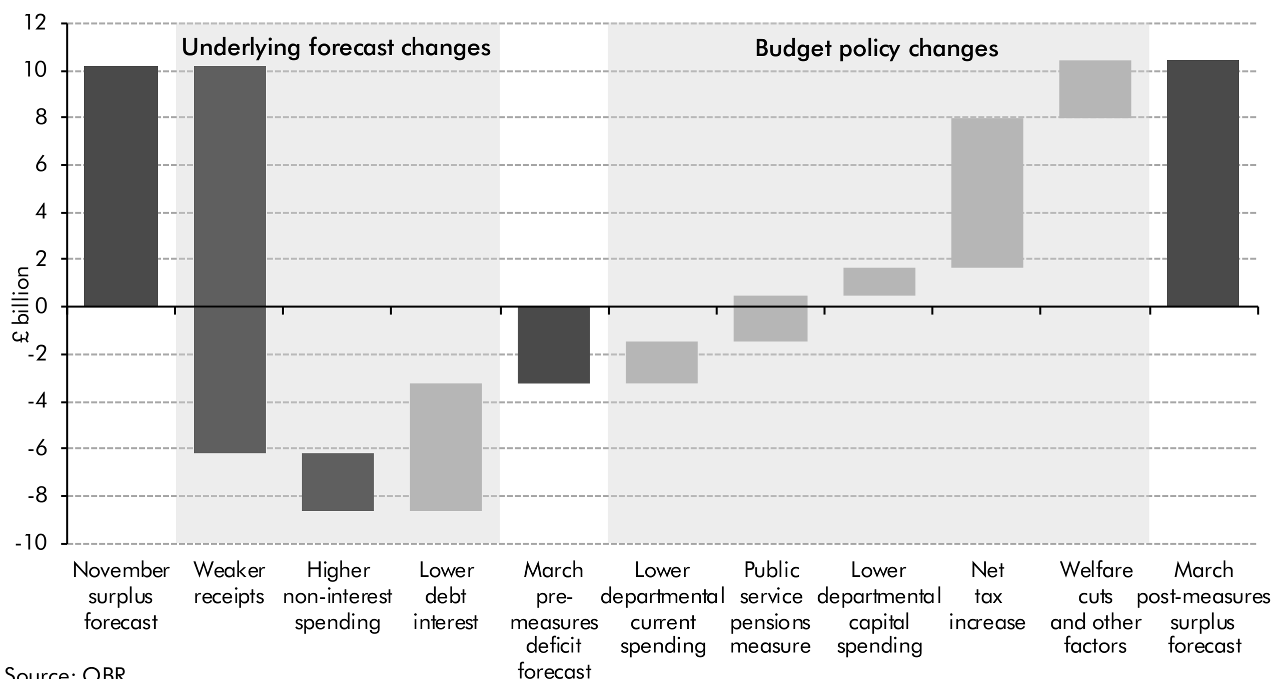
- cut its limit on **departmental capital spending** by £1.2 billion, largely by bringing £1.6 billion forward from the 2019-20 target year to 2017-18 and 2018-19, which it describes as "accelerating investment plans". We assume that £0.2 billion of the spending brought forward to 2018-19 will in reality slip back into 2019-20. There are also £0.2 billion of new spending commitments, for example to ease congestion on the M62;

- announced a net **tax increase** of £6.3 billion in 2019-20, although across the forecast as a whole Budget tax measures *reduce* receipts by £0.7 billion a year on average. All but £300 million of this increase reflects the Government's decision to delay the July Budget measure that brings forward the timing of large firms' quarterly corporation tax payments "to give businesses more time to prepare". This also boosts receipts by £3.6 billion in 2020-21 (but not at all thereafter). However, combined with an additional net cut in other (mostly business) taxes taking effect in 2020-21, this gives a much more modest overall net tax increase in that year of £0.8 billion. So the Government

needs a much bigger cut in current departmental spending in 2020-21 – £8.1 billion compared to £1.8 billion in 2019-20 – to achieve the surplus it wants; and

- cut **welfare spending** by £1.4 billion in 2019-20, largely through a further tightening of the disability benefits system. **Other factors** include a small boost to receipts from easing fiscal tightening over the next two years.

Chart 5.1: Changes to public sector net borrowing in 2019-20



Source: OBR

5.11 The budget balance is now expected to move from a deficit of 3.8 per cent of GDP this year to a surplus of 0.5 per cent in 2019-20. As Chart 5.2 illustrates, the main factors that contribute (negatively and positively) to this 4.3 per cent of GDP improvement include:

- relatively small increases in **debt interest** spending (0.2 per cent of GDP). Interest rates are assumed to rise in line with market expectations, but these remain well below historical averages by the end of the forecast period;

- a small increase in **capital spending** (0.1 per cent of GDP). As noted above, capital spending in 2019-20 has been reduced by moving some spending forward to earlier years, thereby boosting the surplus in the target year;

- a small decrease in **annually managed expenditure (AME) other than on debt interest and welfare** (0.2 per cent of GDP). The declining path we forecast for housing associations' capital spending explains much of this fall;

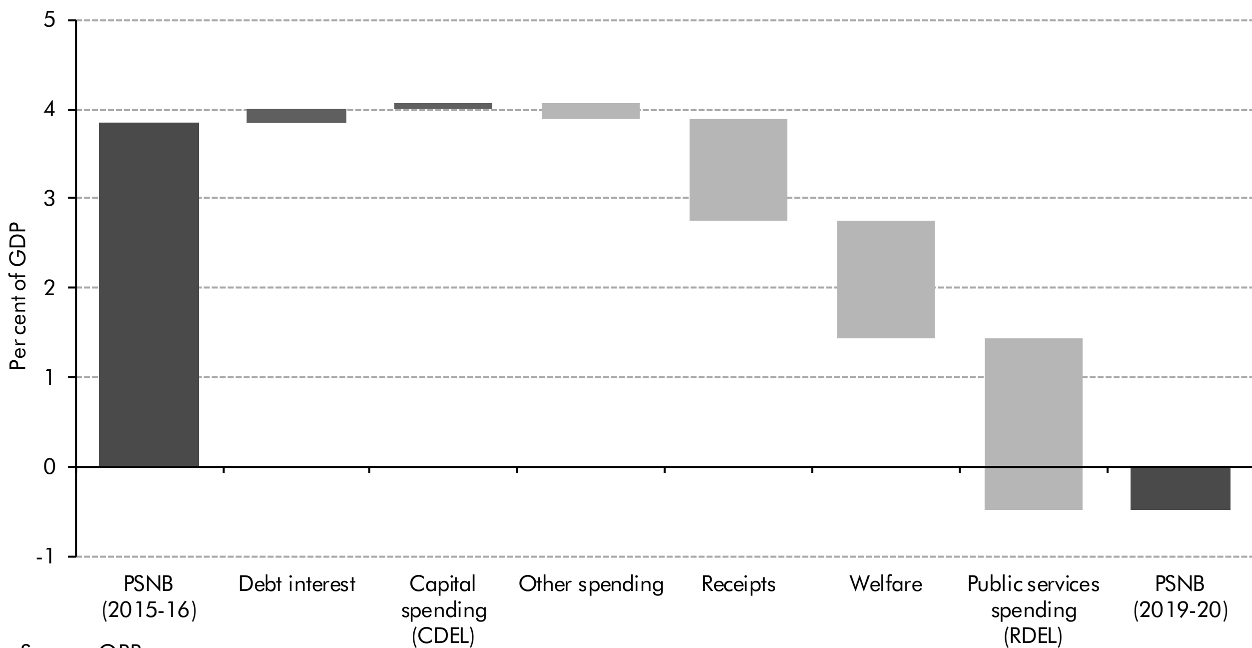
- a 1.1 per cent of GDP rise in **receipts**. This is largely explained by a rise in the tax-to-GDP ratio, as the NICs contracting out rebate is abolished in 2016-17 and as a return to (subdued) real earnings growth pulls more income into higher tax brackets over

time. In 2019-20 the tax-to-GDP ratio is increased by the one-off boost to corporation tax receipts from the quarterly instalment payments policy measure described above. Higher receipts also reflect a 0.2 per cent of GDP rise in interest and dividend receipts on the government's stock of financial assets as interest rates rise;

- a 1.3 per cent of GDP fall in **welfare spending**. This mostly reflects average awards rising more slowly than earnings. Spending subject to the welfare cap accounts for 1.1 per cent of GDP of the fall, while spending outside falls by just 0.2 per cent of GDP. State pensions continue to be uprated with the triple-lock, so – unlike most working-age benefits – average awards do not fall relative to earnings. State pension spending thus falls only slightly as a share of GDP as the pension age continues to rise; and

- a 1.9 per cent of GDP cut in **day-to-day spending on public services and administration**, reflecting the Government's November Spending Review plans and the further cuts in 2019-20 set out in this Budget.

Chart 5.2: Sources of deficit reduction from 2015-16 to 2019-20



Source: OBR

5.12 The fiscal mandate then requires a headline budget surplus in all subsequent years, subject to the economy not being hit by a negative shock. This is ambitious relative to the performance of past governments. The public sector has run a surplus in only five of the last 40 years – and in four of those years that was only because economic activity was running above its sustainable level (at least with the benefit of hindsight). Our central forecast of structural budget surpluses of 0.5 per cent of GDP in 2019-20 and 2020-21 would equal the largest in the past 40 years for which we have estimated the structural fiscal position – matching the 0.5 per cent achieved in 2000-01.

The negative shock threshold

5.13 Beyond 2019-20, the Government's fiscal targets only apply if we confirm that the UK economy is not expected to experience a 'negative shock' – defined by the Government as real GDP growth of less than 1 per cent on a rolling 4 quarter-on-4 quarter basis.[1] As described in Chapter 3, we expect the economy to be growing at a rate consistent with its underlying potential in the final year of the forecast, so we are not forecasting a negative shock on the Government's definition after 2019-20. But, based on past official forecast errors (as used in the fan charts we present in our *EFOs*), our central forecast nonetheless implies that there is around a 35 per cent chance that GDP growth will be below 1 per cent in 2020, in which case we would also expect the budget balance to be weaker.

The previous fiscal mandate

5.14 As in our November forecast, the previous target to achieve cyclically adjusted current balance (CACB) by the third year of the forecast period (2018-19 in this forecast) would be met. We forecast the CACB will move from deficit in 2017-18 to a surplus of 0.5 per cent of GDP in 2018-19. The surplus in 2018-19 has been revised down by 0.7 per cent of GDP since November, reflecting the structural fiscal hit associated with the downward revision we have made to trend productivity growth in this forecast.

The supplementary target

5.15 The supplementary target requires public sector net debt (PSND) to fall as a share of GDP in every year to 2019-20. The previous target required PSND to fall as a share of GDP between 2015-16 and 2016-17, with that year fixed. In November, we expected PSND to fall as a share of GDP in every year of the forecast, so that in our central forecast the Government was on course to meet both the current and the previous supplementary targets. We now expect the debt-to-GDP ratio to rise between 2014-15 and 2015-16, thereby missing the current supplementary target. But we still expect it to fall between 2015-16 and 2016-17, so the previous target would have been met. It is also forecast to fall in each year thereafter.

5.16 Chart 5.3 decomposes the year-on-year changes in the debt-to-GDP ratio that we expect to see over the forecast period. It shows that in 2015-16 the ratio rises by 0.4 per cent of GDP. A primary deficit of 2.1 per cent of GDP and net lending to the private sector (the largest element of which is student loans) of 0.8 per cent push net debt higher as a share of GDP. This is only partly offset by the proceeds from a number of large financial asset sales (1.7 per cent of GDP), the effect of issuing government bonds at a premium to their nominal value (0.6 per cent) and the effect of sterling depreciation on the value of the UK's foreign exchange reserves (0.5 per cent). As described in Chapter 4, the reserves effect is a peculiarity of the PSND calculation, since in reality the reserves are largely hedged against currency movements so that their hedged sterling value is not subject to big fluctuations.

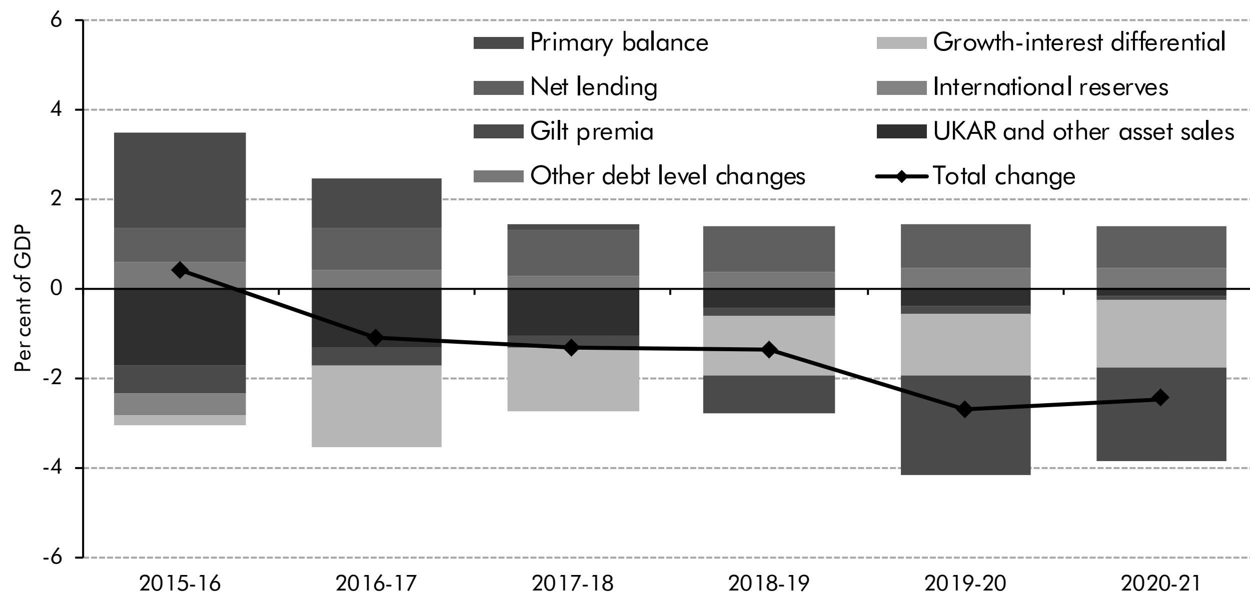
[1] In Chapter 5 of our November 2015 *EFO*, we looked back at how GDP growth over the past six decades and how it would have related to this threshold. It showed that it would have been triggered in four distinct episodes, with two coinciding with recessions (where those were associated with tighter domestic macroeconomic policy attempting to reduce domestic inflation) and two following soon after recessions (where global economic shocks led to more abrupt falls in output).

