

Budget 2008

March 2008



Stability and opportunity:
building a strong, sustainable future



HM TREASURY

Budget 2008

**Stability and opportunity:
building a strong, sustainable future**

**Economic and Fiscal Strategy Report and
Financial Statement and Budget Report**

March 2008

Return to an Order of the House of Commons dated 12 March 2008

*Copy of Economic and Fiscal Strategy Report and Financial Statement and Budget Report – March 2008
as laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget.*

Jane Kennedy
Her Majesty's Treasury
12 March 2008

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HM Treasury contacts

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For general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

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The Economic and Fiscal Strategy Report and the Financial Statement and Budget Report contain the Government's assessment of the medium-term economic and budgetary position. They set out the Government's tax and spending plans, including those for public investment, in the context of its overall approach to social, economic and environmental objectives. After approval for the purposes of Section 5 of the European Communities (Amendment) Act 1993, these reports will form the basis of submissions to the European Commission under Article 99 (ex Article 103) and Article 104 (ex Article 104c) of the Treaty establishing the European Community.

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Economic and Fiscal Strategy Report

OVERVIEW

The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all. Budget 2008, *Stability and opportunity: building a strong, sustainable future*, presents updated assessments and forecasts of the economy and public finances, and reports on how the Government's policies are delivering its long-term goals. The Budget:

- reports that the economy is stable and resilient, and continuing to grow, and that the Government is meeting its strict fiscal rules for the public finances;
- sets out further financial support for children, which will lift 250,000 children out of poverty;
- alongside the Winter Fuel Payment, an additional one-off payment of £100 to over 80's households and £50 to over 60's households in 2008-09. This will benefit around 9 million households;
- announces a package of access to finance measures including enhancing the Small Firms Loan Guarantee Scheme and the Enterprise Capital Funds to support small firms in accessing the resources they need to start up and grow;
- sets out a £200 million package over the next three years to bring forward by a year to 2011 the Government's ambition for no school to have fewer than 30 per cent of its pupils achieving 5 A*-C grades at GCSE, including English and maths.
- takes further steps to meet the long term challenge of delivering decent and affordable housing;
- postpone the planned fuel duty increase of 2 pence per litre in April 2008 until 1 October 2008;
- increases alcohol duty rates by 6 per cent from 17 March 2008;
- lays the ground work for the introduction of five-year carbon budgets, and announces that the first budgets will be set as part of Budget 2009;
- announces further steps to tackle climate change including reforms to Vehicle Excise Duty, auctioning of 100 per cent of allowances for large electricity producers in Phase III of the EU Emissions Trading Scheme, and that to eliminate single use carrier bags, the Government will legislate and impose a charge if retailers do not take voluntary action; and
- introduces further reforms to modernise the tax system, and a number of measures to tackle tax fraud and avoidance.

1.1 The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all.

1.2 The long-term decisions the Government has taken – independence for the Bank of England, new fiscal rules and a reduction in debt – have created a strong platform of economic stability. With low and stable inflation, interest rates set by the Monetary Policy Committee to meet the Government's symmetric inflation target, and fiscal policy supporting monetary policy over the cycle, the economy has grown continuously for 62 consecutive quarters.

Meeting global economic challenges **I.3** The world economy is now facing a more challenging environment than was apparent at the time of the 2007 Pre-Budget Report, with continued disruption in global financial markets. While the UK and other economies have benefited significantly from globalisation, recent events have shown how interconnected capital markets mean shocks in one region can easily be transmitted elsewhere. In addition to responding to the short term challenges, in this Budget the Government has taken further action to ensure the UK is well placed to adapt to the long-term challenges of globalisation, technological change and climate change.

Box 1.1: The UK economy: analysis of long-term performance and strategic challenges

The UK economy: analysis of long-term performance and strategic challenges, published alongside the Budget, analyses the long-term performance of the UK economy and updates recent work on the economic challenges ahead.

