

The Pre-Budget Report interim projections for the public finances show that the Government is firmly on track to meet its fiscal rules over the economic cycle, including in the cautious case:

- the average current budget since the start of the present cycle in 1999-2000 is comfortably in surplus, ensuring that the Government is on track to meet the golden rule, using cautious assumptions and in the cautious case;
- this is confirmed by the cyclically-adjusted current budget, which allows for the impact of the economic cycle and is in surplus in every year throughout the projection period; and
- public sector net debt is projected to be low and stable throughout the next five years, comfortably meeting the sustainable investment rule and, at 31 to 33 per cent of GDP, the lowest in the G7.

In a period of global economic weakness and uncertainty, the use of cautious assumptions and the 'stress test' against the cautious case help ensure that the public finances are sound and sustainable and that the Government is vigilant in the face of potential risks. In the short term, the automatic stabilisers are operating freely, as a cyclical shortfall in receipts this year and over the next two years – particularly in income tax and corporation tax – helps to support monetary policy in maintaining economic stability while the economy is below trend. In the medium term, the public finances return towards the Budget 2002 profile as the economy returns to trend.

INTRODUCTION

B1 Chapter 2 describes the Government's fiscal policy framework and shows how the projections of the public finances presented in this Pre-Budget Report are consistent with the fiscal rules. This annex explains the fiscal projections in more detail. It includes:

- six-year projections of the current budget and public sector net debt, the key aggregates for assessing performance against the golden rule and the sustainable investment rule respectively;
- projections of public sector net borrowing, the fiscal aggregate relevant to assessing the impact of fiscal policy on the economy;
- projections of the cyclically-adjusted fiscal balances; and
- detailed analyses of the outlook for government receipts and expenditure.

B2 As described in Chapter 2, **an *End of year fiscal report* is published alongside this Pre-Budget Report.** The Report underlines the Government's commitment to transparency in fiscal policy by providing detailed retrospective information on the state of the public finances in 2000-01 and 2001-02, including their performance against the fiscal rules and against published forecasts and plans. The information set out in the *End of year fiscal report* supplements the historical and provisional outturn data published in this annex and in the Financial Statement and Budget Report.

B3 The Pre-Budget Report updates the projections of the public finances contained in Budget 2002, to take account of subsequent developments in both the public finances and the world and UK economies. The projections represent an interim forecast update and are not necessarily the outcome the Government is seeking.

B4 Table B1 compares the Pre-Budget Report projections for the current budget and net borrowing with those made in Budget 2002. As explained in Annex A, the short-term outlook for the world economy has weakened since Budget 2002. This has important implications for the UK economy and in turn for public sector receipts and expenditure. Table B1 shows that the current budget has been revised down from a surplus of £3.2 billion to a deficit of £5.7 billion in 2002-03, and from a surplus of £7 billion to a deficit of £5 billion in 2003-04. It also shows that net borrowing has been revised up from £11.2 billion to £20.1 billion in 2002-03 and from £13 to £24 billion in 2003-04. As discussed in Chapter 2, current estimates of the impact of changes in the output gap on the public finances over previous cycles suggest that automatic stabilisers account for £9 billion of the change in the current budget and net borrowing in 2003-04. As a result, the cyclically-adjusted fiscal balances are only slightly changed from their Budget 2002 levels, while the actual fiscal balances are projected to return to their Budget 2002 levels in the medium term.

Table B1: Fiscal balances compared with Budget 2002

	Outturn		Projections			
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Surplus on current budget (£ billion)						
Budget 2002	10.6	3.2	7	9	7	9
PBR 2002	7.7	-5.7	-5	3	5	8
Net borrowing (£ billion)						
Budget 2002	1.3	11.2	13	13	17	18
PBR 2002	1.2	20.1	24	19	19	19
Cyclically-adjusted surplus on current budget (per cent of GDP)						
Budget 2002 ¹	1.0	0.5	0.6	0.7	0.6	0.7
PBR 2002	0.7	0.2	0.3	0.6	0.5	0.6
Cyclically-adjusted net borrowing (per cent of GDP)						
Budget 2002 ¹	0.2	0.9	1.2	1.2	1.4	1.4
PBR 2002	0.2	1.2	1.5	1.3	1.5	1.5

¹ The 2001-02 figures were estimates in Budget 2002.

MEETING THE FISCAL RULES

B5 Table B2 shows six-year projections for the current budget and public sector net debt, the key aggregates for assessing performance against the golden rule and the sustainable investment rule respectively. Outturns and projections of other important measures of the public finances, including net borrowing and net worth, are also shown.

B6 As explained in Chapter 2, the Government's provisional view is that the current economic cycle started in 1999-2000. Based on the assumptions used in these projections, the economy will next return to trend levels, ending the current cycle, in 2005-06.

B7 The projections show that the Government is firmly on track to meet the golden rule. Over the period of this cycle, from 1999-2000 to 2005-06, the current budget is comfortably in surplus, with an accumulated surplus of £46 billion. Similarly, the average surplus on the current budget is positive since the start of the cycle and throughout the projection period.

The same is true were the cycle to start in 1997-98. The cyclically-adjusted surplus, which allows underlying or structural trends in the indicators to be seen more clearly by removing the estimated effects of the economic cycle, is also positive in every year of the forecast.

B8 Following a deficit of 3 per cent of GDP in 1996-97, current budget surpluses of more than 2 per cent were recorded in 1999-2000 and 2000-01 and of about $\frac{3}{4}$ per cent in 2001-02. Largely as a result of cyclical and other temporary factors, the current budget moves into a deficit of about $\frac{1}{2}$ per cent of GDP in 2002-03 and 2003-04, before returning to surplus in 2004-05 and recovering to a surplus of around $\frac{3}{4}$ per cent of GDP by 2007-08.