Unusually in the current low interest rate environment, the growth-interest rate differential – a key component of public sector debt dynamics – makes only a very small negative contribution to the change in net debt this year.

5.17 From 2016-17 onwards, Chart 5.3 shows that:

- changes in the year-on-year profile typically reflect the steady expected improvement in the **primary balance** (a measure of the deficit excluding interest payments). But the debt-to-GDP ratio falls in 2016-17 despite a primary deficit of 1.1 per cent of GDP;
- significant **financial asset sales** continue to reduce PSND each year, by diminishing amounts. Our latest estimates of these sales are described from paragraph 4.158 in Chapter 4. The biggest effect is in 2016-17, when additional UKAR asset sales, the postponed Lloyds share sales and further RBS share sales are sufficient to push the debt-to-GDP ratio down despite the remaining primary deficit. (Financial asset sales typically bring forward cash that would otherwise have been received in future revenues, in the shape of mortgage repayments and dividends, so they only reduce the debt-to-GDP ratio temporarily. In broad terms, financial asset sales leave the public sector's net worth unchanged. When the Government gives away some of the assets that it is disposing of, as with the disposal of Royal Mail shares last year and the planned retail offering of Lloyds shares in 2016-17, the sale raises less than the asset is worth and the public sector's net worth is reduced);
- the fact that **nominal GDP growth exceeds expected interest rates** would, all else equal, be sufficient for debt to fall by 1.8 per cent of GDP in 2016-17 and by 1.5 per cent of GDP in 2020-21. This differential is an extremely important component of public sector debt dynamics, especially over longer timeframes. In our *Fiscal sustainability reports*, we analyse the impact of different assumptions on our results;
- **net lending to the private sector** – mainly student loans, but also through schemes like Help to Buy – 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**, including those associated with the Asset Purchase Facility's (APF) balance sheet and various timing effects, are fairly constant. 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 5.3: Year-on-year changes to the debt-to-GDP ratio



Source: OBR

5.18 Table 5.2 decomposes the changes in the profile of net debt since our November forecast. It shows that the reason we now expect PSND to rise as a share of GDP in 2015-16 largely reflects the denominator in the calculation: non-seasonally adjusted nominal GDP growth in the year centred on the end of March 2016.

5.19 In November, we expected the cash level of PSND at the end of 2015-16 to be 3.5 per cent (£54 billion) higher than a year earlier. Thanks to higher expected gilt premia and a rise in the sterling value of the UK's foreign exchange reserves as recorded for PSND, we now expect the rise to be slightly smaller at 2.8 per cent (£44 billion) despite £4½ billion of Lloyds share sales having been postponed. But at the same time we have revised down growth in the denominator by much more: from 4.3 per cent (£79 billion) in November to 2.3 per cent (£43 billion). So, despite a lower cash increase, PSND is expected to rise by 0.4 per cent of GDP rather than falling by 0.6 per cent.

5.20 The downward revision to growth in the denominator largely reflects weakness in the latest ONS estimates of GDP deflator growth over the past year, which has knock-on effects to our forecast for 2016, plus some more technical factors (as explained in Box 4.1 in Chapter 4). In broad terms, around three-quarters of the revision reflects weakness in headline nominal GDP growth (thanks largely to a wider trade deficit and weak investment) and a quarter is due to changes in the implied seasonal pattern of GDP through the year (with the ONS having revised away a pattern that in November we had noted looked unusual).

5.21 From 2016-17 onwards, the table shows that:

- with the exception of 2016-17, the downward revision to our trend **productivity growth** assumption feeds through to lower nominal GDP growth, which has reduced the pace at which debt falls relative to GDP;

- the large upward revision to our **pre-measures borrowing forecast** has also reduced the pace at which debt falls. That is partly offset by the effect of Government decisions on borrowing, particularly towards the end of the forecast;

- changes to our forecast of **financial asset sales** have slowed the pace of decline in most years, reflecting the postponement of the Lloyds share sales into 2016-17 and the significant fall in the RBS share price since November reducing the proceeds from the Government selling its remaining stake over this Parliament. Partly offsetting those changes are further active asset sales by UKAR in 2016-17 and 2017-18 (on top of the natural rundown of its mortgage assets);

- movements in expected **gilt premia** push PSND down in every year of the forecast, with the further fall in gilt yields since November implying issuance at greater premia; and

- changes to **other factors**, including government lending to the private sector and APF balance sheet effects, have been subject to relatively small revisions that are uneven from year-to-year.

Table 5.2: Changes in the profile of net debt since November

	Per cent of GDP					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast	-0.6	-0.7	-1.8	-2.6	-3.0	-3.0
March forecast	0.4	-1.1	-1.3	-1.4	-2.7	-2.5
Change	**1.0**	**-0.4**	**0.5**	**1.3**	**0.3**	**0.5**
of which:						
Nominal GDP[1]	1.6	-0.1	0.2	0.2	0.2	0.1
Pre-measures borrowing	-0.1	0.3	0.3	0.6	0.6	0.7
Effect of Government decisions on borrowing	0.0	-0.1	0.3	0.2	-0.6	-0.6
UKAR asset sales and rundown	0.0	-0.4	-0.4	0.2	0.2	0.1
Other financial asset sales	0.2	-0.1	0.0	0.0	0.0	0.2
Foreign exchange reserves	-0.5	0.0	0.0	0.0	0.0	0.0
Gilt premia	-0.1	-0.1	0.0	-0.1	0.0	0.0
Other factors	0.0	0.1	0.0	0.1	0.0	0.0

[1]GDP is centred end-March.

The welfare cap

5.22 The welfare cap was initially set in line with our March 2014 forecast for the items of spending that are subject to it. As required under the *Charter*, the welfare cap was reset for this Parliament at the July 2015 Budget, where the Government chose to set it at our then post-measures forecast. This locked in a reduction in the level of the cap that reached £16.3 billion by 2019-20. The Government sets a 2 per cent forecast margin above the cap, which can be used if our forecast judgements push up expected spending, but cannot be used to accommodate policy measures that increase spending. We are required to assess the Government's performance against the cap formally at each Autumn Statement. In November 2015, we reported that the Government had breached the terms of the cap. In

this *EFO*, we provide an update on performance against the cap, but will not make another formal assessment until the next Autumn Statement.

Performance against the welfare cap

5.23 Based on the forecasting and policy changes described below, Table 5.3 shows our forecast for spending subject to the welfare cap in each year to 2020-21. It shows that spending remains above the welfare cap in all years and above the forecast margin in all years. On this basis, our November 2015 assessment that the cap has been breached would still hold.

Table 5.3: Performance against the welfare cap

	£ billion				
	Forecast				
	Welfare cap period				
	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare cap set in July 2015					
Welfare cap	115.2	114.6	114.0	113.5	114.9
2 per cent forecast margin	2.3	2.3	2.3	2.3	2.3
Latest forecast and changes since November 2015					
November forecast	119.2	117.7	115.9	115.3	117.1
March forecast	119.8	118.0	116.4	116.2	118.1
Change	**0.6**	**0.3**	**0.6**	**0.9**	**1.1**
of which:					
Forecasting changes	**0.6**	**1.1**	**2.0**	**2.4**	**2.6**
Disability benefits	0.3	0.8	1.3	1.5	1.4
Incapacity benefits	0.2	0.3	0.3	0.4	0.4
Carer's allowance	0.2	0.3	0.3	0.4	0.4
Universal credit	0.1	0.1	0.3	0.4	0.3
Personal tax credits	-0.3	-0.4	-0.2	-0.2	0.0
Attendance allowance	0.1	0.1	0.2	0.2	0.3
Tax free childcare	0.0	-0.1	0.0	-0.1	-0.1
Other factors	0.2	0.0	-0.2	-0.2	-0.2
Classification changes	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Scorecard measures	**0.0**	**-0.7**	**-1.3**	**-1.5**	**-1.5**
Indirect effects of Government decisions	**0.0**	**-0.1**	**-0.1**	**0.0**	**0.0**
Difference from welfare cap	**+4.6**	**+3.4**	**+2.5**	**+2.7**	**+3.2**
Difference from welfare cap + forecast margin	**+2.3**	**+1.1**	**+0.2**	**+0.4**	**+0.9**

Forecasting changes

5.24 As the 2 per cent margin can be used for forecasting reasons, but not for policy reasons, we need to track the sources of changes to our welfare cap spending forecast in order to assess performance against it. Since November we have revised up expected spending on a number of benefits, most notably disability benefits but also incapacity benefits, attendance allowance and carer's allowance. We have revised down spending on tax credits. These changes – particularly the rise in spending on disability benefits resulting from the latest evidence on PIP reassessments (described in Chapter 4) – mean that forecasting changes have further increased the amount by which spending is expected to exceed the welfare cap and the forecast margin above it.

Policy changes

5.25 The Government has announced a number of policy measures in the Budget that reduce spending subject to the welfare cap. The biggest is the reduction in the number of points awarded on the basis of 'aids and appliances' in the PIP assessment, reducing welfare cap spending by £1.3 billion in 2019-20 and 2020-21.

Classification changes

5.26 The *Charter* requires that fiscally neutral classification changes of spending subject to the cap into departmental expenditure limits (DEL) must be accompanied by an adjustment of the cap, although it does not specify when that change must take place. The Treasury has informed us that the fees associated with the administration of tax-free childcare, which had previously been captured in the relevant welfare cap spending line, were transferred into HMRC's DEL in the Spending Review. Given that there has been no underlying change in welfare cap spending, we therefore expect the cap to be reduced by £0.1 billion a year on average. The Treasury has advised us that it intends to make that adjustment at the next Autumn Statement.

Risks to performance against the welfare cap

5.27 Developments in the economy – notably in the labour and housing markets – pose important risks to our welfare spending forecast. Typically, inflation would also be an important source of risk, because the welfare cap is set in cash terms and changes in inflation typically feed through to spending via uprating. But the four-year freeze on the uprating of most benefits subject to the cap means that, for most of the forecast period, welfare cap spending will be relatively insensitive to changes in inflation.

5.28 We highlighted other key sources of uncertainty – and therefore risks to the forecast – in our 2015 *Welfare trends report*. These in particular related to reforms to incapacity and disability benefits, and the rollout of universal credit. We have had to make a succession of large revisions to our forecasts of incapacity benefits as the rollout of reassessments has continued to disappoint against the assumptions in our forecast. In this forecast, we have again revised up spending on disability benefits due to a higher than expected proportion of reassessments resulting in an award, and those awards being higher on average than had been assumed. The evidence on which our latest forecast is based remains a relatively early sample of actual reassessments, so considerable uncertainty remains. It is a concern for us that, despite repeated and often large revisions, we cannot be certain whether we have reached a point where the risks to our forecast are balanced.

5.29 We have attempted to apply the lessons of this significant underperformance in scrutinising the aids and appliances policy costing included in this forecast, but the experience of recent years illustrated the uncertainty that surrounds such estimates. As reported in Annex A, we have assigned a 'medium-high' uncertainty rating to this costing.

5.30 The lessons from the rollout of incapacity and disability benefits reforms highlight the even greater uncertainty that must be associated with our forecast of universal credit spending.

Forecasting the impact of universal credit requires capturing changes in six legacy benefits within an entirely new benefit, where the timing of the transition from legacy benefit to universal credit has large effects on spending. Modelling these effects is a significant challenge that requires the transfer of data, expertise and evolving policy designs across departments. As set out in Chapter 4, we continue to work with DWP on how best to forecast universal credit, but this should be considered one of the largest sources of uncertainty in our forecast for welfare spending.

Recognising uncertainty

5.31 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. The size and composition of the remaining fiscal consolidation – and its impact on national income and spending – create additional uncertainty.

5.32 Given these uncertainties, it is important to stress-test our judgements about the Government performance against its fiscal targets. We do this in three ways:

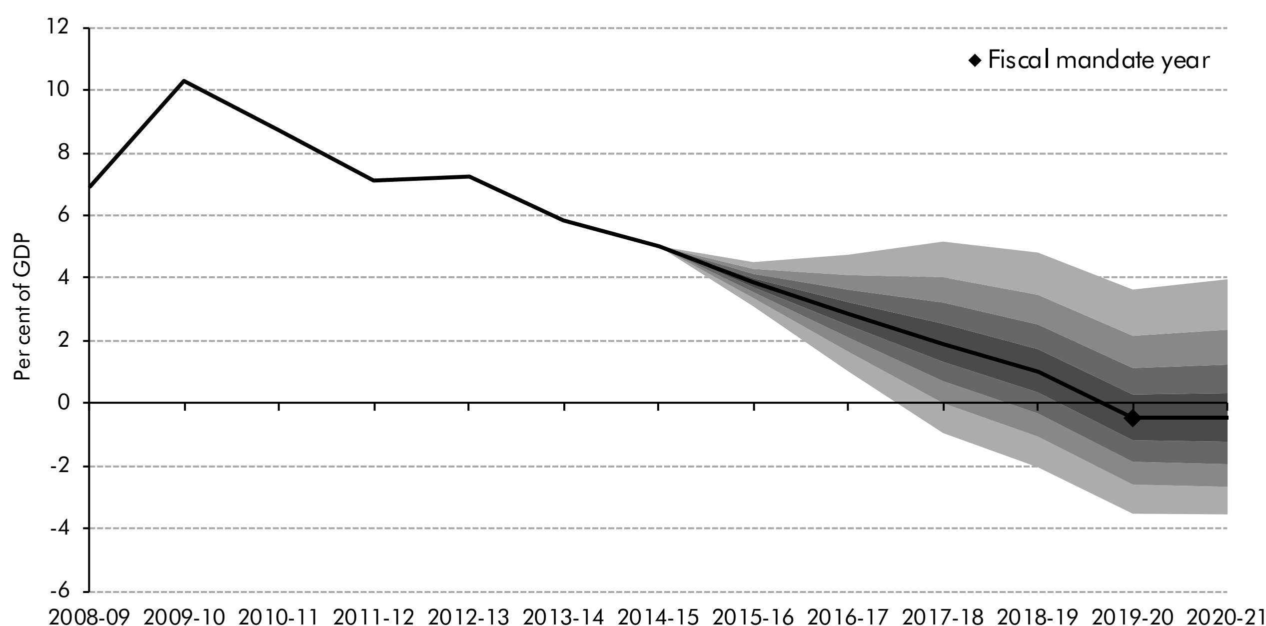
- by looking at the evidence from past forecast errors;
- by seeing how our central forecast would change if we altered some of the key judgements and assumptions that underpin it; and
- by looking at alternative economic scenarios.