The analysis of the performance of the economy over the past decade highlights two key trends:

- much improved resilience – the ability to cope with economic shocks quickly and with low economic costs – which has resulted in an unprecedented period of macroeconomic stability. The UK economy is now the most stable in the G7 and GDP per capita has increased faster than in any other G7 economy over the past decade with employment reaching record levels of more than 29 million; and
- the UK has adapted successfully to the changing structure of the world economy by switching resources to sectors in which it maintains a comparative advantage such as services and high-technology manufacturing. While the UK's share of world goods trade has fallen in the context of dramatic increases from emerging markets, it is the only G7 country that has achieved a rising share of global trade in services.

The Government's macroeconomic framework and the flexibility of the UK's product, labour and capital markets have been key to building resilience and to allowing the economy to adapt efficiently to longer-term structural changes affecting the world economy.

The analysis also highlights areas where further progress needs to be made. It will be vital that the UK continues to narrow the productivity gap between the UK and other major economies. The skills of UK workers still lag behind other countries and must be enhanced to ensure the economy is equipped to compete in high value-added sectors in the future. Although progress has been made in recent years to narrow the gap in growth rates between regions, there are still persistent long-established gaps in employment, skills and enterprise.

Analysis of the strategic challenges ahead shows the importance of continuing to make progress in all these areas. Demographic trends will lead to an increase in the proportion of retired people in the economy relative to those of working age. Emerging markets are quickly developing skilled labour forces and innovative business sectors and are moving into higher value-added sectors. Climate change means that the UK will need to adapt and make the most of the economic opportunities from the transition to a low-carbon economy. Recent events show how the interconnectedness of global capital markets means shocks in one region of the world can be quickly transmitted elsewhere. This Budget sets out the next stages in the Government's programme of reform to address these strategic challenges.

Resilience of the UK economy **I.4** As set out in Box 1.1 and Chapter B, over the past decade the UK economy has become increasingly resilient to shocks. This has led to an unprecedented period of economic stability and growth with record levels of employment. Key to developing greater resilience has been the Government's macroeconomic framework and promotion of open and flexible labour,

product and capital markets. This resilience puts the UK in a strong position to deal with the current global economic uncertainties.

Budget 2008 **1.5** This Budget sets out the action the Government is taking to support the economy in the short term, ensure the resilience of the past decade continues, combined with action to make further progress against its long-term goals of:

- maintaining macroeconomic stability, ensuring the fiscal rules are met and that inflation remains low;
- sustainable growth and prosperity, through reforms that promote enterprise, support business growth, simplify the tax system, and enhance flexibility and promote science, innovation and skills;
- ensuring fairness and opportunity for all, tackling child and pensioner poverty, providing opportunity for all children and young people, delivering security for all in retirement, and ensuring a modern and fair tax system where everyone pays their fair share of tax;
- creating stronger communities and effective public services, and improving long-term housing supply and affordability; and
- ensuring an environmentally sustainable world, with action to address the global challenge of climate change.

MAINTAINING MACROECONOMIC STABILITY

1.6 The Government's long-term goal is to maintain macroeconomic stability in order to achieve its objective of a fair society where there is security and opportunity for all. Chapter 2 sets out how the government is working to achieve this objective and summarises prospects for the UK economy and public finances, details of which are set out in Chapters B and C of the Financial Statement and Budget Report (FSBR).

The policy framework **1.7** The Government's macroeconomic framework and promotion of flexible and open labour, product and capital markets continue to deliver sustained economic growth with low inflation. The monetary policy framework seeks to deliver low and stable inflation by ensuring that interest rates are set in a forward looking manner to meet the Government's symmetric inflation target. Fiscal policy is determined by clear objectives and two rules to ensure fiscal policy can support monetary policy. The fiscal rules underpin the Government's public spending framework which facilitates long-term planning and provides departments with the flexibility and incentives they need to increase the quality of public services and deliver specified outcomes.