Table B2: Summary of public sector finances

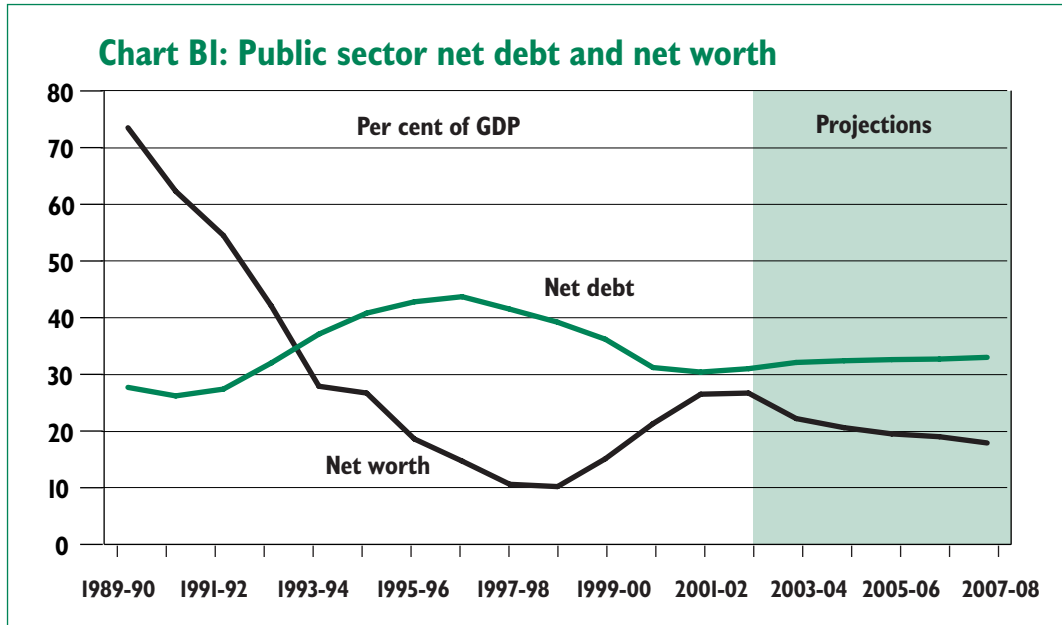
	Per cent of GDP							
	Outturns				Projections			
	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Fairness and prudence								
Surplus on current budget	2.2	0.8	-0.5	-0.4	0.2	0.4	0.6	0.7
Average surplus since 1999-2000	2.2	1.7	1.2	0.8	0.7	0.7	0.7	0.7
Cyclically-adjusted surplus on current budget	1.7	0.7	0.2	0.3	0.6	0.5	0.6	0.7
Long-term sustainability								
Public sector net debt	31.2	30.4	31.0	32.1	32.4	32.6	32.7	33.0
Core debt	31.1	30.3	30.3	30.6	30.6	30.8	31.0	31.3
Net worth ¹	21.3	26.5	26.7	22.2	20.6	19.5	19.0	17.9
Primary balance	3.8	1.7	-0.3	-0.6	0.0	0.0	0.1	0.0
Economic impact								
Net investment	0.6	0.9	1.4	1.8	1.9	2.0	2.1	2.2
Public sector net borrowing (PSNB)	-1.7	0.1	1.9	2.2	1.6	1.6	1.5	1.5
Cyclically-adjusted PSNB	-1.2	0.2	1.2	1.5	1.3	1.5	1.5	1.5
Financing								
Central government net cash requirement	-3.7	0.3	1.8	2.8	1.9	1.7	1.9	1.6
European commitments								
Treaty deficit ²	-1.7	0.2	1.8	2.2	1.7	1.6	1.6	1.6
Cyclically-adjusted Treaty deficit ²	-1.2	0.2	1.1	1.4	1.3	1.5	1.6	1.6
Treaty debt ratio ³	39.9	38.2	37.9	38.8	38.9	38.9	39.1	39.2
Memo: Output gap	0.9	-0.3	-1.3	-1.0	-0.3	0.0	0.0	0.0

¹ At end-December; GDP centred on end-December.

² General government net borrowing on a Maastricht basis.

³ General government gross debt.

B9 The sustainable investment rule is also met comfortably over the projection period. In 1996-97, public sector net debt stood at 44 per cent of GDP. The tough decisions on taxation and spending taken by the Government over the course of the last Parliament, including the decision to use the proceeds from the auction of spectrum licences to repay debt, reduced net debt to around 30 per cent of GDP by the end of 2001-02. It is now projected to grow slowly and stabilise at around 33 per cent of GDP by 2007-08, as the Government borrows modestly to fund increased investment in public services, consistent with the fiscal rules. The projections for core debt, which exclude the estimated impact of the economic cycle, increase more slowly to just over 31 per cent of GDP.



B10 Net worth is the approximate stock counterpart of the current budget balance. Current budget surpluses of over 2 per cent of GDP in recent years have increased net worth to 26.7 per cent of GDP in 2002-03. Modest declines are projected during the projection period. At present, net worth is not used as a key indicator of the public finances, mainly as a result of the difficulties involved in measuring accurately many government assets and liabilities.

B11 The primary balance is equal to net borrowing excluding net debt interest payments – thus subtracting the implications of past fiscal deficits. If real interest rates exceed trend output growth, a primary surplus is required to stabilise the net debt ratio. The primary balance is projected to show a modest deficit in 2002-03 and 2003-04, but then to return to balance for the remainder of the projection period.

B12 As a result of decisions taken in the 2002 Spending Review, public sector net investment is projected to rise steadily to $2\frac{1}{4}$ per cent of GDP in 2007-08. These increases are sustainable and fully consistent with the Government's long-term approach and the fiscal rules, since net debt is being held at a stable and prudent level, well below 40 per cent of GDP. This increase in net investment, together with the new projections for the current budget, mean that public sector net borrowing is expected to increase from 0.1 per cent of GDP in 2001-02 to a maximum of $2\frac{1}{4}$ per cent in 2003-04, before falling back to about $1\frac{1}{2}$ per cent of GDP in later years. Cyclically-adjusted net borrowing is $1\frac{1}{2}$ per cent of GDP or lower in every year.

B13 The central government net cash requirement (CGNCR) was 0.3 per cent of GDP in 2001-02. The CGNCR is projected to increase in 2002-03 and subsequent years, mirroring the profile of public sector net borrowing.