Past performance

5.33 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 that we presented for GDP growth in Chapter 3. The 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.

5.34 Chart 5.4 shows our central forecast for PSNB on the same basis. Again, a direct reading of the chart would imply that the probability that PSNB will reach balance rises from 20 per cent in 2017-18 to 35 per cent in 2018-19, then to 55 per cent in 2019-20 and 2020-21. The Government therefore has a small margin against its fiscal mandate. It is notable that the £13.7 billion revision to our pre-measures PSNB forecast in 2019-20 was equivalent to moving only 20 percentage points through the fan chart distribution, but that – absent the Government's policy response – this would have been sufficient to move from above to below 50 per cent chance of meeting the target.

Chart 5.4: Public sector net borrowing fan chart



Source: ONS, OBR

5.35 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 rising in 2015-16 and falling in each year thereafter, implying a less than 50-50 chance that the supplementary target will be met since it requires the ratio to be falling in every year. 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

5.36 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 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.

5.37 In thinking about the evolution of the public finances over the medium term, there are several parameters that have an important bearing on the forecast. Here we focus on:

- the **sensitivity of the fiscal mandate** headline surplus measure to changes to the level of GDP, inflation, interest rates and effective tax rates; and
- the **sensitivity of the supplementary debt target** to differences in the level of debt or the growth rate of the economy, which both affect how debt changes from year-to-year as a share of GDP (as has been illustrated by the revision to the debt-to-GDP profile in 2015-16 in this forecast).

The fiscal mandate

5.38 We have already shown that, on the basis of past forecast errors, there is a 45 per cent probability that the budget will be in deficit rather than surplus in 2019-20. There are many reasons why we could see such an outcome. For example, economic developments could be less favourable than we forecast or we could be wrong about prospects for receipts or spending for a given state of the economy. And while our forecasts are conditioned on current Government policy, that may also evolve over time.

5.39 In Annex B of our March 2015 *EFO*, we presented a range of ready-reckoners that show how the public finances could be affected by changes in selected economic determinants of our fiscal forecast. It is important to stress that these were stylised quantifications that reflect the typical impact of changes in variables on receipts and spending. They are subject to significant uncertainty. But with those caveats in mind, we can use these ready-reckoners to calibrate a number of possible negative surprises relative to our central forecast that would be sufficient to push the budget from surplus to deficit in 2019-20. Where possible, we assess the probability of such a surprise on the basis of past forecast errors.

5.40 This analysis suggests that the 0.5 per cent of GDP surplus in 2019-20 could fall to zero if:

- there was a **negative output gap** of 0.7 per cent or **potential output** was 1.0 per cent lower. Swings in the output gap have a larger effect since we assume that these also drive changes in asset prices, which have geared effects on receipts. As the scenario analysis below illustrates, the composition of any shock to potential output can affect these sensitivities, with a productivity-driven shock likely to have a greater impact than an employment- or population-driven shock;

- **whole economy prices** rise by 1.2 per cent less than expected. This is important because receipts are linked to nominal tax bases and thus rise and fall with prices (slightly more than proportionately). However, much public spending is fixed in nominal terms in Spending Reviews or relatively insensitive to prices (e.g. much of debt interest on conventional gilts is based on the stock that has already been accumulated, on which interest rates are fixed). That is particularly true in our current forecast since most working-age welfare spending is subject to a four-year freeze on uprating;

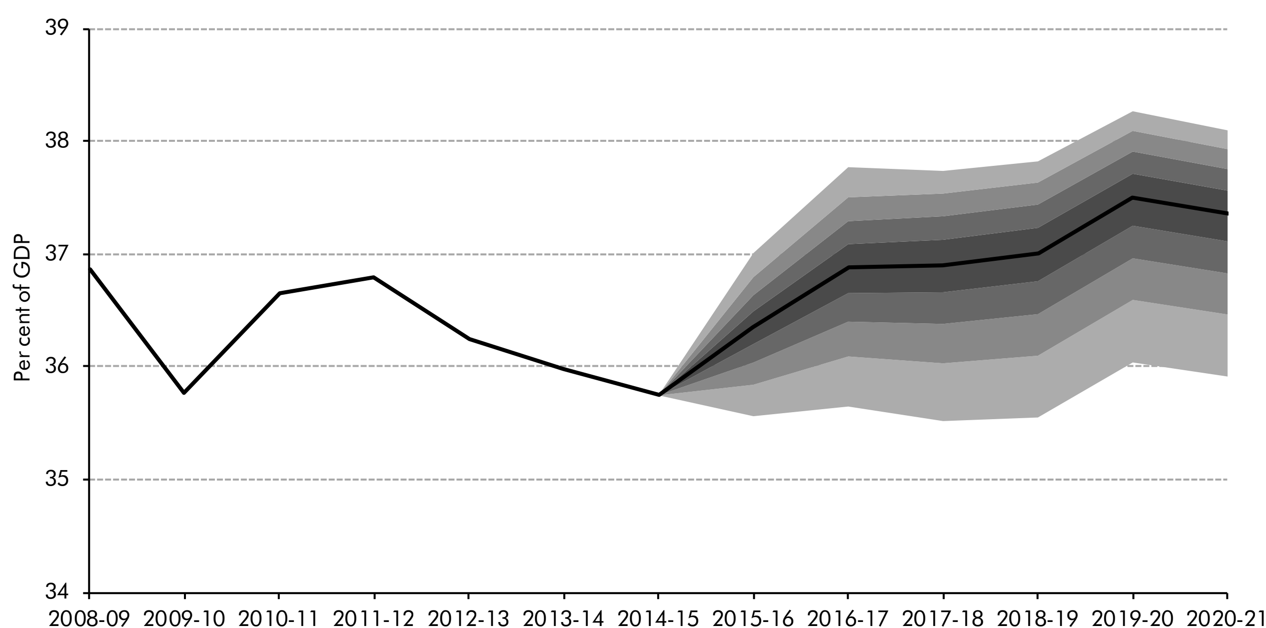
- higher **interest rates** pushed up debt interest spending. If interest rates were 1.2 percentage points above market expectations by 2019-20, this would be sufficient to add 0.5 per cent of GDP to spending on debt interest. Such an effect would not happen in isolation – for example, a boost to interest receipts on the government's stock of financial assets would partly offset higher debt interest;

- the **effective tax rate** – as measured by the tax-to-GDP ratio – was 0.5 per cent of GDP lower than in our central forecast. This could be because the composition of GDP was less tax rich than expected, or asset markets underperformed our assumptions, or the income distribution was skewed towards people with lower effective tax rates. Chart 5.5 presents a fan chart for receipts as a share of GDP using a similar methodology to

that used in the PSNB fan chart above. It suggests there is a 35 per cent chance that receipts could be 0.5 per cent of GDP lower than forecast;

- planned **spending cuts** – which reduce RDEL by 1.9 per cent of GDP between 2015-16 and 2019-20 in our forecast – fell short by around a quarter; and
- a jump in **RPI inflation** could increase accrued interest on index-linked gilts. Taken in isolation, if RPI inflation was 2.2 percentage points higher than expected in 2019-20, that alone would add 0.5 per cent of GDP to debt interest costs. Based on past forecast errors, there would be around a 10 per cent probability of that happening. Of course, this sort of shock to inflation would be likely to have other material effects on the public finances.

Chart 5.5: Receipts fan chart



Source: ONS, OBR

The supplementary debt target

5.41 The supplementary debt target is focused on year-on-year changes in the debt-to-GDP ratio. Table 5.4 shows how our central forecast for a 2.7 per cent of GDP fall in PSND in 2019-20 would be affected by two sources of sensitivity: differences in the level of debt in the preceding year and by differences in growth in 2019-20. We use cyclical adjustment coefficients to estimate the effect of GDP growth shocks on borrowing, but do not vary interest rates, so that differences in the assumed GDP growth rate result in changes to the interest rate-growth rate differential. On that basis, the table shows that:

- in most cases, the extent to which debt falls in 2019-20 is inversely related to **the level of debt in the preceding year**. That counter-intuitive result is due to the low level of interest rates assumed in our central forecast, which means that the effect of GDP growth on the denominator in the debt-to-GDP ratio is greater than the effect of

interest rates on growth in the cash level of debt (via debt interest spending). The higher the starting level of debt, the more the denominator effect outweighs the interest rate effect. It is only the bigger negative growth shocks that see the growth rate fall close to the interest rate. When they are similar (which would be the case if growth was around 2 percentage points lower), the two effects cancel out. When the growth rate is lower than the interest rate, the extent to which debt falls is positively related to the level of debt in the preceding year; and

- as expected, negative **shocks to GDP growth** reduce the extent by which debt falls as a share of GDP and positive shocks increase it. The year-on-year change in the debt-to-GDP ratio is more sensitive than the deficit to GDP shocks, because it is affected both by the deficit channel (which drives the accumulation of debt in that year) and by the denominator channel (which means the previous year's cash debt is divided by a different level of nominal GDP).

Table 5.4: Illustrative debt target sensitivities in 2019-20

		Year on year change in the PSND-to-GDP ratio in 2019-20					
		Difference in GDP growth in 2019-20 (percentage points)					
		-3	**-2**	**-1**	**0**	**+1**	**+2**
Difference in the level of PSND in 2018-19 (per cent of GDP)	**-20**	1.5	0.2	-1.1	-2.4	-3.6	-4.9
	-10	1.6	0.2	-1.2	-2.5	-3.9	-5.2
	+0	1.7	0.2	-1.2	**-2.7**	-4.2	-5.6
	+10	1.8	0.2	-1.3	-2.9	-4.4	-5.9
	+20	2.0	0.3	-1.4	-3.1	-4.7	-6.3

Scenario analysis

5.42 The sensitivity analysis discussed above focuses on individual factors and therefore offers only a limited assessment of potential uncertainty. In this section, we set out the fiscal implications of 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.

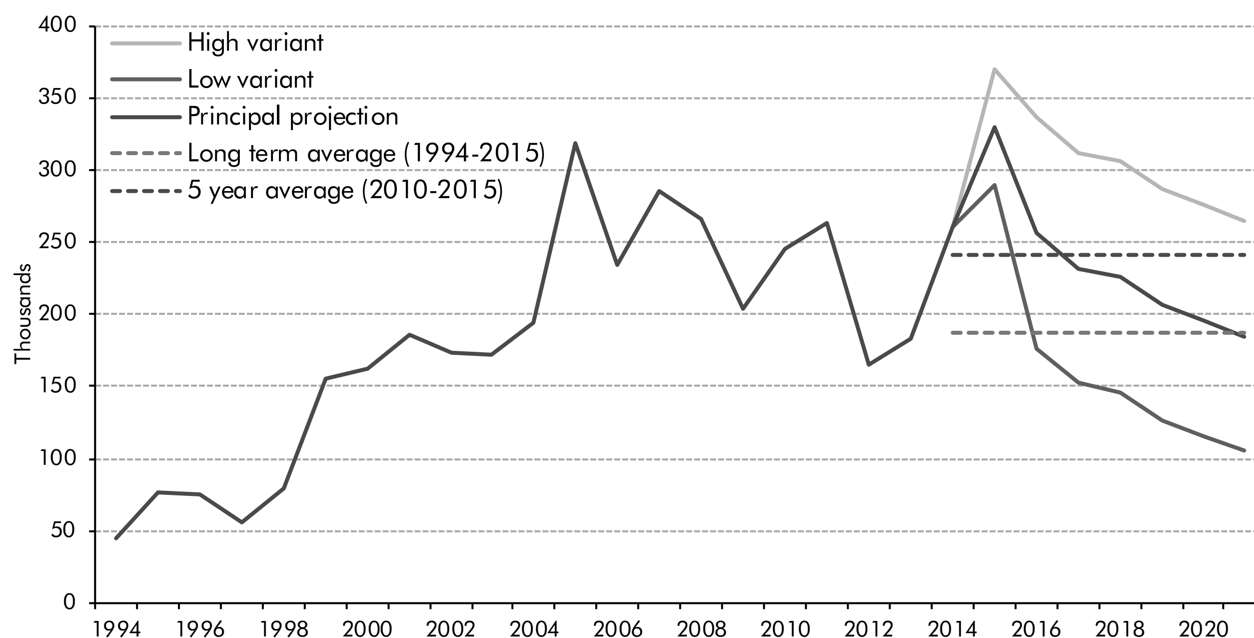
5.43 Net international migration to the UK is an important driver of the economy's underlying growth potential. It affects it directly (via population growth) and indirectly (by contributing to changes in the employment rate, average hours worked or underlying productivity growth). Net migration has accounted for over half of UK population growth over the past 15 years and the ONS projects that this will remain so over the five years of our forecast period. Net migration to the UK has typically been concentrated among people of working age, which the ONS assumes will continue over the coming years. That means net migration leads to a higher employment rate and lower dependency ratio than would otherwise be the case.

5.44 In our central forecast, we capture the effects of net migration on population growth and the employment rate, while assuming that it has no effect on underlying productivity growth.

The latest data reported net international migration to the UK of 323,000 in the year to September 2015. Our central forecast is based on the ONS principal population projection, which assumes 329,000 in 2015 and 256,000 in 2016, declining to 185,000 in 2021 – close to the average of the past 20 years, but much lower than in the past five years.

5.45 To illustrate the effect of different net migration assumptions, we consider the effects on our economy and fiscal forecast of three alternative ONS population projections: 'high migration', 'low migration' and 'zero net migration' (or 'natural change'). The principal projection and the high and low variants are shown in Chart 5.6. Even under the low scenario, net inward migration does not quite drop into the 'tens of thousands' sought by the Government within the forecast period. We include the natural change scenario as a means of illustrating the short-term fiscal effects of demographic trends in the currently resident population, not to suggest it is a plausible scenario in the immediate future.

Chart 5.6: Past and projected net migration to the UK



Source: ONS, OBR

5.46 For the purposes of these scenarios, we have assumed that net migration affects potential output growth (via population and employment rate effects), but not the output gap. As such, while real and nominal GDP growth vary in each scenario, inflation, average earnings growth, interest rates and the unemployment rate are unchanged. We have, however, assumed that given the very low responsiveness of housing supply in the UK to changes in demand, changes in population growth will feed through to changes in house prices.