Economic prospects **1.8** The UK economy continued to perform strongly in 2007, growing 3 per cent on a year earlier, the fastest growth rate among the G7 economies. Employment reached a record high and claimant count unemployment fell to a 32 year low. The UK is the only G7 economy to have avoided any single quarter of negative growth over the past decade. The flexibility and resilience of the UK economy provides a solid platform from which to face the global economic shocks from the continued disruption in global financial markets and the increase in energy and commodity prices. UK GDP growth is forecast to slow from 3 per cent in 2007 to 1¾ to 2¼ per cent in 2008, before picking up to 2¼ to 2¾ per cent in 2009 and 2½ to 3 per cent in 2010.

The public finances **1.9** Despite the impact of financial market disruption on the public finances, the Budget 2008 projections show that the Government is meeting its strict fiscal rules:

- the current budget shows an average surplus as a percentage of GDP over the current economic cycle, which began in 1997-1998, ensuring the Government is meeting the golden rule. The current budget moves clearly into surplus from 2010-11 onwards; and
- public sector net debt is projected to remain low and stable over the forecast period, stabilising below the 40 per cent ceiling set in the sustainable investment rule.

Table 1.1 – meeting the fiscal rules

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Golden Rule							
Surplus on current budget	-0.3	-0.6	-0.7	-0.2	0.3	0.6	1.0
Average surplus since 1997-1998	0.1	0.1	0.0	0.0	0.0	0.1	0.1
Cyclically-adjusted surplus on current budget	-0.3	-0.7	-0.5	0.1	0.5	0.8	1.0
Sustainable investment rule							
Public sector net debt ¹	36.6	37.1	38.5	39.4	39.8	39.7	39.3

¹Debt at end March; GDP centred on end March

I.10 An analysis of long-term fiscal sustainability is published alongside Budget 2008 in the *2008 Long-term public finance report*. As set out in Chapter 2, this report confirms that the Government will be in a position to meet its fiscal rules in the long-term, ensuring that the long-term public finances remain sustainable.

SUSTAINABLE GROWTH AND PROSPERITY

Budget 2008 policy decisions

Productivity growth, alongside high and stable levels of employment, is central to long-term economic performance. The UK has made good progress over the last decade in improving productivity and levels of employment have risen to record highs. The Government's strategy is structured around the drivers of productivity: competition, innovation, investment, skills and enterprise. The Government's actions have ensured that the UK is one of the best places in the world to do business¹.

I.II The Government remains committed to maintaining an environment that encourages investment and growth. Budget 2008 provides short-term action to help business deal with current economic uncertainties, and drives forward delivery on longer term reforms to ensure UK businesses are able to take advantage of the opportunities presented by the changing global economy. The Budget announces:

- **access to finance measures including enhancing the Small Firms Loan Guarantee Scheme and the Enterprise Capital Funds** to support small firms in accessing the resources they need to start up and grow;
- **a package of reforms on regulation and tax simplification and implementation of the business tax reforms announced in Budget 2007**, including the lowest rate of Corporation Tax in the G7;

¹ *Doing Business 2008*, World Bank, ranked the UK ranked UK 6th out of 178 countries.

- **further implementation of the Leitch² and Sainsbury³ Reviews** to build on improvements in the UK skills base and to provide a world-class science base and innovation framework;
- **exploring options to make better use of transport infrastructure, on top of the major programme of investment** announced in the 2007 Comprehensive Spending Review;
- **progress on business support simplification and measures to ensure better access to Government procurement for small firms;** and
- **a study of public service markets and a new framework for infrastructure procurement.**

FAIRNESS AND OPPORTUNITY FOR ALL

I.12 The Government is committed to employment opportunities for all. As well as ensuring that individuals can take advantage of the opportunities of an increasingly globalised world, it is also critical to the ambition of eradicating child poverty and promoting saving. The Government's approach to delivering on this commitment is twofold: integrating the tax and welfare system, so that work always pays; and providing everyone the support they need to find, retain and progress in work.