B14 Table B2 also shows the Treaty measures of deficit and debt used in the Excessive Deficits Procedure. The reference levels of 3 per cent of GDP for the deficit and 60 per cent of GDP for gross debt are comfortably achieved throughout the projection period.

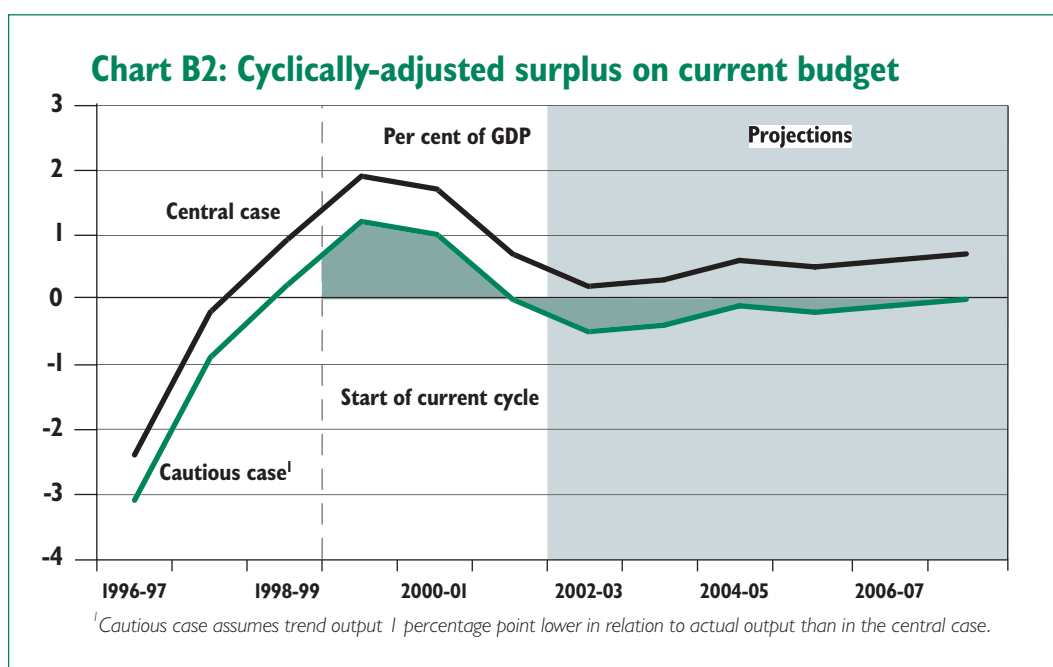
FORECAST DIFFERENCES AND RISKS

B15 The fiscal balances represent the difference between two large aggregates of spending and receipts, and forecasts are inevitably subject to wide margins of uncertainty. Over the past ten years, the average absolute difference between one-year ahead forecasts of net borrowing and subsequent outturns has been around 1 per cent of GDP. This difference tends

to grow as the forecast horizon lengthens. A full account of differences between the projections made in Budget 2000 and Budget 2001 and the subsequent outturns is provided in the *End of year fiscal report*.

BI6 The uncertainties surrounding the current projections are both global and domestic. Global downside risks include continued volatility in equity prices, the recovery in business investment being delayed, the possibility of renewed rises in oil prices, and the possible disorderly unwinding of current account imbalances. Upside risks include faster productivity growth and quicker global recovery. Domestic risks include house prices continuing to grow steeply, increasing the possibility of a sharp correction, and the emergence of inflationary pressures in the labour market. For these reasons the public finance projections continue to be based on cautious assumptions, including equity prices and trend growth. This helps to ensure that the public finances are sound, that fiscal policy can support monetary policy over the economic cycle and that the Government is on track to meet its tough fiscal rules.

BI7 Short-term forecasts of the public finances are critically dependent on the path of the economy, as most tax revenues and some public expenditure - notably social security - vary directly with the economic cycle. Earlier work¹ suggested that if GDP growth were one percentage point higher or lower than assumed over the coming year, net borrowing might be lower or higher by 0.4 per cent of GDP in the first year and by a further 0.3 per cent of GDP the following year. These figures are now closer to 0.5 and 0.2 per cent respectively, as the introduction of the corporation tax instalment system has reduced the lag between profits and tax receipts. However, not all cycles will conform exactly to these parameters, notably because the estimates are based on historical data (since which time both the state of the economy and the tax regime have changed) and because cycles differ in respects other than magnitude.



¹ *Fiscal policy: public finances and the cycle*, HM Treasury, March 1999.

B18 Forecast differences in short-term growth forecasts may have only a temporary effect on the public finances. For a given path of trend output, higher or lower growth in the short term will be followed by lower or higher growth later on, and the public finances may be little affected on average over the cycle.

B19 However, changes in the estimated cyclical position of the economy in relation to its trend - the output gap - will have a permanent effect on prospects. For this reason, the public finances projections are stress-tested against an alternative cautious case, in which the level of output is assumed to be 1 percentage point lower than the Government's central view. This scenario would imply that a greater proportion of any projected surplus on the current budget was due to the cyclical strength of the economy – a 1 per cent larger positive output gap reduces the structural surplus on the current budget by about $\frac{3}{4}$ per cent of GDP a year. This is illustrated in Chart B2. Even in this more cautious case, the cyclically-adjusted current budget is estimated to have been comfortably in surplus over the past four years. The impact of the temporary fall in receipts means that it is projected to move into a modest deficit over the short term, before returning broadly to balance towards the end of the projection period. However, since the start of the current cycle, the average surplus on the cyclically-adjusted current budget in the cautious case stays positive in each year, meaning that the golden rule is met, even in the cautious case. The same is true were the cycle to start in 1997-98.