5.47 Relative to our central forecast, the main differences in the three scenarios are:

- in the **'high migration'** scenario, net inward migration falls to 265,000 by 2021. The population is 0.6 per cent higher by 2020 and the employment rate 0.1 percentage

points higher. That translates into potential output and nominal GDP 0.8 per cent higher. House prices are 1.3 per cent higher;

- in the **'low migration'** scenario, net inward migration falls to 105,000 by 2021.The population is 0.6 per cent lower by 2020 and the employment rate 0.1 percentage points lower. That translates into potential output and nominal GDP 0.8 per cent lower. House prices are 1.3 per cent lower; and

- in the **'zero net migration'** scenario the population is 1.5 per cent lower by 2020 and the employment rate 0.2 percentage points lower. That translates into potential output and nominal GDP 1.9 per cent lower. House prices are 3.0 per cent lower.

5.48 In assessing the fiscal implications, we have made the following key assumptions:

- net migrants to the UK on average have the same **age- and gender-specific characteristics** as the native population, with the same employment rates and productivity and the same net contributions to the public finances. These assumptions look reasonable at a whole economy level (as discussed in Annex A to our 2013 *FSR*), but what is true on average will of course not be true of every individual migrant;

- the impact of different migration assumptions on **receipts** is estimated using the age-specific profiles that underpin our *FSR* projections. For each scenario, we hold per capita receipts by age and gender fixed and use the demographic projection to estimate total receipts in each year;

- the impact of different migration assumptions on **welfare spending** is also modelled using age-specific profiles for tax credits, child benefit and social security spending administered by DWP. As inflation and earnings are unchanged across the scenarios, the impact on welfare spending is relatively small since only caseloads vary;

- **debt interest spending** is modelled using our debt interest ready reckoner (see Box 4.4 in Chapter 4), applied to the difference in borrowing relative to the central forecast. Since the interest paid on debt that has already been issued is fixed in cash terms, in per capita terms it varies negatively with changes in net migration – i.e. higher net migration spreads the cost of a given amount of debt interest across more people and vice versa; and

- **departmental expenditure limits (DEL)** are fixed in cash terms at the levels set out in the November Spending Review and this Budget, so changes in the size of the population do not affect the level of spending on public services or investment. This means that DEL spending on a per capita basis and as a share of GDP changes inversely with the assumed level of net migration. This is different to the assumption underpinning our long-term fiscal projections, where age- and gender-specific spending are held constant as a share of GDP so that demographic trends lead to changes in spending on age-related public services. But since the Government has set out departmental spending plans in cash terms for the next four years, and a cash total for 2020-21,

using our *FSR* assumption would not be consistent with 'unchanged government policy' for the purposes of these medium-term scenarios.

5.49 As we noted in Box 3.4 of our 2014 *FSR*, it is important to emphasise that just because we find that higher net inward migration is likely to improve the fiscal position, that does not mean that we are recommending that the Government should aim for more inward migration rather than less. This judgement lies outside our remit and for those that have to make it there are clearly other factors to consider beyond the impact of migration on the public finances via the age structure of the population. It would also be wrong to conclude from our analysis that the Government has to accept higher inward migration in order to put or to keep the public finances on a sustainable path. If a government succeeded in reducing net inward migration from what would otherwise occur then that would be likely to create additional fiscal pressures, but it could always choose to offset those pressures through additional spending cuts or tax increases.

5.50 Given the assumptions above, Table 5.5 sets out the main fiscal implication for each scenario on each Government's fiscal targets. It shows that:

- under the **'high migration' scenario** receipts would be higher in cash terms due to the larger population, but also slightly higher as a share of GDP due to the higher employment rate. In terms of the tax-to-GDP ratio, the main effect would come via income tax and NICs receipts. Spending would be higher in cash terms, again due to the larger and younger population feeding through to working-age welfare spending. However, it would be lower as a share of GDP, partly due to the lower dependency ratio affecting state pensions spending but more significantly because DELs are held flat in cash terms. In this scenario, PSNB and PSND would fall faster than in our central forecast. The fiscal mandate would be met by a margin £4½ billion larger in 2019-20 and £6 billion larger in 2020-21. Lower borrowing and higher surpluses would reduce debt interest spending by around 0.7 per cent (around 1.5 per cent on a per capita basis) by 2020-21. Since the improvement in the fiscal position would partly reflect DEL spending per capita being around 1 per cent lower, a government might choose to use some of that improvement to finance higher DELs, but we have not quantified such a response as we are not allowed to consider alternative policies. PSND would still rise in 2015-16, so the supplementary target would be missed, but it would fall more rapidly than in our central forecast in subsequent years. Welfare cap spending would remain significantly higher than the cap, as in our central forecast;

- under the **'low migration' scenario**, the effects described in the 'high migration' scenario would operate in reverse, with the tax-to-GDP ratio slightly lower and spending-to-GDP ratio slightly higher. The fiscal mandate would be met by a margin £4½ billion smaller in 2019-20 and £6 billion smaller in 2020-21. Debt interest spending would be around 0.8 per cent higher by 2020-21 (1.6 per cent higher in per capita terms). Mirroring the 'high migration' scenario, part of the deterioration in the fiscal position would reflect higher per capita DEL spending, which a government might choose to adjust. As in our central scenario, the supplementary target would be

missed because debt would rise as a share of GDP in 2015-16. Welfare cap spending would remain significantly higher than the cap, despite the smaller population; and

- under the **'natural change' scenario**, the effects on the public finances of a smaller and older population would be more significant. The tax-to-GDP ratio would be lower due to a lower employment rate, while non-interest spending would be significantly higher as a share of GDP because cash DELs are fixed and a higher proportion of the population receiving state pensions. Debt interest spending would be 1.5 per cent higher, offsetting the lower cash spending on items linked to the size of the population. As a consequence, the budget would be close to balance in 2019-20 and 2020-21, just missing the fiscal mandate by the end of the forecast period. But GDP growth in this scenario would remain above 1 per cent on a 4-quarter-on-4-quarter basis, so this would occur in 'normal times' as defined by the *Charter*. As in the other scenarios, the supplementary target would be missed and welfare cap spending would continue to exceed the cap.

5.51 These results illustrate the value of running full scenarios rather than relying on sensitivity analysis. The reduction in potential output in the 'low migration' scenario is of a similar size to that which the sensitivity analysis suggests would be sufficient to miss the surplus target, yet that scenario shows the surplus target still being met. The difference is that the top-down estimate will reflect the sensitivity of the budget balance to all aspects of potential output shocks – population, hours worked and productivity – according to how they have moved on average in the past. The scenarios focus on population-driven changes to employment, with productivity assumed to be unchanged. These have smaller implications for the tax-to-GDP ratio: employment-driven total wage growth is less tax-rich than earnings-driven total wage growth, because it lowers the average tax rate (as more people get tax-free personal allowances for example) rather than raising it (as fiscal drag pushes some people up a tax bracket). But as our long-term fiscal projections have illustrated, even relatively small differences over a medium-term horizon can be material over the long term.

5.52 The effects of these scenarios on the public finances are reasonably linear, so they can be scaled to provide an approximate illustration of different assumptions. For example, multiplying the results of the 'low migration' scenario by 1.5 would be illustrative of the impact on the public finances if net migration fell below 100,000 by 2019-20. On that basis, the surplus in 2019-20 would fall closer to zero. These results would remain subject to the important caveat that they reflect the age composition of migration assumed in the ONS population projections.

Table 5.5: Key economic and fiscal aggregates under alternative scenarios

	Per cent of GDP (unless otherwise stated)					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
	Central forecast					
Economic assumptions						
GDP growth	2.1	2.0	2.2	2.2	2.1	2.1
Fiscal outcome						
Public sector net borrowing (£ billion)	72.2	55.5	38.8	21.4	-10.4	-11.0
Public sector net debt	83.7	82.6	81.3	79.9	77.2	74.7
Difference from welfare cap (per cent)		4.0	2.9	2.2	2.4	2.8
Cyclically adjusted current deficit	1.8	0.9	0.2	-0.5	-2.0	-2.4
	High migration					
Economic assumptions						
GDP growth	2.1	2.2	2.3	2.3	2.3	2.3
Fiscal outcome						
Public sector net borrowing (£ billion)	72.2	54.7	36.9	18.4	-14.8	-16.9
Public sector net debt	83.7	82.5	81.0	79.3	76.2	73.3
Difference from welfare cap (per cent)		4.1	3.2	2.5	2.8	3.4
Cyclically adjusted current deficit	1.8	0.9	0.3	-0.4	-1.8	-2.1
	Low migration					
Economic assumptions						
GDP growth	2.1	1.9	2.0	2.0	1.9	1.9
Fiscal outcome						
Public sector net borrowing (£ billion)	72.2	56.3	40.6	24.5	-6.1	-5.2
Public sector net debt	83.7	83.0	81.9	80.8	78.3	76.1
Difference from welfare cap (per cent)		3.8	2.7	1.8	1.9	2.2
Cyclically adjusted current deficit	1.8	0.8	0.1	-0.7	-2.2	-2.6
	Natural change					
Economic assumptions						
GDP growth	2.1	1.7	1.7	1.7	1.7	1.7
Fiscal outcome						
Public sector net borrowing (£ billion)	72.2	57.0	42.5	27.7	-1.6	0.8
Public sector net debt	83.7	83.3	82.5	81.8	79.6	77.7
Difference from welfare cap (per cent)		3.2	1.8	0.8	0.6	0.7
Cyclically adjusted current deficit	1.8	0.8	0.0	-0.8	-2.3	-2.8

Executive summary

Overview

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 – a conclusion echoed in the European Commission's 2015 *Ageing Report*.

5 Separate from our central projections, we also look at the long-term sustainability of particular tax revenues. We have updated our assessment of the outlook for oil and gas receipts, which we have revised down again.

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 through sensitivity analyses, particularly relating to demographic trends and 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 2019-20. 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 on the public sector's balance sheet. We look at two presentations of the balance sheet: the National Accounts and the 2013-14 Whole of Government Accounts (WGA).

10 The last two governments 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. At the end of 2014-15, PSND was £1,484 billion, equivalent to 80.4 per cent of GDP or £55,600 per household. Our forecast for the level of PSND has risen since last year's *FSR*, but that revision reflects accounting changes implemented by the Office for National Statistics (ONS). We expect that – thanks to significant planned asset sales during 2015-16 – PSND will peak a year earlier than was forecast last year, in 2014-15.

11 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. More information on liabilities of this sort is available in the WGA, which are produced using commercial accounting rules.

12 According to the 2013-14 WGA, as of the end of March 2014:

- the net present value of future **public service pension payments** arising from past employment was £1,302 billion or 73 per cent of GDP. This is £130 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 – once again, a lower discount rate used to convert the projected flow into a one-off net present value has added to the measured liability;

- liabilities include £142 billion (8.0 per cent of GDP) in **provisions** for future costs that are expected (but not certain) to arise. Total provisions have increased by £11 billion since last year's WGA. As in last year's WGA, the two largest sources of provisions – for future nuclear decommissioning costs (particularly at Sellafield) and clinical negligence claims – increased significantly, by £7.6 billion and £3.0 billion respectively. Repeated and substantial increases in these provisions suggest they could become significant future pressures on public spending; and

- £63 billion (3.6 per cent of GDP) of quantifiable **contingent liabilities** had been identified – 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 £25 billion reduction compared with last year was more than accounted for by the removal of the £30 billion contingent liability associated with the

UK's capital subscription to the European Investment Bank and the cancellation of the £8 billion contingent capital facility available to the Royal Bank of Scotland (RBS). This was partly offset by a doubling of HMRC's contingent liability associated with ongoing tax litigation cases, after an adverse judgement in a 'lead' case that prompted a number of 'follower' cases to be classified as contingent liabilities.

13 Overall gross liabilities in the WGA increased by £264 billion over the year to reach £3,189 billion at the end of March 2014. 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.

14 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 £769 billion or 43.3 per cent of GDP at the end of March 2014. They have increased by £12 billion since last year's WGA. The overall net liability in the WGA was £1,852 billion or 104.4 per cent of GDP at the end of March 2014, up £224 billion on the previous year's restated results. This compares with PSND of £1,402 billion or 79.1 per cent of GDP at the same date.

15 One theme in this year's report is that the direct effects of the late-2000s financial crisis on the public sector balance sheet are now declining:

- the PSND inc measure of debt – which includes all net debt of the public sector banks, not just the government borrowing that financed purchase of equity in those banks – is now £0.3 trillion above the headline PSND ex measure, down from a peak of almost £1.5 trillion at the end of 2008. That reflects the public sector banks shrinking their assets and liabilities, but also Lloyds Banking Group being reclassified to the private sector as the Government has reduced its equity stake;

- the WGA contingent liabilities that the Government classifies as associated with financial sector interventions have fallen to £0.3 billion from £9.9 billion a year earlier, as the £8 billion contingent capital facility available to RBS was withdrawn. While these contingent liabilities have fallen to almost zero, there will remain a significant, if unquantifiable, fiscal risk related to the financial system (as is the case for all governments); and

- our medium-term forecast shows PSND ex falling in 2015-16 thanks to the sale of £20 billion of assets that the Government holds as a result of interventions made during the financial crisis – notably mortgage assets held by NRAM and much of its remaining stake in Lloyds. As these sales exchange one form of asset (e.g. mortgages or shares) for another (e.g. cash), they could have little or no effect on WGA net liabilities. That contrasts with the effect on PSND, where the assets being sold are not netted off net debt because they are illiquid, but the proceeds of the sale would either increase liquid assets if held as cash or reduce gross liabilities if used to pay down debt.

16 While these direct effects on the public sector balance sheet are now diminishing quite rapidly, the indirect effect via the recession that accompanied the financial crisis and, more importantly, the large and persistent hit to the economy's potential to produce national income continues. Our latest medium-term forecast is consistent with the hit to potential output relative to the pre-crisis expectation being 11 per cent by 2013-14 rising to 14 per cent by 2019-20, helping to explain why the structural fiscal deficit remained at 4.2 per cent of GDP (£76 billion) in 2014-15, despite five years of fiscal consolidation.

17 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 fiscal projections

18 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 2015 *EFO*. This allows us to focus on long-term trends rather than making fresh revisions to the medium-term forecast.