Budget 2008 policy decisions

I.13 Budget 2008 takes the next steps towards tackling child poverty, provides support to pensioner households, promotes financial inclusion and announces measures to ensure that everyone pays their fair share of tax under a modern and fair tax system in order to deliver efficient and effective public services. The Budget announces:

- **further financial support for children**, which will lift up to 250,000 children out of poverty;
- **Work Capability Assessments for all existing Incapacity Benefit claimants**, focusing on what people can do in work;
- **further action, with the energy companies and Ofgem, to help vulnerable groups deal with rising energy prices;**
- **alongside the Winter Fuel Payment, an additional one-off payment of £100 to over-80s households and £50 to over-60s households in 2008-09.** This will benefit around 9 million households;
- **the Saving Gateway**, which is a cash saving scheme for those on lower incomes, **will be introduced nationally, with the first accounts available to savers in 2010;**
- **increasing all alcohol duty rates by 6 per cent.** This will add 4 pence to the price of a pint of beer, 14 pence to the price of a bottle of wine and 55 pence to the price of a bottle of spirits;
- **increasing tobacco duty in line with inflation.** This will add 11 pence to the price of a packet of cigarettes; and
- **further reforms to modernise the tax system, modernise tax administration and protect tax revenues.**

²Leitch Review on skills, prosperity for all in the global economy – world-class skills, HM Treasury, December 2006.

³The race to the top: A review of Government's science and technology policies, Lord Sainsbury of Turville, October 2007.

STRONGER COMMUNITIES AND EFFECTIVE PUBLIC SERVICES

I.14 Building on the platform of stability, successive Spending Reviews have delivered sustained increases in spending on public services. By matching this growth in spending with ambitious reforms to support the efficiency, delivery and accountability of public services the Government has been able to achieve improvements in outcomes achieved across frontline services. The Government is also committed to ensuring that everyone should have access to a home at a price they can afford in the communities where they want to live and work. Efficient and effective public services play a central role in building the foundations of strong, sustainable communities.

Budget 2008 policy decisions

I.15 The Government is supporting schools and wider children's services to raise attainment for all pupils, is bringing forward a package of measures to help respond to short-term and long-term housing challenges and is supporting the third sector with a package measures to enhance Gift Aid. The Budget announces:

- that in order to maintain the pace of reform the Government will **achieve significant further operational savings in the post-Comprehensive Spending Review period** and will launch the **Public Value Programme** to look at all major areas of public spending to identify where there is scope to improve value for money.
- the Department for Children Schools and Families will take forward a **£200 million package over the next three years** to bring forward by a year to 2011 the Government's ambition for **no school to have fewer than 30 per cent of its pupils achieving 5 A* to C grades at GCSE**, including English and maths.
- a **package of measures to deliver decent and affordable housing for all** by increasing housing supply and making housing more affordable;
- a **working group that will take forward market initiatives to improve liquidity in the mortgage-backed securities market**. The working group will include the mortgage industry, the investment industry and also HM Treasury, the Bank of England and the Financial Service Authority. The Working Group will report initially to the Chancellor in summer 2008 and present proposals at the 2008 Pre-Budget Report;
- **the Government is also inviting views on options for a UK legislative framework to deliver more affordable long-term fixed-rate mortgages**, and the lessons to be learned from international markets and institutions. The Government will work with a range of stakeholders and experts and will provide an update at the 2008 Pre-Budget Report.
- a **transitional rate of Gift Aid worth around £300 million over three years**, enabling Gift Aid to be paid at a rate of 22 per cent in 2008-09, 2009-10, and 2010-11 from 6 April; and
- a number of measures that reduce burdens on charities and include **major reforms to the audit process, a comprehensive programme for bringing additional smaller charities into Gift Aid** and measures to increase the awareness of Gift Aid including **the launch of targeted marketing tools**.