ASSUMPTIONS

B20 The fiscal projections are based on the following assumptions:

- the economy follows the path described in Annex A. In the interests of caution, the fiscal projections continue to be based on the deliberately prudent and cautious assumption of trend output growth of $2\frac{1}{2}$ per cent a year up to 2006-07, $\frac{1}{4}$ percentage point lower than the Government's neutral view. Beyond 2006-07, projections by the Government Actuary imply a slowdown in the growth in the population of working age, due to demographic effects. As set out in the Budget 2002 paper, the Government's neutral view of trend output growth is reduced to $2\frac{1}{2}$ per cent in 2007-08, and so, to maintain a cautious approach, an assumption of $2\frac{1}{4}$ per cent is used in the public finance projections in that year, still $\frac{1}{4}$ percentage point lower than the Government's neutral view. The main economic assumptions are set out in Table B3;
- there are no tax changes beyond those announced since Budget 2002 or in this Pre-Budget Report (see Table B4), and the indexation of rates and allowances. Consistent with the *Code for fiscal stability*, the forecast does not take account of measures proposed in this Pre-Budget Report for consultation or other proposals where final decisions have yet to be taken;
- firm Departmental Expenditure Limits (DEL) as set out in the 2002 Spending Review up until 2005-06, but adjusted for the impact of policy decisions (see paragraph B64) and DEL/ AME reclassifications (see paragraph B69);
- total Annually Managed Expenditure (AME) is as set out in the 2002 Spending Review up until 2005-06, but adjusted for DEL/AME reclassifications and for the estimated costs of spending measures announced in this Pre-Budget Report or before (see Table B4). The forecast of individual components in AME has been updated with changes absorbed by the AME margin within set total AME;

- prior to spending plans being set in the 2004 Spending Review, real growth in DEL after 2005-06 in line with the economic growth assumption used for the public finances, supplemented by an addition to allow for the five-year health settlement of the difference between planned health growth and health's long term average growth of 3.6 per cent. Other current spending in AME is forecast to grow from 2005-06 onwards at 1³/₄ per cent in real terms in line with its recent trend; and
- within these aggregates, net investment is forecast to increase from 2 per cent of GDP in 2005-06 towards an assumption of 2¹/₄ per cent in 2007-08, while remaining consistent with the sustainable investment rule.

Table B3: Economic assumptions for public finance projections

	Percentage changes on previous year						
	Outturn	Projections					
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Output (GDP)	1 ¹ / ₂	2	2 ³ / ₄	3	2 ³ / ₄	2 ¹ / ₂	2 ¹ / ₄
Prices							
RPIX	2 ¹ / ₄	2 ¹ / ₄	2 ¹ / ₄	2 ¹ / ₂	2 ¹ / ₂	2 ¹ / ₂	2 ¹ / ₂
GDP deflator	2 ¹ / ₄	2 ¹ / ₂	2 ¹ / ₄	2 ¹ / ₂	2 ¹ / ₂	2 ¹ / ₂	2 ¹ / ₂
RPI ¹ (September)	1 ³ / ₄	1 ¹ / ₂	2 ¹ / ₂	3	2 ³ / ₄	2 ¹ / ₂	2 ¹ / ₂
Rossi ² (September)	1 ³ / ₄	1	1 ³ / ₄	2 ¹ / ₄	2	2	2
Money GDP ³ (£ billion)	998	1044	1096	1158	1220	1281	1342

¹ Used for revalorising excise duties in current year and uprating income tax allowances and bands and certain social security benefits in the following year.

² RPI excluding housing costs, used for uprating certain social security benefits.

³ Not seasonally adjusted.

B2I The key assumptions underlying the fiscal projections are audited by the National Audit Office (NAO) under the three-year rolling review process. Details of all the audited assumptions are given in Box B1. For this Pre-Budget Report, the Comptroller and Auditor General has audited the assumptions for oil prices under the three-year rolling review, and examined extensions to the assumptions covering VAT and tobacco smuggling measures. All three of the assumptions were deemed to be both reasonable and cautious². Revisions to the VAT and tobacco assumptions are described in detail later in this annex, and the effects of changes on receipts projections are shown in Tables B7 and B8.

Box BI: Key assumptions audited by the NAO

- **Privatisation proceeds^{1,6}** Credit is taken only for proceeds from sales that have been announced.
- **Trend GDP growth^{1,6,9}** 2½ per cent a year to 2006-07 and 2¼ per cent in 2007-08.
- **UK claimant unemployment^{1,4,7,9}** Rising slowly to 0.99 million in 2005-06, from recent levels of 0.94 million, consistent with average of independent forecasts.
- **Interest rates^{1,6,7}** 3-month market rates change in line with market expectations (as of 15 November).
- **Equity prices^{2,7}** FTSE All-Share index rises from 1963 (close 15 November) in line with money GDP.
- **VAT^{2,7,10}** Ratio of underlying VAT to consumption falls by 0.05 percentage points a year.
- **GDP deflator and RPI^{2,7}** Projections of price indices used to plan public expenditure are consistent with RPIX.
- **Composition of GDP^{3,8}** Shares of labour income and profits in national income are broadly constant in the medium term.
- **Funding^{3,8}** Funding assumptions used to project debt interest are consistent with the forecast level of government borrowing and with financing policy.
- **Oil prices^{5,10}** \$25.10 a barrel in 2003, the average of independent forecasts, and then constant in real terms.
- **Tobacco^{6,10}** Only the direct effects of the tobacco anti-smuggling strategy, including deterrent effects of fiscal marks, and any existing indirect effects are allowed for.

¹Audit of Assumptions for the July 1997 Budget Projections, 19 June 1997 (HC3693).

²Audit of Assumptions for the Pre-Budget Report, 25 November 1997 (HC361).

³Audit of Assumptions for the Budget, 19 March 1998 (HC616).

⁴Audit of the Unemployment Assumption for the March 1999 Budget Projections, 9 March 1999 (HC294).

⁵Audit of the Oil Price Assumption for the Pre-Budget Report, November 1999 (HC873).

⁶Audit of Assumptions for the March 2000 Budget, 21 March 2000 (HC348).

⁷Audit of Assumptions for the Pre-Budget 2000 Report, 8 November 2000 (HC959).

⁸Audit of Assumptions for the March 2001 Budget, 7 March 2001 (HC304).