Demographic and economic assumptions

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

20 We base our analysis on detailed population projections produced by the ONS. In last year's report, we used the ONS 'low migration' variant of the projections, which we considered reasonable given international trends and the direction of Government policy. But with net migration having been much higher than expected over the past year, we have switched to the 'principal' variant – as we did for our medium-term forecasts in the March *EFO*. This is consistent with annual net migration of 165,000 a year rather than 105,000 a year, though it is still well below the 318,000 estimate of net migration in 2014. The effect of this change in assumption is to increase the size of the population by the end of our projections by 5.6 per cent, with the working-age population up 6.5 per cent and the over-65 population up 3.4 per cent. This therefore reduces the old-age dependency ratio relative to last year's projections.

21 As regards the economy, we assume in our central projection that whole economy productivity growth will average 2.2 per cent a year, in line with its pre-crisis average rate. As in each *FSR* to date, we assume CPI inflation of 2.0 per cent (consistent with the Bank of England's target). But we have made small revisions to other price assumptions, revising our GDP deflator growth assumption up to 2.3 per cent (from 2.2 per cent) and our long-term RPI inflation assumption down to 3.0 per cent (from 3.3 per cent). We have also revised up the assumed additional effect of the triple lock on pension uprating, which is informed by an estimate of its average cost had it been in place since the early 1990s.

Defining 'unchanged' policy

22 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.

23 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 be unrealistic. 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*".

24 In our central projections, our assumption for unchanged policy is that beyond 2019-20 underlying age-specific spending on public services, such as health and education, rises 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 2019-20:

- 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 1.0 per cent and 0.6 per cent of GDP respectively between 2015-16 and 2019-20 (equivalent to £22 billion and £14 billion in nominal terms in 2019-20); or

- we could assume for these three years – as we do beyond 2019-20 – 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 four years. The Government would then have to find cuts in other spending of 1.9 per cent of GDP (£42 billion in nominal terms in 2019-20) to stick to the March 2015 policy assumption for total spending.

25 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 average earnings in the rest of the economy.

Results of our projections

26 Having defined unchanged policy, we apply our demographic and economic assumptions to produce projections of the public finances over the next 50 years. When comparing this year's results with our 2014 *FSR*, we have restated last year's projections to be as consistent as possible with the latest National Accounts treatment of the public finances and GDP.

Expenditure

27 An ageing population will put upward pressure on public spending. We project total non-interest public spending to rise from 33.6 per cent of GDP at the end of our medium-term forecast in 2019-20, to 38.0 percent of GDP by 2060-61, before falling slightly to 37.8 per cent of GDP in 2064-65. That would represent an overall increase of 4.2 per cent of GDP – equivalent to £79 billion in today's terms.

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

- **health spending** rises from 6.2 per cent of GDP in 2019-20 to 8.0 per cent of GDP in 2064-65, rising smoothly as the population ages. This profile is little changed from last year, with spending slightly lower by the end of the period due to the effect of higher migration on the old-age dependency ratio. A larger, but slightly younger, population means higher health spending and higher GDP in cash terms, but with the effect on GDP proportionately larger;

- **state pension costs** increase from 5.1 per cent of GDP in 2019-20 to 7.3 per cent of GDP in 2064-65 as the population ages. This profile is also little changed from last year, but due to the broadly offsetting effects of a higher assumed cost of uprating (in line with the triple lock) and a lower old-age dependency ratio (associated with higher net migration); and

- **long-term social care costs** rise from 1.2 per cent of GDP in 2019-20 to 2.2 per cent of GDP in 2064-65, 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.

29 Our conclusions about age-related pressures on public spending in the UK are similar to those in the European Commission's 2015 *Ageing Report*, which was published in May. The Commission's results suggest these pressures in the UK are close to the average projected across the EU.

Revenue

30 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.

31 In our detailed analysis this year, we have again updated our long-term projections of North Sea revenues, in light of the substantial drop in oil prices since last year and the changes to the policy regime announced in Autumn Statement 2014 and Budget 2015. Our latest medium-term receipts forecast – the starting point for our long-term projection – is for receipts of just £0.7 billion in 2019-20. That compares with the £3.5 billion in 2018-19 that underpinned last year's projections.

32 Our latest projection shows that the effect of lower oil and gas prices and production has been partly offset by lower expenditure to leave the implied pre-tax profits from the North Sea positive, but relatively low. The effects of accumulated losses reducing the effective tax rate paid by companies in the North Sea, plus the repayments associated with decommissioning costs, mean that in our central projection just £2 billion of receipts will be raised in total between 2020-21 and 2040-41. That is down from around £37 billion in last year's projection.

33 As we always stress, North Sea revenues have been the most volatile receipts stream and are subject to large forecast errors, even over the short term. These projections are therefore subject to considerable uncertainty. It is quite possible that the industry's response to conditions that currently prevail could lead to very different outcomes.

Financial transactions

34 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 public sector financial transactions into account. These affect net debt directly, without affecting accrued spending or borrowing.

35 For the majority of financial transactions, we assume that the net effect is zero. Student loans are an important exception. The Government's decision to sell the pre-2012 student loan book exchanges some future loan repayments for upfront sale proceeds, while crystallising the loss associated with interest rate and write-off subsidies. We have lowered our medium-term forecast for student numbers, which knocks through to our long-term projections. That slows the accumulation of debt over the near term, as it immediately cuts outlays but only gradually lowers repayments. Its ultimate effect is to lower the stock of debt in the long term, but not its profile from year to year. But this is eventually outweighed by other changes, such as lowering the assumption on prepayments, so that the peak impact on debt is 8.8 per cent of GDP by the late-2030s – 0.5 per cent lower than last year's figure (adjusted for National Accounts methodology changes) – and the impact at the end of the 50-year horizon is 8.0 per cent of GDP – 0.1 per cent higher than projected last year (again, on an adjusted basis).

36 On top of the sale of student loans, the Government has announced the sale of mortgage assets of NRAM and its shareholding in Lloyds Banking Group that are together expected to reduce PSND by £20 billion in 2015-16. The sale of financial assets is classified as a financial transaction in the public finances data. So sales reduce public sector net debt directly and indirectly via net borrowing (because interest is paid on a smaller stock of debt), but typically they also have offsetting effects when the government loses a related income stream. This is the case in each of these sales – forgoing repayments on student loans and

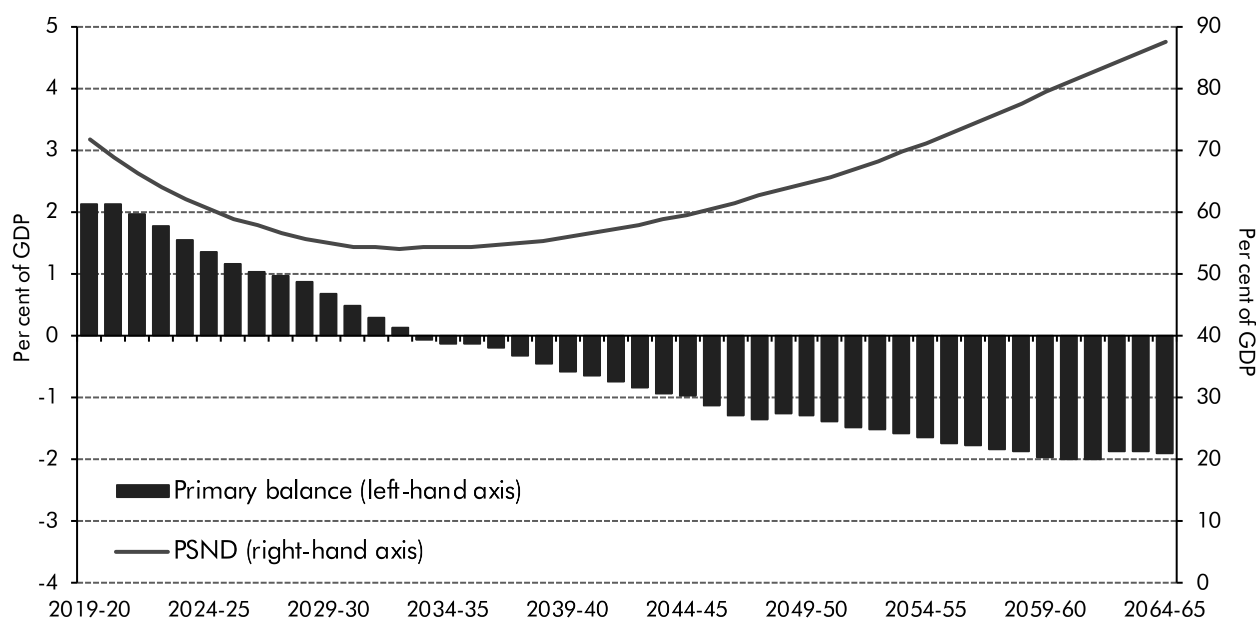
NRAM mortgages, and dividends from Lloyds shares. Over the long term, therefore, the net impact of asset sales on net debt is significantly less than the sale price.

Projections of the primary balance and public sector net debt

37 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 2.1 per cent of GDP in 2019-20 to rough balance in the mid-2030s and then to a deficit of 1.9 per cent of GDP in 2064-65 – an overall deterioration of 4.0 per cent of GDP, equivalent to £76 billion in today's terms.

38 Taking this and our projection of financial transactions into account, PSND is projected to fall from its medium-term peak of just over 80 per cent of GDP in 2014-15 to 54 per cent of GDP in the early 2030s, before rising to 87 per cent of GDP in 2064-65. Beyond this point, debt would remain on a rising path.

Chart 1: Central projection of the primary balance and PSND



Source: OBR

39 The primary balance and PSND at the end of the projection period are little changed from last year's projections. That reflects the net effect of a number of offsetting factors:

- classification changes have had a small effect on the primary balance, but a larger effect on net debt in the short term that diminishes over the projection period;
- the primary surplus at the end of our medium-term forecast is lower than last year, which pushes through to the long-term projections, raising net debt. The main factors explaining this difference relate to the Coalition Government's spending assumption

that was applied in our March 2015 forecast. Lower debt interest spending implied higher departmental spending within a total spending envelope that had been tightened up to 2018-19. In addition, the spending assumption for 2019-20 implied departmental spending rising as a share of GDP in that year; and

- the effect of a looser fiscal position at the end of the medium term was broadly offset by our decision to switch our central projections from the ONS low migration population projections to the principal projections. That reduces the old-age dependency ratio relative to last year, reducing the extent to which age-related spending rises as a share of GDP in the long term.

40 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.

41 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.

42 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 5.0 per cent of GDP by 2064-65. 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 2019-20. This would be compounded by the demographics to increase health (and therefore total) spending by a further 0.4 per cent of GDP by 2064-65.

Summary indicators of fiscal sustainability

43 In our central projections, and under 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 rising trajectory as a share of national income. This would be unsustainable.

44 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'.

45 There is no consensus on what would be an optimal level for the public debt to GDP ratio. So for illustration, we calculate the additional fiscal tightening necessary from 2020-21 to return PSND to 20, 40 or 60 per cent of GDP at the end of our projections in 2064-65.

46 Under our central projections, a once-and-for-all policy tightening of 1.1 per cent of GDP in 2020-21 (£20 billion in today's terms) would see the debt ratio reach 40 per cent of GDP in 2064-65. But this is less than the 1.9 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 0.4 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 conclusions are little changed from last year. Targeting debt ratios of 20 and 60 per cent of GDP would require larger and smaller adjustments respectively.

47 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 2019-20 than we forecast in the *EFO*, the necessary tightening would be bigger or smaller by the same amount. 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.

B Fiscal impact of policy decisions

B.1 The tables in this annex show the fiscal impact of policy decisions taken at Summer Budget 2015, Autumn Statement 2015, and Budget 2016; and of measures announced earlier which take effect from April 2016 or later.

Table B.1: Summer Budget 2015 policy decisions[1]

	Head	£ million					
		2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Personal tax							
1 Personal allowance: increase to £11,000 in 2016-17, with equal gains to higher rate taxpayers	Tax	0	-1,055	-1,160	-1,195	-1,160	-1,200
2 Higher Rate Threshold: increase to £43,000 in 2016-17	Tax	0	-90	-200	-190	-255	-310
3 Inheritance Tax: £1m couples allowance from 2020 through new main residence nil-rate band phased in from 2017	Tax	0	0	-270	-630	-790	-940
4 Pensions tax relief: restrict for gross income over £150,000 from 2016-17	Tax	-70	+260	+425	+900	+1,180	+1,280
5 Rent-a-room relief: increase to £7,500	Tax	0	-5	-10	-10	-10	-15
Childcare							
6 Childcare: 30 hour entitlement for working parents of 3 and 4 year olds	Spend	0	-15	-365	-640	-660	-670
7 Tax Free Childcare: updated rollout	Spend	+165	+370	-95	-130	-90	-40
8 Adoption reform	Spend	-20	-20	0	0	0	0
Business and Growth							
9 Corporation Tax: reduce to 19% from 2017-18, and 18% from 2020-21	Tax	0	-10	-605	-1,600	-1,870	-2,475
10 Annual Investment Allowance: set at new permanent level of £200,000	Tax	-5	-215	-850	-895	-840	-795
11 Banks: 8% Corporation Tax Surcharge and changes to Bank Levy	Tax	0	+415	+555	+365	+225	+105
12 Corporation Tax: bringing forward payments for large groups	Tax	0	0	+4,495	+3,135	+140	+60
13 Employment Allowance: increase by £1,000 from 2016-17	Tax	0	-630	-670	-685	-700	-695
14 Oil and gas: expand investment allowance	Tax	*	-5	-5	-5	-5	-10
15 Transport for the North and Midlands Connect: set up costs	Spend	-15	-10	-10	0	0	0
Reform and sustainability							
16 Dividends tax: abolish credit, introduce new £5,000 allowance, and increase effective rates by 7.5pp	Tax	0	+2,540	-890	+1,120	+2,055	+1,960
17 Residential property: restrict finance relief to basic rate, phase from 2017	Tax	0	0	0	+225	+415	+665
18 Residential property: reform wear and tear allowance	Tax	0	0	+205	+165	+165	+170
19 Insurance Premium Tax: increase by 3.5pp to 9.5%	Tax	+530	+1,460	+1,510	+1,530	+1,550	+1,580
20 VED: reform for new cars purchased from 2017, hypothecated to roads fund from 2020-21	Tax	0	+250	+195	+670	+940	+1,425
Imbalances in the tax system							
21 Non-domiciles: abolish permanent status	Tax	0	0	-15	+475	+380	+385