AN ENVIRONMENTALLY SUSTAINABLE WORLD

I.16 Tackling climate change is the most serious and pressing environmental challenge the world faces. The UK has been at the heart of efforts to tackle climate change in the EU and internationally, and has already put in place a broad set of measures to reduce greenhouse gas emissions. The UK is well-placed to succeed in the low-carbon economy of the future.

Budget 2008 policy decisions I.17 The Stern Review on the Economics of Climate Change⁴ concluded that the costs of reducing emissions to levels that avoid the worst risks of climate change are significant but manageable, whereas delay will be costly and dangerous. Budget 2008 takes action to bring about reductions in the emissions from the transport, energy, business and household sectors. The Budget announces:

- **laying the ground work for the introduction of five-year carbon budgets, and that the first budgets will be set alongside Budget 2009;**
- **reform of car vehicle excise duty rates and bandings, introducing new bands from 2009 to reward drivers of the cleanest cars, and higher first year rates in 2010-11 to influence purchasing choices when people buy cars. As a result in 2009 the majority of drivers will be better or no worse off;**
- **the planned fuel duty increase of 2 pence per litre in April 2008 will now be postponed until 1 October 2008. Main road fuel duty rates will rise by 1.84 pence per litre on 1 April 2009, and will increase by 0.5 pence per litre above inflation on 1 April 2010;**
- **auctioning 100 per cent of allowances for large electricity producers in Phase III of the EU Emissions Trading Scheme;**
- **funding for the Green Homes Service to advise consumers on how they can reduce carbon emissions, waste and water consumption;**
- **strengthening the environmental incentives for taxation of business cars, along with simplifying measures;**
- **incentivising only the most sustainable biofuels, by shifting support away from the duty differential to the Renewable Transport Fuel Obligation in future years;**
- **increasing climate change levy rates in line with inflation, in order to maintain the environmental incentive effect;**
- **to strengthen the environmental signal through taxation, forecast tax revenues from the new per plane duty, due to replace air passenger duty on 1 November 2009, will increase by 10 per cent in the second full year of operation;**
- **an ambition for all new non-domestic buildings to be zero carbon from 2019 with consultation at the timeline and its feasibility and new public sector buildings from 2018;**
- **extending the Stamp Duty Land Tax exemption from zero carbon homes to new flats, retrospectively from 1 October 2007.**
- **that to eliminate single-sue carrier bags, the Government will legislate and impose a charge and if retailers do not take voluntary action; and**

⁴The Economics of Climate Change: The Stern Review, Cambridge University Press, 2007.

- **increasing the aggregates levy from 1 April 2009** to maintain its environmental impact.

BUDGET MEASURES AND THE IMPACT ON HOUSEHOLDS

I.18 Consistent with the requirements of the *Code for fiscal stability*, the updated public finance projections in Budget 2008 take into account the fiscal effects of all firm decisions announced in the Budget. The fiscal impact of Budget policy decisions is set out in Table 1.2. Full details are provided in Chapter A of the FSBR.