⁹Audit of Assumptions for the April 2002 Budget, 17 April 2002 (HC760).

¹⁰Audit of Assumptions for the 2002 Pre-Budget Report, 27 November 2002 (HC109)

PRE-BUDGET REPORT POLICY DECISIONS

B22 Consistent with the requirements of the *Code for fiscal stability*, the updated projections take into account the fiscal effects of all firm decisions announced in this Pre-Budget Report or since Budget 2002, including the abolition of North Sea Royalty payments and further measures to tackle tax avoidance and establish a modern and fair tax system. The fiscal impact of these measures is set out in Table B4.

B23 In line with the convention adopted in previous Pre-Budget Reports, expenditure measures in AME for future years have been added to total AME. DEL spending measures have only been added to total DEL where they are funded by increased revenue or are the direct result of a decision to increase public spending as a whole. The measures that affect DEL are:

- the decision to reform the Landfill Tax Credit Scheme from April 2003 will release funding to encourage sustainable waste management. The design of this programme will be determined following further work on the management of waste policy. In advance of allocation decisions on the programme, these funds have been added to total DEL and credited to the Reserve;
- as in previous years, the underspend from 2001-02 has been carried forward and added to total DEL in 2002-03; and
- in 2002-03 there is a special reserve addition.

B24 The projections do not take account of measures proposed in this Pre-Budget Report for consultation prior to Budget 2003 and other proposals where final decisions have yet to be taken, including medium to long-term increases in the standard rate of landfill tax.

Table B4: Estimated costs of Pre-Budget Report policy decisions and others announced since Budget 2002¹

	(+ve is an Exchequer yield) £ million			
	2002-03	2003-04	2004-05	2005-06
Measures announced since Budget 2002				
Housing Benefit: standard rate pilot	0	-20	-20	-20
<i>Anti-avoidance measures</i>				
Derivative contracts: amendments to close loopholes in existing legislation	200	300	0	0
Controlled Foreign Companies: removing Ireland from excluded countries list	5	15	15	15
Total measures announced since Budget 2002	205	295	-5	-5
Measures announced in the Pre-Budget Report				
Share schemes – statutory corporation tax deduction	0	5	-45	-75
Transition to work: extending the Job Grant	0	0	-15	-15
Increases to the Social Fund budget	0	-25	-35	-45
Freeze of Class 2 NICs	0	-5	-5	-5
Extension of the Payroll Giving supplement for one year	0	-10	0	0
Abolition of North Sea Royalty from 1 January 2003	0	-170	-140	-120
Replacement of Landfill Tax Credit Scheme	0	100	110	110
<i>Anti-avoidance measures</i>				
Abuse of Employee Benefit Trusts	135	315	425	435
Claims for unfairly accelerated capital allowances	0	20	30	30
Controlled Foreign Companies: avoidance of UK tax on profits from extended warranties	0	0	50	170
Avoidance of VAT on sales of freehold buildings	60	165	165	165
Total Pre-Budget Report measures	195	395	540	650
Additional Pre-Budget Report policy decisions				
Additional waste spending in DEL	0	-100	-110	-110
Special reserve addition to DEL	-1000	0	0	0
Carry forward from 2001-02	-435	0	0	0
TOTAL POLICY DECISIONS	-1035	590	425	535

¹ All costings shown relative to an indexed base.

FISCAL AGGREGATES

B25 Tables B5 and B6 provide more detail on the projections for the current and capital budgets. The tables show the current budget and net borrowing both including and excluding Windfall Tax and associated spending (WTAS). WTAS now has much less impact and, unless otherwise stated, all projections now cover all public expenditure. Latest estimates of associated spending are given in Table 4.1.

Table B5: Current and capital budgets

	£ billion						
	Outturn		Projections				
	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
Current budget							
Current receipts	390.7	399.7	430	463	493	521	548
Current expenditure	369.6	391.4	420	444	471	496	520
Depreciation	13.4	14.1	15	15	16	17	18
Surplus on current budget (excluding WTAS ¹)	8.4	–4.8	–5	3	5	8	10
Surplus on current budget	7.7	–5.7	–5	3	5	8	10
Capital budget							
Gross investment	26.5	32.2	38	41	44	48	52
less asset sales	–4.3	–3.8	–4	–4	–4	–4	–4
less depreciation	–13.4	–14.1	–15	–15	–16	–17	–18
Net investment	8.8	14.3	20	22	24	27	30
Net borrowing (excluding WTAS ¹)	0.0	19.1	24	19	19	19	20
Net borrowing	1.2	20.1	24	19	19	19	20
Public sector net debt – end year	310.9	332.0	362	385	407	430	454
Memos:							
Treaty deficit ²	1.7	18.7	24	19	19	21	21
Treaty debt ³	380.7	396.0	426	450	475	500	527

¹ Windfall Tax receipts and associated spending.

² General government net borrowing on a Maastricht basis.

³ General government gross debt.

B26 The current budget surplus is equal to public sector receipts minus public sector current expenditure and depreciation. The current budget is projected to show a modest deficit in 2002–03 and 2003–04, before moving back into surplus throughout the rest of the projection period. These temporary deficits are consistent with allowing the automatic stabilisers to operate fully over the economic cycle, while continuing to meet the golden rule.

B27 The cumulative total surplus on the current budget between 1999–2000, the beginning of the current economic cycle, and 2001–02 is £49 billion. If the cycle were to start in 1997–98, the accumulated surplus would be £58 billion. Even after the modest cyclical deficits expected in 2002–03 and 2003–04, the current budget will therefore be comfortably in surplus over this cycle.

B28 Underlying the projections of the current budget are steady increases in the ratios of public sector receipts and current expenditure to GDP, shown in Table B6, largely reflecting measures announced in Budget 2002 and the 2002 Spending Review. By 2005–06, when the current cycle ends under the assumptions used in these projections, the accumulated total surplus over this economic cycle will be £46 billion.