		Head	£ million					
			2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
22	Non-domiciles: IHT on UK residential property	Tax	-5	-5	+35	+100	+75	+85
23	Climate Change Levy: equal treatment for generators	Tax	+450	+490	+575	+685	+800	+910
24	Intangible assets: remove relief for new claims	Tax	+35	+100	+165	+220	+280	+320
25	Employment Allowance: withdraw from single person companies	Tax	0	+80	+95	+100	+105	+110
26	Tax Motivated Incorporation: reduction due to dividend tax reform	Tax	0	+190	+360	+445	+505	+565
Avoidance and tax planning								
27	Capital Gains Tax: avoidance by private equity and hedge funds	Tax	0	+265	+375	+390	+390	+375
28	Controlled Foreign Companies: loss restriction	Tax	+65	+140	+190	+165	+150	+150
29	Corporation Tax: intra-group transfers	Tax	+15	+30	+30	+20	+15	+15
30	Indirect tax: overseas insurance	Tax	0	+5	+5	+5	+5	+5
Evasion and compliance								
31	Large Business: enhanced compliance	Tax	0	+40	+170	+340	+480	+625
32	Specialist Personal Tax: enhanced compliance	Tax	0	+5	+40	+110	+195	+280
33	Wealthy: enhanced compliance	Tax	0	-65	+40	+185	+260	+280
34	Tackling illicit tobacco and alcohol	Tax	0	+15	+115	+285	+430	+450
35	Hidden economy	Tax	0	+15	+110	+195	+255	+285
36	Local compliance	Tax	0	+15	+135	+360	+640	+920
Welfare								
37	Uprating: freeze working-age benefits, tax credits and Local Housing Allowances for 4 years from 2016-17	Spend	0	+90	+940	+2,325	+3,885	+4,010
38	Benefit cap: reduce to £20,000, and £23,000 in London	Spend	0	+100	+310	+360	+405	+495
Tax credits and Universal Credit								
39	Limit child element to 2 children for new births in tax credits and new claims in UC	Spend	0	0	+315	+700	+1,055	+1,365
40	Remove family element in tax credits and UC, and the family premium in Housing Benefit, for new claims	Spend	0	+55	+220	+410	+555	+675
41	Increase tax credits taper rate to 48%	Spend	0	+1,475	+1,035	+600	+345	+245
42	Reduce income thresholds in tax credits and work allowances in UC	Spend	0	+2,880	+3,060	+3,180	+3,310	+3,440
43	Reduce income rise disregard in tax credits	Spend	0	+170	+225	+250	+180	+110
44	UC waiting days: revised schedule	Spend	-5	0	0	0	0	0
Housing Benefit								
45	End automatic entitlement for out-of-work 18-21 year olds	Spend	0	0	+25	+35	+35	+40
46	Reduce social sector rents by 1% each year for 4 years from 2016-17	Spend	0	+165	+475	+875	+1,320	+1,445

		Head	£ million					
			2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
47	Pay to stay: higher income social housing tenants to pay market rents	Spend	0	0	+365	+185	+245	+240
48	Limit backdating awards to 4 weeks	Spend	0	+10	0	*	*	*
49	Support for Mortgage Interest: change from welfare payment to loan; maintain capital limit at £200,000	Spend	0	-30	-35	+270	+255	+255
	Employment and Support Allowance							
50	Align Work-Related Activity Group rate with JSA for new claims	Spend	0	0	+55	+225	+445	+640
	Other							
51	UC parent conditionality from when youngest child turns 3	Spend	0	0	-5	-5	+35	+30
52	Fraud, error and debt: tax credits changes	Spend	+60	+55	+30	*	*	*
Changes to spending								
53	In-year savings[2]	Spend	+2,595	0	0	0	0	0
54	HMRC funding	Spend	-60	-225	-270	-270	-265	-255
55	Discretionary Housing Payments	Spend	0	-150	-185	-170	-155	-140
56	Other welfare funding – including Youth Obligation and extra JCP support	Spend	-10	-100	-205	-285	-300	-325
57	TV Licence: BBC funding for over-75s	Spend	0	0	0	+200	+445	+745
58	Efficiency and reform	Spend	-55	0	0	0	0	0
59	Equitable Life: doubling payments to Pension Credit recipients	Spend	-50	0	0	0	0	0
60	Royal Mail share scheme	Spend	-50	0	0	0	0	0
	TOTAL POLICY DECISIONS		**+3,570**	**+9,075**	**+11,035**	**+15,095**	**+17,065**	**+18,885**
	Total spending policy decisions		+2,590	+5,095	+5,945	+8,270	+11,280	+12,415
	Total tax policy decisions		+980	+3,980	+5,090	+6,825	+5,785	+6,470
	Total welfare policy decisions		*+55*	*+4,970*	*+7,015*	*+9,410*	*+12,070*	*+12,990*
	Total receipts from avoidance and tax planning, evasion and compliance, and imbalances in the tax system		*+560*	*+1,320*	*+2,425*	*+4,080*	*+4,965*	*+5,760*

** Negligible*

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

[2] This measure forms part of the £3 billion departmental savings identified in 2015-16. See also the financial transactions table later in this chapter.

Table B.2: Autumn Statement 2015 policy decisions[1]

	Head	£ million					
		2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Business, growth and skills							
1 Apprenticeship Levy (funding employer apprenticeship scheme)	Tax	0	0	+2,730	+2,845	+2,970	+3,095
2 Business Rates: small business relief extension[2]	Tax	0	-700	+40	+15	0	0
3 Enterprise Zones	Tax	0	*	-10	-15	-15	-5
4 Royal Mail share scheme	Spend	-45	0	0	0	0	0
Property and housing							
5 Stamp Duty Land Tax: higher rates on additional properties	Tax	+30	+625	+700	+760	+825	+880
6 Stamp Duty Land Tax: bringing forward payments	Tax	0	0	+110	+10	+10	+10
7 Capital Gains Tax: reduce payment window for residential property	Tax	0	0	0	0	+930	+230
8 Temporary accommodation: impact of new funding mechanism[3]	Spend	0	0	+225	+235	+245	+260
Energy, environment and transport							
9 Renewable Heat Incentive: capping costs and improving value for money	Spend	0	+30	+100	+245	+460	+690
10 Landfill Communities Fund: reform	Tax	0	+20	+20	+20	+20	+20
11 Flood Re: levy and premiums income	Spend	-10	+75	+65	+70	+70	+65
12 Company Car Tax: retain the diesel supplement until 2021	Tax	0	+280	+275	+275	+265	+265
13 Insurance Premium Tax: reform to motor insurance claims rules	Tax	0	0	-35	-45	-55	-55
Avoidance, evasion and tax planning							
14 Stamp Duty Reserve Tax: options abuse	Tax	0	+35	+40	+40	+40	+45
15 Venture capital schemes: restrictions on use	Tax	+15	+95	+95	+95	+90	+95
16 Capital allowances and leasing: reducing avoidance	Tax	+5	+25	+40	+30	+20	+20
17 Corporation Tax: disposals of intangible fixed assets to related parties	Tax	+15	+45	+70	+35	+30	+25
18 Company distributions: preventing avoidance	Tax	0	*	+35	+20	+15	+10
19 General Anti-Abuse Rule: penalties	Tax	*	+10	+20	+25	+5	+5
Modernising the tax and benefit system							
20 Making Tax Digital: reducing errors through record keeping	Tax	0	0	*	+10	+300	+610
21 Corporation Tax: special rate on restitution payments	Tax	+270	+55	+55	+75	+100	+115
22 Fraud, error and debt: DWP and HMRC changes	Spend	0	+85	+135	+105	+135	+145

	Head	£ million					
		2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare							
23 Tax credits: maintain taper and income threshold	Spend	0	-3,385	-2,875	-1,735	-910	-465
24 Universal Credit: updated delivery schedule	Spend	0	+60	+250	+225	+70	-215
25 Universal Credit: uprate Minimum Income Floor with National Living Wage	Spend	0	*	+10	+55	+120	+180
26 Housing Benefit: limit social sector rates to the equivalent private sector rate	Spend	0	0	0	+120	+170	+225
27 Housing Benefit and Pension Credit: limit temporary absence	Spend	0	+25	+20	+15	+10	+10
28 Childcare: revised eligibility criteria	Spend	0	+10	+70	+90	+110	+125
Pensions and pensioners							
29 Pensions automatic enrolment: align with start of tax year	Tax	0	0	+390	+450	-10	-10
30 Pension Credit Savings Credit: freeze	Spend	0	+135	+130	+125	+125	+120
31 Social care reforms: updated implementation date	Spend	0	+105	+110	+100	+75	-75
TOTAL POLICY DECISIONS		**+280**	**-1,965**	**+2,815**	**+4,295**	**+6,220**	**+6,420**
Of which: welfare cap policy decisions		*-5*	*-2,970*	*-1,920*	*-670*	*+140*	*+290*
Total tax policy decisions		+335	+585	+4,545	+4,620	+5,520	+5,335
Of which: Apprenticeship Levy		*0*	*0*	*+2,730*	*+2,845*	*+2,970*	*+3,095*
MEMO: SPENDING REVIEW: SAVINGS FROM DEPARTMENTAL RESOURCE BUDGETS[4]			**+600**	**+4,400**	**+8,400**	**+12,200**	

** Negligible*

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

[2] Costing includes the impact on local government grants which have been incorporated in departmental settlements.

[3] This reflects the reduction in Annually Managed Expenditure from this measure. Funding for managing temporary accommodation will be included within DCLG Communities DEL. See Chapter 3 for further detail.

[4] RDEL savings calculated compared to a counterfactual in which RDEL excluding depreciation grows in line with whole economy inflation from its 2015-16 level (excluding the OBR's Allowance for Shortfall).

Table B.3: Budget 2016 policy decisions[1]

		Head	£ million				
			2016-17	2017-18	2018-19	2019-20	2020-21[2]
Spending and Efficiency							
1	Resource spending adjustment	Spend	0	0	0	+3,500	-
2	Capital spending: accelerate investment plans[3]	Spend	0	-760	-970	+1,585	+150
3	Public Service Pensions: update to discount rate	Spend	0	0	0	+1,970	+2,005
Personal Tax and Savings							
4	Personal Allowance: increase to £11,500 in April 2017	Tax	0	-1,665	-1,945	-1,945	-1,985
5	Higher Rate Threshold: increase to £45,000 in April 2017	Tax	0	-365	-595	-565	-600
6	Lifetime ISA and raise ISA limit to £20,000	Spend	*	-170	-330	-590	-850
7	Savings: remove withholding tax obligations	Tax	0	-260	-45	-100	-120
8	Financial Advice Markets Review: increase tax relief on employer provided pension advice	Tax	0	-10	-10	-5	*
Childhood Obesity and Education							
9	Soft Drinks Industry Levy	Tax	0	0	+520	+500	+455
10	Education: doubling the school sports premium	Spend	0	-110	-190	-190	-
11	Education: longer school day and breakfast clubs	Spend	-5	-85	-250	-350	-
12	Education: full academisation and accelerate transition to National Funding Formula	Spend	-75	-260	-195	-110	-
13	Education: Northern Powerhouse	Spend	-10	-25	-25	-20	-
14	Student Loans: postgraduate loans for part-time and distance learning	Spend	0	0	0	+5	+5
Business Tax							
15	Business Rates: permanently double the Small Business Rate Relief and extend thresholds	Tax	0	-1,575	-1,410	-1,420	-1,460
16	Business Rates: increase threshold for higher multiplier to £51,000	Tax	0	-125	-110	-110	-115
17	Business Rates: switch from RPI in April 2020	Tax	0	0	0	0	-370
18	Corporation Tax: reduce to 17% in April 2020	Tax	0	0	0	-120	-945
19	Corporation Tax: restrict relief for interest	Tax	0	+920	+1,165	+995	+885
20	Corporation Tax: withholding tax on royalties	Tax	+210	+165	+115	+120	+125
21	Corporation Tax: extend scope of hybrid mismatch rules	Tax	+15	+265	+255	+215	+200
22	Corporation Tax: reform loss relief	Tax	0	+395	+415	+295	+255
23	Corporation Tax: further restrict use of banks' pre-2015 losses	Tax	+330	+520	+465	+375	+315
24	Corporation Tax: implement agreed patent box nexus approach	Tax	0	+15	+25	+35	+45
25	Corporation Tax: extend first year allowance and lower emission thresholds for business cars	Tax	0	0	+5	+35	+80
26	Corporation Tax: defer bringing forward payment for large groups for two years	Tax	0	-6,000	-3,850	+5,965	+3,600
27	Stamp Duty Land Tax for non-residential property: reform freehold and leasehold premium regime to slice and increase leasehold rate over £5m	Tax	+385	+515	+535	+560	+590

		Head	£ million				
			2016-17	2017-18	2018-19	2019-20	2020-21[2]
Enterprise							
28	Capital Gains Tax: reduce basic rate to 10% and main rate to 20% excluding residential property and carried interest	Tax	-105	-630	-605	-670	-735
29	Entrepreneurs Relief: extend to long-term investors in unlisted shares	Tax	*	+5	-25	-40	-60
30	Capital Gains Tax: lifetime limit under Employee Shareholder Status	Tax	0	0	0	+10	+35
31	Capital Gains Tax: extend reliefs	Tax	-45	-20	-40	-40	-40
32	Self Employed: abolish Class 2 NICs	Tax	0	0	-355	-360	-360
33	Sharing Economy: £1,000 allowance for both trading and property income	Tax	0	-15	-235	-195	-200
Energy and Environment							
34	Oil and Gas: abolish Petroleum Revenue Tax and reduce Supplementary Charge to 10%	Tax	-165	-265	-225	-155	-200
35	North Sea Seismic Survey	Spend	-15	0	0	0	-
36	Business Energy: abolish Carbon Reduction Commitment and offsetting increase to Climate Change Levy	Tax	0	0	0	+425	+35
37	Carbon Price Support Rate: cap at £18/tCO_2 in April 2019 and uprate in April 2020	Tax	0	0	0	0	+25
38	Corporation Tax: update technologies with access to enhanced capital allowances	Tax	*	+5	+5	+5	+5
Avoidance, Evasion, Imbalances, and Operational Measures							
39	Disguised remuneration: tackling historic and new schemes	Tax	+100	+335	+645	+1,235	+215
40	Off-payroll working: transfer liability to public sector employers	Tax	0	+265	+65	+105	+120
41	Loans to participators: align rates with dividend higher rate	Tax	+15	+80	+80	+70	+65
42	Removing employer tax advantage of different forms of remuneration: pay-offs over £30,000	Tax	0	+45	+420	+470	+485
43	Offshore Property Developers: tackle avoidance and evasion	Tax	+130	+435	+550	+640	+520
44	Stamp Duty Land Tax on additional properties: exemptions	Tax	+45	+55	+60	+65	+70
45	Corporation Tax: removing the renewals allowance	Tax	+5	+5	+5	+5	+5
46	Value Added Tax: tackling overseas trader evasion	Tax	0	+65	+130	+315	+365
47	Value Added Tax: extend reverse charge to electronic communications services	Tax	+115	+105	+90	+75	+60
48	Gambling Duties: reform treatment of freeplays	Tax	-20	+45	+90	+100	+110
49	Asset Managers: reform treatment of performance awards	Tax	+15	+210	+115	+90	+65
50	Border Force: Illicit Tobacco Strategy	Tax	-5	+20	+25	+30	+45
51	Landfill Tax: tackling waste crime	Tax	0	+5	+10	+20	+30
52	Tax Free Childcare and Employer Supported Childcare: updated roll-out and grandfathering	Tax	+20	-35	-155	-120	-85
53	DWP and HMRC operational and policy measures	Spend	-35	-50	+5	+45	+30