Table I.2: Budget 2008 policy decisions

	(+ve is an Exchequer yield)			£ million
	2008-09 indexed	2009-10 indexed	2010-11 indexed	2008-09 non-indexed
Modernising the tax system				
1 Charities: gift aid transitional rate	-60	-105	-120	-60
2 Enterprise management incentive	-10	-10	-10	-10
3 Enterprise investment schemes: increase in investor limit	0	-5	-5	0
4 Remittance basis: foreign dividend tax rate	0	+15	+10	0
5 Extension of the dividend tax credit	0	*	-20	0
6 Corporation tax: treatment of unclaimed assets	+90	-15	-15	+90
7 North Sea fiscal regime modernisation	-25	-25	-20	-25
8 VAT: staff hire concession	0	+150	+125	0
9 VAT: reduced rate for smoking cessation products	-10	-15	-15	-10
10 Stamp duty land tax: removal of lease duty rule from residential property	-5	-5	-5	-5
11 Review of powers: penalties	0	0	+10	0
Simplification				
12 Corporation tax: reform of associated companies rules	0	*	-5	0
13 Capital allowances: write-off of small pools	0	-25	-15	0
14 VAT: revalorisation of registration and deregistration thresholds	0	0	0	-5
15 VAT: option to tax exempt land and property	-25	-5	-5	-25
16 VAT: extension of the exemption for fund management	+5	+15	+15	+10
Fairness and opportunity for all				
17 Increase in child element of Child Tax Credit by £50 a year	0	-340	-350	0
18 Increase first child rate of Child Benefit to £20 a week	0	-210	-170	0
19 Pilots of new approaches to tackling child poverty	-10	-35	-80	-10
20 Child Benefit disregard for Housing Benefit and Council Tax Benefit	0	-180	-350	0
21 Age related payments: to pensioner households	-575	0	0	-575
22 Reassessment of work capability of incapacity benefits claimants	0	0	-10	0
23 Income tax: indexation of savings and basic rate limit	0	0	0	-810
Duties changes				
24 Tobacco duties: indexation	0	0	0	+35
25 Alcohol duties: increase in rates	+400	+505	+625	+600
26 Amusement machine license duty: indexation	0	0	0	+5
Protecting the environment				
27 Increase in value of landfill communities fund	*	*	*	-5
28 Landfill tax: reform of waste exemption	0	*	+20	0
29 Extension of land remediation relief	0	-10	-20	0
30 Extension of enhanced capital allowances	*	*	-5	*
31 Road fuel duties	-550	0	+270	-550
32 Rebated oils duties	-10	0	+5	-10
33 Biofuels: removal of the duty differential	0	0	+550	0
34 Biofuels: reduced rate for off-road biofuel use	*	+5	+10	*
35 Vehicle excise duty: new rates, bands and first year charge	0	+465	+735	0
36 Vehicle excise duty: reduced rate for cleanest vans	-5	-15	-15	-5
37 Company car tax thresholds	0	-5	+80	0
38 Fuel benefit charge: revalorisation	*	+10	+25	*
39 Fuel scale charge: revalorisation and realignment	*	*	*	+15
40 Capital allowances: business cars	-10	+40	+75	-10
41 Aviation duty	0	0	+40	0

Table 1.2: Budget 2008 policy decisions (continued)

	(+ve is an Exchequer yield)			£ million
	2008-09 indexed	2009-10 indexed	2010-11 indexed	2008-09 non-indexed
Protecting tax revenues				
42 Disclosure regime: user identification	0	+10	+20	0
43 Disguising interest	+55	+120	+105	+55
44 Controlled foreign companies	+150	+150	+100	+150
45 Intangible assets regime	0	+10	+15	0
46 North Sea oil and gas: abuse of management expenses rules	+140	+175	+175	+140
47 Double taxation treaties	+200	+40	+30	+200
48 Life insurance: taxation of interest	+25	+35	+35	+25
49 Sideways loss relief	+25	+40	+15	+25
50 Unauthorised Unit Trusts: payments on account	+50	0	0	+50
51 Stamp duty land tax: alternative finance	+5	*	*	+5
52 Stamp duty land tax: group relief	+10	+10	+10	+10
TOTAL POLICY DECISIONS:	-140	+790	+1,865	-700

1.19 The measures announced in this Budget help the Government contribute towards its aims of reducing child and pensioner poverty and making work pay. Together with measures announced in Budget 2007 and the Pre-Budget Report 2007 they will mean that by April 2010 families with children will be £475 per year better off on average whilst those in the poorest fifth of the population will be, on average, £800 per year better off as a result of measures announced in this Budget. Pensioner households will be £200 better off, on average.