B29 Table B5 also shows that net investment is projected to more than double from £14¹/₄ billion in 2002-03 to £30 billion in 2007-08, as the Government seeks to rectify historical under-investment in public infrastructure. These increases are sustainable and fully consistent with the Government's long-term approach and the fiscal rules, as debt is being held at 33 per cent of GDP or below throughout the projection period, well within the 40 per cent limit set by the sustainable investment rule, as shown in Table B6.

Table B6: Current and capital budgets

	Per cent of GDP						
	Outturn		Projections				
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Current budget							
Current receipts	39.2	38.3	39.3	39.9	40.4	40.6	40.8
Current expenditure	37.0	37.5	38.4	38.4	38.6	38.7	38.8
Depreciation	1.3	1.4	1.3	1.3	1.3	1.3	1.3
Surplus on current budget (excluding WTAS ¹)	0.8	-0.5	-0.4	0.3	0.4	0.6	0.7
Surplus on current budget	0.8	-0.5	-0.4	0.2	0.4	0.6	0.7
Capital budget							
Gross investment	2.7	3.1	3.5	3.5	3.6	3.7	3.9
less asset sales	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3
less depreciation	-1.3	-1.4	-1.3	-1.3	-1.3	-1.3	-1.3
Net investment	0.9	1.4	1.8	1.9	2.0	2.1	2.2
Net borrowing (excluding WTAS ¹)	0.0	1.8	2.2	1.6	1.6	1.5	1.5
Net borrowing	0.1	1.9	2.2	1.6	1.6	1.5	1.5
Public sector net debt – end year	30.4	31.0	32.1	32.4	32.6	32.7	33.0
Memos:							
Treaty deficit ²	0.2	1.8	2.2	1.7	1.6	1.6	1.6
Treaty debt ratio ³	38.2	37.9	38.8	38.9	38.9	39.1	39.2

¹ Windfall Tax receipts and associated spending.

² General government net borrowing on a Maastricht basis.

³ General government gross debt.

B30 Table B7 sets out the effects of revisions and forecasting changes, including the effect of the changes to the VAT and tobacco audited assumptions, Pre-Budget Report policy decisions and other discretionary changes since Budget 2002 on the main fiscal aggregates.

Table B7: Fiscal balances compared with Budget 2002

	£ billion					
	Outturn		Projections			
	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07
Surplus on current budget						
Budget 2002	10.6	3.2	7	9	7	9
Effect on receipts of:						
Revisions and forecasting changes	–0.1	–7.8	–12	–6	–2	0
of which:						
Indirect tax fraud and avoidance changes	0.0	0.0	1	1	2	2
Policy decisions since Budget 2002	—	0.4	1	1	1	1
Effects on spending of:						
Revisions and forecasting changes	–2.8	–0.1	0	0	–1	–1
Policy decisions since Budget 2002	—	–1.4	0	0	0	0
PBR 2002	7.7	–5.7	–5	3	5	8
Net borrowing						
Budget 2002	1.3	11.2	13	13	17	18
Effects of changes in the current surplus	3.0	8.9	12	6	2	1
Effects of changes in net investment	–3.1	–0.1	0	0	0	0
PBR 2002	1.2	20.1	24	19	19	19

Note: Figures may not sum due to rounding.

B31 The latest available outturn information for 2001-02 shows current receipts only £0.1 billion lower than estimated in Budget 2002, but current expenditure, including depreciation, £2.8 billion higher. As a result, the current budget surplus was around £3 billion lower than expected at Budget 2002. However, net borrowing was only around £0.1 billion lower, as net investment was around £3 billion lower than estimated in Budget 2002. Further explanation of the differences between outturns and earlier forecasts is given in the *End of year fiscal report*.

B32 The current surplus for 2002-03 onwards is lower than in Budget 2002, mainly because of lower tax receipts, especially income tax and corporation tax. Further details of these changes are given in the next section. Net borrowing is also increased by the forecasting changes to receipts.

B33 There are only minor forecasting changes to total expenditure in 2002-03 and during the 2002 Spending Review period. However, changes to the composition of expenditure announced in the Spending Review, coupled with the assumptions used to project spending after the end of the Spending Review period, lead to small increases in spending in 2006-07.

RECEIPTS

B34 This section looks in detail at the Pre-Budget Report projections for public sector tax receipts. Table B8 provides a detailed breakdown of the main factors that have led to changes in the overall projections since Budget 2002, while Table B9 shows the changes to the individual taxes. Table B10 sets out projections of the overall tax-GDP ratio and Table B11 shows projections of receipts from major taxes as a per cent of GDP. Tables B12 and B13 give more information on the level of tax receipts in 2001-02, 2002-03 and 2003-04.

Total receipts

B35 As shown in Table B8, relative to Budget 2002, current receipts are projected to be around £7½ billion lower in 2002-03 and around £11½ billion lower in 2003-04. Most of these falls are explained by cyclical or other temporary factors. As a result, overall levels of receipts are expected to return to their Budget 2002 levels over the medium term.

B36 Changes to the assumptions audited by the NAO explain only a small proportion of the fall in receipts in 2002-03. However, they have a much larger impact in subsequent years, mainly because of changes in equity prices. The audited assumption underpinning the current projections is that equity prices increase in line with money GDP from the existing level of the FTSE All-Share Index, 1963 in these projections, compared with the Budget 2002 starting point of 2542. As a result, equity prices are 23 per cent lower than the Budget forecast for 2002-03 and 25 per cent lower for 2003-04. Equity price levels are important determinants of capital taxes, stamp duty and, because of their impact on the capital gains of life insurance companies, corporation tax, though the timing of the impact varies from tax to tax, and the size of the impact increases after the first year. Lower equity prices reduce receipts by around £1 billion in 2002-03, by £3½ billion in 2003-04, and by around £4 billion a year from 2004-05 onwards.

Table B8: Changes in current receipts since Budget 2002

	£ billion				
	Projections				
	2002-03	2003-04	2004-05	2005-06	2006-07
Effect on receipts of changes in:					
Assumptions audited by the NAO	0	-3½	-3	-2½	-1½
of which: Equity prices	-1	-3½	-4	-4	-4
Revised tobacco and VAT assumptions	0	½	1½	2	2
Financial company profits	-5	-5	-3½	-1½	-1
Other economic and forecasting effects¹	-2½	-3½	½	2	2½
Total before policy changes	-8	-12	-6	-2	0
Policy decisions since Budget 2002 affecting receipts	½	½	½	½	1
Total change	-7½	-11½	-5½	-1½	½

¹ Excluding assumptions audited by the NAO.