		Head	£ million				
			2016-17	2017-18	2018-19	2019-20	2020-21[2]
Duties							
54	Fuel Duty: freeze in April 2016	Tax	-440	-435	-445	-445	-450
55	Alcohol Duty: freeze for beer, spirits and cider	Tax	-85	-85	-85	-85	-85
56	Heavy Goods Vehicles: freeze VED and Road User Levy	Tax	-5	-5	-5	-5	-5
57	Hand-rolling Tobacco: increase by RPI+5%	Tax	+10	+10	+10	+10	+10
58	Aggregates Levy: freeze rates	Tax	-5	-5	-5	-5	-5
59	Package Recycling Target: reform	Tax	+5	+10	+5	0	-5
Local Growth							
60	Flood Defence and Resilience: additional investment	Spend	-80	-200	-205	-205	-
61	Insurance Premium Tax: increase by 0.5%	Tax	+80	+200	+205	+205	+210
62	City Deals	Spend	-145	-60	-10	-10	-
63	Smart Motorways: M62	Spend	*	*	-75	-115	-
64	Office for National Statistics: Bean Review	Spend	-5	-10	0	0	-
65	Enterprise Zones: extend enhanced capital allowances	Tax	0	0	0	0	-5
66	Cathedrals repairs fund	Spend	-5	-5	0	0	-
67	Additional cultural investment	Spend	-25	-30	-15	-15	-
68	Other local growth measures	Spend	-5	-5	-10	-5	-
Previously announced measures							
69	Local Government Assets: receipts flexibility	Spend	+100	+250	+380	+380	+190
70	Help to Save	Spend	0	0	0	-20	-70
71	Education: mentoring for disadvantaged pupils	Spend	-5	-5	-5	-5	-
72	Right to Buy: pilots	Spend	0	-35	-35	-5	0
73	Personal Independence Payments: aids and appliances	Spend	+15	+590	+1,190	+1,300	+1,280
74	Pay to Stay: introduce taper and make voluntary for housing associations	Spend	0	+260	+205	+260	+305
75	Social Rent downrating: one year deferral for supported housing	Spend	-15	-20	-20	-25	-25
76	Benefit Cap: exemption for recipients of carers and guardians allowance	Spend	-10	-20	-20	-20	-20
77	Local Housing Allowance: implement for new tenancies from April 2017	Spend	0	0	-60	-25	-15
	TOTAL POLICY DECISIONS		**+285**	**-7,550**	**-4,770**	**+13,915**	**+4,175**
	Memo: TOTAL POLICY DECISIONS *(excluding the impact of CT payment date measure)*[4]		***+285***	***-1,550***	***-920***	***+7,950***	***+575***
	Total tax policy decisions (excluding the impact of CT payment date measure)[4]		+645	-960	-470	+330	-2,760
	Total spending policy decisions		-360	-590	-450	+7,620	+3,335

**negligible*

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

[2] *At Spending Review 2015, the government set departmental spending plans for RDEL for years up to 2019-20. RDEL budgets have not been set for most departments for 2020-21. Given this, RDEL figures are not set out for 2020-21.*

[3] *This measure is fiscally neutral over the scorecard period. Figures do not sum to zero due to rounding.*

[4] *This measure delays the introduction of a new corporation tax payment schedule for larger groups. As it defers the policy, rather than changing it, its effect over the scorecard period is broadly neutral.*

Table B.4 : Measures announced at Spending Review and Autumn Statement 2015 or earlier that will take effect from April 2016 or later[1,2]

		Head	£ million				
			2016-17	2017-18	2018-19	2019-20	2020-21
Measures announced at Spending Review and Autumn Statement 2015							
a	Apprenticeship Levy (funding employer apprenticeship scheme)	Tax	0	+2,675	+2,780	+2,885	+3,000
b	Business Rates: small business relief extension	Tax	-730	+90	+20	0	0
c	Enterprise Zones	Tax	*	-10	-15	-15	-5
d	Stamp Duty Land Tax: higher rates on additional properties	Tax	+630	+695	+750	+805	+855
e	Stamp Duty Land Tax: bringing forward payments	Tax	0	+105	+10	+10	+10
f	Capital Gains Tax: reduce payment window for residential property	Tax	0	0	0	+930	+220
g	Temporary accommodation: impact of new funding mechanism	Spend	0	+225	+235	+245	+260
h	Renewable Heat Incentive: capping costs and improving value for money	Spend	+75	+175	+300	+480	+705
i	Landfill Communities Fund: reform	Tax	+20	+20	+20	+20	+20
j	Company Car Tax: retain the diesel supplement until 2021	Tax	+270	+270	+270	+265	+270
k	Insurance Premium Tax: reform to motor insurance claims rules	Tax	0	-35	-45	-55	-55
l	Stamp Duty Reserve Tax: options abuse	Tax	+35	+40	+40	+40	+45
m	Company distributions: preventing avoidance	Tax	*	+30	+20	+15	+15
n	General Anti-Abuse Rule: penalties	Tax	+10	+20	+25	+5	+5
o	Making Tax Digital: reducing errors through record keeping	Tax	0	0	+10	+310	+625
p	Fraud, error and debt: DWP and HMRC changes	Spend	+80	+130	+90	+115	+100
q	Universal Credit: uprate Minimum Income Floor with National Living Wage	Spend	*	+10	+60	+125	+185
r	Housing Benefit: limit social sector rates to the equivalent private sector rate	Spend	0	0	+265	+335	+390
s	Housing Benefit and Pension Credit: limit temporary absence	Spend	+25	+20	+15	+10	+10
t	Childcare: revised eligibility criteria	Spend	0	+45	+75	+90	+105
u	Pensions automatic enrolment: align with start of tax year	Tax	0	+385	+440	-10	-10
v	Pension Credit Savings Credit: freeze	Spend	+140	+140	+140	+135	+130
Measures announced at Summer Budget 2015							
w	Personal allowance: increase to £11,000 in 2016-17, with equal gains to higher rate taxpayers	Tax	-1,060	-1,170	-1,145	-1,150	-1,220
x	Higher Rate Threshold: increase to £43,000 in 2016-17	Tax	-95	-185	-175	-185	-195
y	Inheritance Tax: £1m couples allowance from 2020 through new main residence nil-rate band phased in from 2017	Tax	0	-295	-675	-775	-830
z	Pensions tax relief: restrict for gross income over £150,000 from 2016-17	Tax	+260	+425	+900	+1,180	+1,280
aa	Rent-a-room relief: increase to £7,500	Tax	-10	-10	-10	-10	-10
ab	Childcare: 30 hour entitlement for working parents of 3 and 4 year olds	Spend	0	-375	-665	-690	-705
ac	Corporation Tax: reduce to 19% from 2017-18, and 18% from 2020-21	Tax	-10	-685	-1,755	-2,070	-2,880

		Head	£ million				
			2016-17	2017-18	2018-19	2019-20	2020-21
ad	Employment Allowance: increase by £1,000 from 2016-17	Tax	-635	-680	-695	-715	-715
ae	Dividends tax: abolish credit, introduce new £5,000 allowance, and increase effective rates by 7.5pp	Tax	+2,540	-795	+1,185	+2,090	+1,980
af	Residential property: restrict finance relief to basic rate, phase from 2017	Tax	0	0	+225	+435	+670
ag	Residential property: reform wear and tear allowance	Tax	0	+205	+150	+170	+170
ah	VED: reform for new cars purchased from 2017, hypothecated to roads fund from 2020-21	Tax	+300	+155	+640	+850	+1,300
ai	Non-domiciles: abolish permanent status	Tax	0	-20	+395	+310	+310
aj	Non-domiciles: IHT on UK residential property	Tax	-5	+30	+90	+60	+70
ak	Employment Allowance: withdraw from single person companies	Tax	+70	+75	+80	+85	+90
al	Tax Motivated Incorporation: reduction due to dividend tax reform	Tax	+210	+375	+515	+650	+795
am	Indirect tax: overseas insurance	Tax	+5	+5	+5	+5	+5
an	Large Business: enhanced compliance	Tax	+40	+175	+345	+480	+635
ao	Specialist Personal Tax: enhanced compliance	Tax	+5	+40	+110	+195	+280
ap	Wealthy: enhanced compliance	Tax	-65	+40	+175	+245	+265
aq	Hidden Economy	Tax	+15	+120	+200	+255	+275
ar	Local compliance resource	Tax	+15	+135	+355	+630	+895
as	Uprating: freeze working-age benefits, tax credits and Local Housing Allowances for 4 years from 2016-17	Spend	0	+505	+1,755	+3,470	+3,580
at	Benefit cap: reduce to £20,000, and £23,000 in London	Spend	+80	+235	+255	+305	+360
au	Limit child element to 2 children for new births in tax credits and new claims in UC	Spend	0	+360	+795	+1,200	+1,585
av	Remove family element in tax credits and UC, and the family premium in Housing Benefit, for new claims	Spend	+110	+230	+405	+540	+645
aw	Reduce work allowances in UC	Spend	+120	+1,225	+2,225	+2,850	+3,190
ax	Reduce income rise disregard in tax credits	Spend	+90	+145	+155	+95	+55
ay	End automatic entitlement for out-of-work 18-21 year olds	Spend	0	+25	+35	+40	+40
az	Reduce social sector rents by 1% each year for 4 years from 2016-17	Spend	+590	+1,180	+2,140	+3,185	+3,165
ba	Pay to stay: higher income social housing tenants to pay market rents	Spend	0	+20	-190	-165	-205
bb	Limit backdating awards to 4 weeks	Spend	+10	*	*	*	0
bc	Support for Mortgage Interest: change from welfare payment to loan; maintain capital limit at £200,000	Spend	-30	-35	+265	+245	+245
bd	Align Work-Related Activity Group rate with JSA for new claims	Spend	0	+30	+180	+345	+450
be	UC parent conditionality from when youngest child turns 3	Spend	0	*	*	+30	+30
bf	Fraud, error & debt: tax credits changes	Spend	+45	+25	+10	+5	0
bg	TV Licence: BBC funding for over-75s	Spend	0	0	+185	+425	+725
Measures announced at March Budget 2015							
bh	Personal Allowance: increase to £10,800 in 2016-17 and to £11,000 in 2017-18 with full gains to higher rate taxpayers	Tax	-1,150	-2,195	-2,410	-2,460	-2,505

		Head	£ million				
			2016-17	2017-18	2018-19	2019-20	2020-21
bi	Savings Tax: allowance and ISA flexibility	Tax	-1,320	-565	-600	-635	-675
bj	Annuities: secondary market	Tax	0	+485	+475	-150	-145
bk	Pensions: lifetime allowance to £1m from 2016-17, and index with inflation from 2018-19	Tax	+245	+370	+505	+550	+570
bl	Employment intermediaries: travel and subsistence (umbrella companies)	Tax	+155	+175	+160	+145	+130
bm	Tobacco: enforcement	Tax	+5	+10	+10	+10	+10
bn	Accelerated Payments: extension	Tax	+135	+195	+75	-35	-110
bo	Restricting EEA jobseekers' access to Universal Credit	Spend	+5	+10	+15	+15	0
bp	DWP Fraud and Error: strategic use of RTI to prevent fraud in pension credit and HB	Spend	+15	+30	+35	+40	+40
bq	Affordable housing: Housing Benefit impact	Spend	0	0	-5	-20	-20
br	Company car taxation: 3ppt increase in 2019-20	Tax	0	0	0	+315	+320
bs	Income Tax: extending farmers' profits averaging period to 5 years	Tax	-15	-30	-35	-35	-35
Measures announced at Autumn Statement 2014							
bt	Employer NICs: abolish for apprentices under 25	Tax	-105	-110	-120	-125	-130
bu	Peer-to-peer lenders: bad debt relief	Tax	-10	-15	-15	-25	-30
bv	Corporation tax: hybrids	Tax	+15	+70	+85	+90	+90
bw	Corporation tax: accounting treatment of credit losses	Tax	+5	+85	+215	-45	-45
bx	Income tax: salary sacrifice and expenses, including umbrella companies	Tax	+85	+65	+55	+60	+60
by	Office of Tax Simplification: review of expenses	Tax	-5	-10	-10	-10	-10
bz	HMRC Operational Measures	Tax	+280	+390	+155	+165	+160
ca	Peer-to-peer lenders: withholding tax regime	Tax	0	+35	0	+15	+25
cb	Universal Credit: supporting 85% of childcare costs	Spend	-10	-185	-285	-320	-290
cc	Bereavement benefits reform	Spend	0	-55	-40	-10	+20
cd	Work allowances: maintain current level in 2017-18	Spend	0	+60	+115	+145	+145
Measures announced at Budget 2014							
ce	Carbon Price Floor: limit disparity between UK and EU to £18 from 2016-17	Tax	-340	-615	-870	-1,030	-1,185
cf	Company Car Tax: continuing to increase by 2ppt in 2017-18 and 2018-19	Tax	0	+210	+425	+445	+455
cg	Tax Credits debt: increasing recovery rate	Tax	+80	+50	+30	+10	+5
Measures announced at Autumn Statement 2013							
ch	Alcohol fraud wholesaler registration	Tax	+15	+245	+235	+215	+190
ci	HMRC: extending online services	Tax	0	+45	+55	+55	+55
Measures announced at Spending Round 2013							
cj	Pension Credit: abolish assessed income periods	Spend	+5	+20	+50	+75	+100
Measures announced at Budget 2013							
ck	Contracting out NICs: public sector employers	Tax	+2,740	+2,740	+2,815	+2,885	+2,975
cl	Contracting out NICs: public sector employees	Tax	+1,125	+1,125	+1,160	+1,185	+1,225
cm	Contracting out NICs: private sector employers	Tax	+1,210	+1,145	+1,075	+1,020	+965
cn	Contracting out NICs: private sector employees	Tax	+495	+470	+440	+420	+395