1.20 As a result of all personal tax and benefit measures coming into effect since 1997, by April 2010:

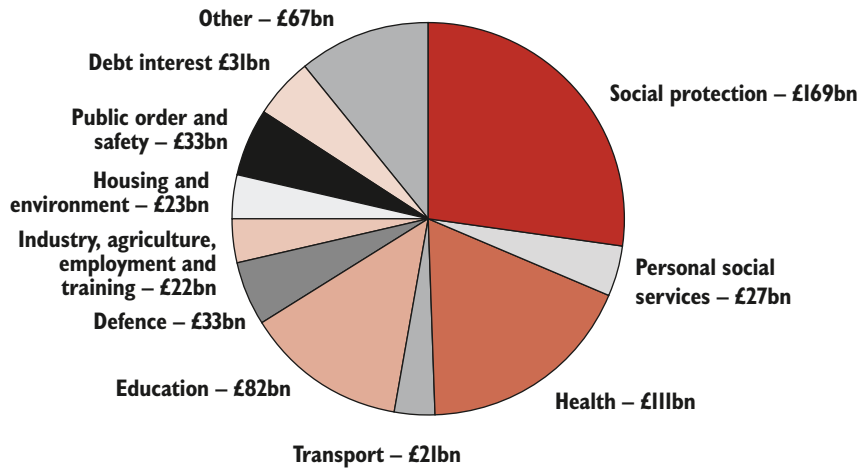
- households will be, on average, £1,250 a year better off;
- families with children will be, on average, £2,000 a year better off; and
- families with children in the poorest fifth of the population will be, on average, £4,500 better off.

GOVERNMENT SPENDING AND REVENUE

1.21 Chart 1.1 presents public spending by main function. Total Managed Expenditure (TME) in 2008-09 is expected to be around £618 billion in 2008-09. TME is divided into Departmental Expenditure Limits (DEL), shown in table C11 of the FSBR, and Annually Managed Expenditure (AME), shown in table C9 of the FSBR.

Chart I.1: Government spending by function

Total managed expenditure: £618 billion

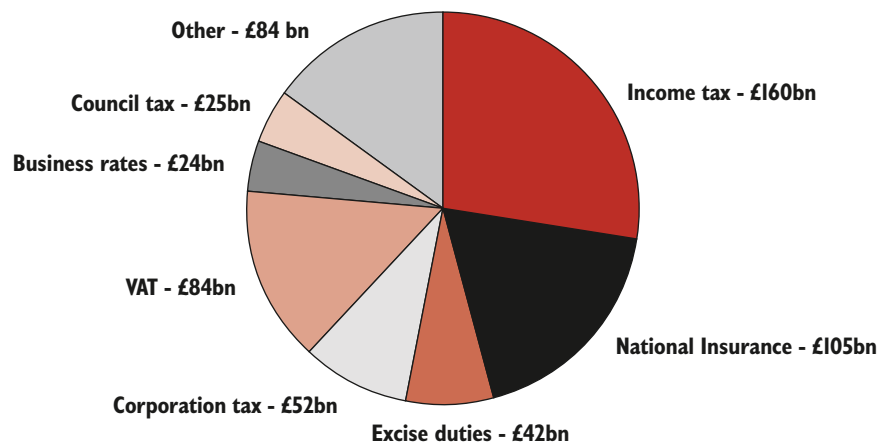


Source: HM Treasury 2008-09 near-cash projections. Spending re-classified to functions compared to previous presentations and is now using methods specified in international standards. Other expenditure includes spending on general public services: recreation, culture, media and sport; international cooperation and development; public service pensions; plus spending yet to be allocated and some accounting adjustments. Social protection includes tax credit payments in excess of an individual's tax liability, which are now counted on AME, in line with OECD guidelines. Figures may not sum to total due to rounding.

I.22 Chart 1.2 shows the different sources of government revenue. Public sector current receipts are expected to be around £575 billion in 2008-09. Table C6 of the FSBR provides a more detailed breakdown of receipts consistent with this chart.

Chart I.2: Government receipts

Total receipts: £575 billion



Source: HM Treasury, 2008-09 projections. Other receipts include capital taxes, stamp duties, vehicle excise duties and some other tax and non-tax receipts – for example, interest and dividends. Figures may not sum to total due to rounding.