Table B9: Changes in current receipts by tax since Budget 2002

	£ billion		
	2001-02	2002-03	2003-04
Income tax (gross of tax credits)	0.1	-3.4	-3.0
Non-North Sea corporation tax ¹	0.0	-3.7	-5.7
Less tax credits ²	0.3	0.5	-2.1
North Sea revenues	0.0	-0.5	-1.2
Capital taxes ³	0.0	0.2	-0.2
Stamp duty	0.0	0.0	0.0
Value added tax	0.0	0.6	0.6
Excise duties ⁴	0.0	-0.3	-0.9
Social security contributions	0.0	0.5	0.7
Other taxes and royalties ⁵	-0.9	0.1	0.9
Net taxes and social security contributions	-0.5	-6.0	-11.0
Other receipts and accounting adjustments	0.4	-1.4	-0.3
Current receipts	-0.1	-7.4	-11.3

¹ National Accounts measure: gross of enhanced and payable tax credits.

² Includes company tax credits.

³ Capital gains tax and inheritance tax.

⁴ Fuel, alcohol and tobacco duties.

⁵ Includes council tax and money paid into the National Lottery Distribution Fund, as well as other central government taxes.

B37 Changes to the audited assumptions for VAT and tobacco add about £½ billion to receipts in 2003-04 and increasing amounts thereafter, reaching almost £2 billion in 2007-08. These effects are also shown in the audited assumptions section of Table B8. The Government aims to reduce VAT fraud by more than £2 billion a year by 2005-06, but in line with its audited, cautious approach to forecasting a lower figure of £1.4 billion a year is used here.

B38 A large proportion of the temporary shortfall in receipts relative to the Budget 2002 forecast is explained by temporarily lower levels of financial companies' profits resulting from the impact of global events, especially further downturns in international capital markets. This impacts most significantly on the corporation tax paid by financial companies (other than life insurance companies – see paragraph B36) and on income tax, through their impact on the level of salaries, especially bonuses, paid by financial companies to their employees.

B39 The other economic and forecasting effects line in Table B8 is driven by a large number of different, but interrelated, factors working in different directions at different times. Some of these effects are temporary but others persist throughout the projection period. They include changes to other economic determinants such as GDP components and price effects and fiscal forecasting changes, which reflect recent tax receipts data that cannot be explained by changes in economic determinants, and changes arising from the models used to forecast receipts relating to, for example, average tax rates. The more important changes are described in the following tax-by-tax analysis section. The figures for 2003-04 onwards include a fall of about £2 billion a year in respect of the revision to the split of tax credits between their negative tax and expenditure components. This has no overall impact on the current budget or net borrowing, and is explained in more detail in paragraph B47.

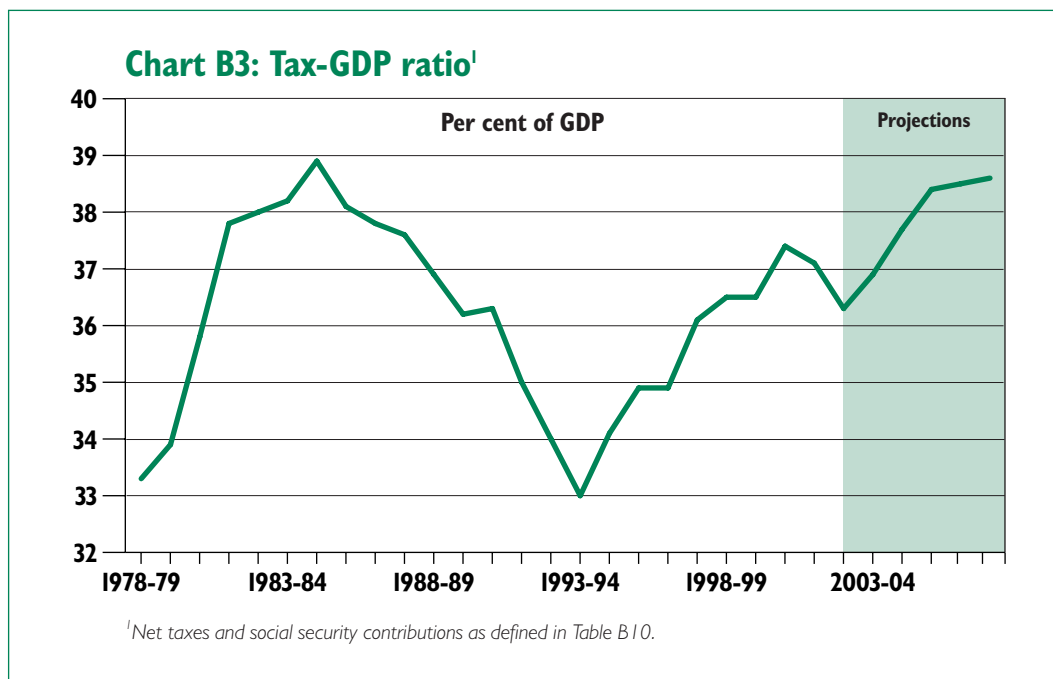
Tax-GDP ratio **B40** Table B10 shows the impact of changes to tax projections on the tax-GDP ratio, which is now expected to fall to 36.3 per cent of GDP in 2002-03, compared with a Budget 2002 projection of 36.7 per cent. Similarly, the tax-GDP ratio in 2003-04 is now projected to be 37.0 per cent, compared with a Budget 2002 projection of 37.6 per cent. Thereafter, the recovery of financial company profits and other cyclical and temporary factors mean that the tax-GDP ratio moves back towards Budget 2002 levels. The additional VAT and tobacco duty receipts resulting from changes to the audited assumptions also increase the ratio, by up to 0.2 percentage points in the medium term. Chart B3 shows the tax-GDP ratio from 1978-79 to 2007-08.