*Negligible

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

[2] *Costings reflect the fact that after Summer Budget 2015 the Government balance sheet now includes Housing Associations.*

C Supplementary data tables

C.1 Information in these tables is consistent with the OBR's March 2016 'Economic and fiscal outlook' (EFO) and supplementary tables, unless otherwise noted. The OBR's supplementary tables are available at: http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2016/

C.2 Any HM Treasury calculations are derived from and consistent with published sources. Further details of outturn statistics drawn from Budget 2016 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					
	2015	2015	2016	2017	2018	2019	2020
Real GDP	1789	2.2	2.0	2.2	2.1	2.1	2.1
Nominal GDP	1864	2.6	3.1	4.1	4.1	4.0	4.1
Private consumption expenditure[2]	1163	2.9	2.4	2.2	2.1	2.0	1.9
Government consumption expenditure	362	1.7	0.2	0.6	0.5	0.2	0.7
Gross fixed capital formation	307	4.2	2.9	4.5	4.1	4.0	4.3
Changes in inventories and net acquisition of valuables (% of GDP)[3]	0.8	-0.1	0.2	0.0	0.0	0.0	0.0
Exports of goods and services	540	5.0	2.5	3.3	3.3	3.4	3.4
Imports of goods and services	599	6.2	3.5	3.3	3.3	3.3	3.3
Contributions to real GDP growth							
Final domestic demand	-	3.2	2.1	2.3	2.2	2.1	2.2
Changes in inventories and net acquisition of valuables	-	-0.4	0.2	0.0	0.0	0.0	0.0
External balance of goods and services	-	-0.5	-0.4	-0.1	-0.1	-0.1	-0.1

[1] Pounds sterling, billion.

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

[3] Rate of change of changes in inventories and net acquisition of valuables is give as the percentage point year-on-year change.

Table C.2: Price developments

	Level	Rate of Change					
	2015	2015	2016	2017	2018	2019	2020
GDP deflator	104.2	0.3	1.1	1.9	2.0	1.9	2.0
Private consumption deflator	104.3	0.3	1.2	1.9	2.2	2.3	2.3
HICP[1]	100.0	0.0	0.7	1.6	2.0	2.1	2.0
Public consumption deflator	100.0	-0.6	0.3	1.4	1.0	0.6	1.2
Investment deflator	104.8	1.2	1.3	1.3	1.6	1.4	1.2
Export price deflator (goods and services)	94.7	-5.2	1.2	2.0	1.3	1.3	1.3
Import price deflator (goods and services)	91.5	-5.9	1.6	2.0	1.2	1.1	1.1

[1] The UK's Harmonised Index of Consumer Prices (HICP) is the Consumer Price Index (CPI).

Table C.3: Labour market developments

	Level	Rate of Change					
	2015	2015	2016	2017	2018	2019	2020
Employment, persons (millions)[1]	31.2	1.5	1.2	0.6	0.4	0.4	0.4
Employment, hours worked[2]	1,000.6	1.3	1.0	0.5	0.1	0.1	0.2
Unemployment rate (%)[3]	5.4	-0.8	-0.4	0.0	0.2	0.1	0.0
Labour productivity, persons[4]	57,359.1	0.7	0.8	1.6	1.7	1.7	1.7
Labour productivity, hours worked[5]	34.4	0.9	1.0	1.7	2.0	1.9	1.9
Compensation of employees[6]	921.0	3.6	3.3	4.4	4.1	3.9	4.0
Compensation per employee[7]	29,529.0	2.1	2.1	3.8	3.6	3.5	3.6

[1] All aged 16 and over.

[2] Millions per week.

[3] ILO measure, all aged 16 and over. Rate of change is percentage point year on year change.

[4] GDP per worker, pounds sterling

[5] GDP per hour, pounds sterling.

[6] Pounds sterling, billion

[7] Pounds per worker

Table C.4: Sectoral balances

% of GDP		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Net lending/borrowing vis-à-vis the rest of the world		-5.2	-4.3	-4.0	-3.8	-3.7	-3.5
of which:							
- Balance on goods and services		-2.0	-2.0	-2.3	-2.4	-2.3	-2.2
- Balance of primary incomes and transfers		-3.4	-2.3	-1.7	-1.4	-1.4	-1.3
- Capital account		0.0	0.0	0.0	0.0	0.0	0.0

Table C.5: General government budgetary prospects

	£ billion	% of GDP						
	Outturn		Forecast					
	2014-15	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Net lending by sub-sector								
General government[1]	91.0	5.0	3.9	2.9	2.0	1.1	-0.3	-0.4
Central government	88.9	4.9	3.7	2.7	1.9	1.1	-0.3	-0.4
Local government	2.2	0.1	0.2	0.1	0.1	0.0	0.0	0.0
General government								
Total revenue	651.9	35.6	36.0	36.7	36.7	36.8	37.1	37.0
Total expenditure	742.9	40.6	39.9	39.5	38.6	37.8	36.8	36.6
Net borrowing[1]	91.0	5.0	3.9	2.9	2.0	1.1	-0.3	-0.4
Interest expenditure	45.9	2.5	2.5	2.5	2.6	2.6	2.5	2.4
Primary balance[2]	45.1	2.5	1.4	0.4	-0.6	-1.5	-2.8	-2.8
Selected components of revenue								
Taxes on production and imports	232.9	12.7	13.0	13.1	13.1	13.2	13.2	13.1
Taxes on income and wealth	212.7	11.6	11.8	12.0	11.9	12.0	12.4	12.2
Capital taxes	3.9	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	110.3	6.0	6.1	6.5	6.6	6.6	6.6	6.6
Other	92.1	5.0	4.8	4.8	4.8	4.8	4.7	4.8
Total revenue	651.9	35.6	36.0	36.7	36.7	36.8	37.1	37.0
Selected components of expenditure								
Current expenditure on goods and services	358.6	19.6	19.2	18.8	18.5	17.9	17.4	17.1
Net social benefits	228.7	12.5	12.3	12.0	11.6	11.3	11.0	10.8
Interest expenditure	45.9	2.5	2.5	2.5	2.6	2.6	2.5	2.4
Subsidies	10.4	0.6	0.7	0.8	0.8	0.9	0.9	1.0
Gross fixed capital formation	45.9	2.5	2.4	2.5	2.5	2.4	2.3	2.6
Other	53.4	2.9	2.8	2.9	2.7	2.8	2.7	2.8
Total expenditure	742.9	40.6	39.9	39.5	38.6	37.8	36.8	36.6

[1] Treaty deficit

[2] General government net borrowing less interest expenditure

Table C.6: Breakdown of revenue

	£billion	% of GDP						
	Outturn		Forecast					
	2014-15	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Total revenue at unchanged policies[1]	651.9	35.6	35.9	36.4	36.5	36.4	36.3	36.4
Discretionary revenue measures[2]	-	-	0.07	0.27	0.14	0.34	0.82	0.56

[1] General government total revenue less discretionary revenue measures at Summer Budget 2015, Autumn Statement 2015 and Budget 2016 (consistent with the OBR's 'Economic and fiscal outlook' for each event)

[2] Sum of discretionary revenue measures taken at Summer Budget 2015, Autumn Statement 2015 and Budget 2016 (consistent with the OBR's 'Economic and fiscal outlook' for each event).

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

	% of GDP	
	2013-14[3]	2015-16[4]
General public services	3.7%	3.4%
Defence, public order and safety	2.9%	2.7%
Economic affairs	1.6%	1.8%
Environmental protection	0.3%	0.3%
Housing and community amenities	0.1%	0.1%
Health	7.2%	7.2%
Recreation, culture and religion	0.4%	0.4%
Education	2.5%	2.3%
Social protection	11.2%	11.0%
Total expenditure [5]	31.8%	30.9%

[1] Spending data used consistent with Public Sector Statistical Analyses 2015, HM Treasury July 2015

[2] Central government data taken from PESA table 6.4

[3] The December 2015 figures as published on gov.uk used to derive 'percentage of GDP calculations

[4] Percentage of GDP calculations consistent with March 2016 EFO

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

Table C.8: General government debt developments

		% of GDP						
		Outturn	Forecast					
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Gross debt[1]		87.4	88.9	88.3	87.1	85.6	83.0	80.3
Change in gross debt ratio		0.8	1.5	-0.5	-1.3	-1.5	-2.6	-2.7
% change		0.9	1.7	-0.6	-1.5	-1.7	-3.0	-3.3
Contributions to changes in gross debt								
Primary balance[2]		2.5	1.4	0.4	-0.6	-1.5	-2.8	-2.8
Interest expenditure		2.5	2.5	2.5	2.6	2.6	2.5	2.4
Stock-flow adjustment[3]		-0.6	-0.4	-0.3	0.1	0.9	1.0	1.0
Implicit interest rate on debt[4]		3.0	2.9	2.9	3.0	3.1	3.1	3.0

[1] Treaty debt

[2] General government net borrowing less interest expenditure

[3] Change in Treaty debt less general government net borrowing

[4] Interest expenditure as a per cent of Treaty debt in previous year

Table C.9: Cyclical developments

	% of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Real GDP growth (%)[1]	2.8	2.1	2.0	2.2	2.1	2.1	2.2
Net borrowing of general government	5.0	3.9	2.9	2.0	1.1	-0.3	-0.4
Interest expenditure	2.5	2.5	2.5	2.6	2.6	2.5	2.4
Potential GDP growth (%)[1]	1.5	1.5	2.0	2.1	2.2	2.2	2.2
Output gap[1]	-0.7	-0.3	-0.1	0.1	0.0	0.0	0.0
Cyclical budgetary component[3]	0.7	0.3	0.1	0.0	0.0	0.0	0.0
Cyclically-adjusted balance	4.2	3.6	2.7	2.0	1.1	-0.3	-0.4
Cyclically-adjusted primary balance[4]	1.7	1.2	0.3	-0.6	-1.5	-2.8	-2.8

[1] Growth in real potential GDP is expressed in financial rather than calendar years and is calculated on a non-oil basis.

[2] A plus sign means deficit-reducing one-off measures.

[3] Treaty deficit less cyclically-adjusted treaty deficit

[4] Cyclically-adjusted treaty deficit less interest expenditure

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

		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Real GDP growth (%)								
Previous update		2.6	2.4	2.3	2.4	2.3	2.4	-
Current update		2.8	2.1	2.0	2.2	2.1	2.1	2.2
Difference		0.2	-0.3	-0.3	-0.1	-0.2	-0.3	-
Treaty deficit (% GDP)[2]								
Previous update		5.2	4.3	2.2	0.8	0.0	-0.1	-
Current update		5.0	3.9	2.9	2.0	1.1	-0.3	-0.4
Difference		-0.2	-0.4	0.7	1.2	1.1	-0.2	-
Treaty debt (% GDP)[3]								
Previous update		88.4	89.7	89.7	88.2	85.7	82.8	-
Current update		87.4	88.9	88.3	87.1	85.6	83.0	80.3
Difference		-1.0	-0.8	-1.4	-1.2	-0.1	0.2	-

[1] Previous update numbers correspond to the OBR's March 2015 'Economic and fiscal outlook'

[2] General government net borrowing on a Maastricht basis

[3] General government gross debt on a Maastricht basis

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

		% of GDP					
	Outturn	Forecasts					
	2014-15	2015-16	2020-21	2030-31	2040-41	2050-51	2060-61
Total expenditure	40.7	39.6	35.9	37.9	39.4	40.6	41.9
Of which: age-related expenditures[2]	21.9	21.4	19.4	21.0	22.3	22.8	23.5
State pensions	5.5	5.4	5.0	5.8	6.6	6.8	7.4
Pensioner benefits	0.9	0.9	0.7	0.8	0.8	0.8	0.8
Public service pensions	2.1	2.1	2.0	1.8	1.6	1.3	1.1
Health	7.3	7.2	6.2	6.9	7.4	7.8	8.0
Long-term care	1.1	1.1	1.3	1.6	1.8	2.0	2.2
Education	4.9	4.8	4.1	4.2	4.1	4.1	4.1
Net interest	1.6	1.5	1.8	1.7	1.8	2.2	2.9
Total revenue	35.8	35.5	36.3	36.7	36.9	36.9	37.0

[1] Consistent with the central projection in the OBR's July 2015 'Fiscal sustainability report'

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

Table C.12: Contingent liabilities[1]

£ billion	Year	
	2012-13	2013-14
Total quantifiable contingent liabilities	87.9	63.0
Of which: financial stability interventions	9.9	0.3

[1] Taken from section 32.2 of 2013-14 Whole of Governments Accounts – year ended 31 March 2014, HM Treasury, June 2015

Table C.13: Basic assumptions

	2014-15	2015-16	2016-17	2017-28	2018-19	2019-20	2020-21
Short-term interest rate[1] (annual average)	0.6	0.6	0.5	0.6	0.8	1.0	1.2
Long-term interest rate[2] (annual average)	2.3	1.9	1.7	1.9	2.1	2.2	2.4
Nominal effective exchange rate[3]	87.9	90.9	86.3	85.8	85.4	85.0	84.5
Exchange rate vis-à-vis the € (annual average)	1.28	1.37	1.28	1.27	1.26	1.25	1.24
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Oil prices (Brent, USD/barrel)	98.9	52.4	35.5	41.9	44.0	44.0	44.0
Euro area GDP growth	0.9	1.5	1.6	1.6	1.6	1.6	1.6
Growth of relevant foreign markets	3.9	4.1	3.4	3.9	4.4	4.5	4.5

[1] 3 month sterling interbank rate (LIBOR)

[2] Weighted average interest rate on conventional gilts

[3] Trade-weighted sterling

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