Table B10: Net taxes and social security contributions¹

	Per cent of GDP						
	Outturn ²		Projections				
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Budget 2002	37.0	36.7	37.6	38.1	38.3	38.3	
PBR 2002	37.1	36.3	37.0	37.7	38.2	38.4	38.6

¹ Cash basis. Uses OECD definition of negative tax personal tax credits. Net of company tax credits.

² The 2001-02 figures were estimates in Budget 2002.



B4I Table B11 provides a more detailed breakdown of the projections of the tax-GDP ratio, which is derived from 'net taxes and social security contributions' (NTSSC). This is a measure of net cash payments made to UK government and differs in several respects from the accruals measures used in the National Accounts. The lower half of Table B11 sets out the adjustments needed to reconcile NTSSC with total current receipts, as defined in the National Accounts. Similar information is given, in £ billion, in Table B12. The main adjustments are:

- accruals adjustments, mainly on income tax, national insurance contributions and VAT, are added to change the basis of figures from cash to National Accounts accruals;
- some tax payments that are collected by the government, but then paid to the EC, are subtracted as they do not score as government receipts in the National Accounts;
- tax paid by public corporations is also subtracted, as it has no impact on overall public sector receipts;
- an adjustment is made for tax credits. In NTSSC, all tax credits are scored as negative tax to the extent that they are less than or equal to the tax liability of the household, and as public expenditure where they exceed the liability, in line with OECD Revenue Statistics guidelines. Although the Office for National Statistics will adopt this treatment in the National Accounts for the Working Tax Credit and Child Tax Credit, due to be introduced in April 2003, they have continued to treat the Working Families' Tax Credit (WFTC), the Disabled Person's Tax Credit (DPTC) and enhanced and payable company tax credits entirely as public expenditure in the National Accounts. Those parts of WFTC, DPTC and company tax credits that offset tax liability in NTSSC are added back into current receipts in Table B11; and
- interest and other non-tax receipts, which are excluded from NTSSC, are added. However, NTSSC includes payments of oil royalties, prior to their abolition from 1 January 2003, which are not scored as tax in the National Accounts.

Table B1 I: Current receipts as a proportion of GDP

	Per cent of GDP						
	Outturn 2001–02	2002–03	2003–04	Projections			
				2004–05	2005–06	2006–07	2007–08
Income tax (gross of tax credits)	11.1	10.9	11.2	11.4	11.6	11.8	11.9
Non-North Sea corporation tax ¹	2.9	2.5	2.5	2.9	3.2	3.3	3.3
Tax credits ²	–0.2	–0.3	–0.4	–0.4	–0.4	–0.4	–0.4
North Sea revenues ³	0.5	0.5	0.4	0.4	0.4	0.4	0.3
Value added tax	6.1	6.2	6.1	6.1	6.1	6.1	6.1
Excise duties ⁴	3.7	3.6	3.5	3.4	3.3	3.3	3.2
Social security contributions	6.3	6.3	6.9	7.0	7.0	7.0	7.1
Other taxes and royalties ⁵	6.7	6.7	6.7	6.8	6.9	7.0	7.1
Net taxes and social security contributions ⁶	37.1	36.3	37.0	37.7	38.2	38.4	38.6
Accruals adjustments on taxes	0.1	–0.1	0.3	0.2	0.2	0.2	0.2
less EC transfers	–0.4	–0.3	–0.2	–0.2	–0.1	–0.1	–0.1
Tax credits ⁷	0.1	0.1	0.1	0.0	0.0	0.1	0.1
Other receipts ⁸	2.2	2.2	2.2	2.2	2.1	2.1	2.1
Current receipts	39.2	38.3	39.3	39.9	40.4	40.6	40.8
Memo:							
Current receipts (£ billion)	390.7	399.7	430	463	493	521	548

¹ National Accounts measure: gross of enhanced and payable tax credits.

² Tax credits scored as negative tax in net taxes and social security contributions.

³ Includes oil royalties, petroleum revenue tax and North Sea corporation tax.

⁴ Fuel, alcohol and tobacco duties.

⁵ Includes council tax and money paid into the National Lottery Distribution Fund, as well as other central government taxes.

⁶ Includes VAT and 'own resources' contributions to EC budget. Cash basis.

⁷ Tax credits scored as negative tax in net taxes and social security contributions, but as expenditure in the National Accounts.

⁸ Mainly gross operating surplus and rent, excluding oil royalties.

Tax-by-tax analysis

B42 This section looks in detail at the projections for individual taxes and receipts. Table B12 contains updated projections for the main components of public sector receipts up to 2003–04, while Table B13 looks in more detail at changes in receipts between 2001–02 and 2002–03.

Income tax B43 As shown in Table B13, total income tax receipts for April to October 2002 have increased very little relative to the same period in 2001–02. Receipts are expected to grow a little more strongly over the rest of the year, mainly because of self assessment receipts, which are due at the end of January, but income tax receipts in 2002–03 are now expected to be £114 billion, around £3½ billion lower than forecast in Budget 2002. This reflects a reduction in the Pay as You Earn (PAYE) projection of just under £4 billion, offset by a £½ billion increase in other types of income tax. As explained in Box 3.2 of the *End of year fiscal report*, PAYE is projected by applying appropriate tax rates to the changes in the tax base. Estimates of wages and salaries, the most important component of the tax base, are only slightly lower than in Budget 2002, and most of the fall in PAYE is due to a fall in the average tax rate. The falls in financial companies' profits this year also seem likely to impact on bonuses at the end of 2002–03, and the forecast prudently makes an allowance for this.

Table B12: Current receipts

	£ billion		
	Outturn 2001–02	2002–03	Projections 2003–04
<i>Inland Revenue</i>			
Income tax (gross of tax credits)	110.4	114.1	123.0
Corporation tax ¹	32.4	29.3	30.8
Tax credits ²	-2.3	-3.5	-4.9
Petroleum revenue tax	1.3	1.1	1.3
Capital gains tax	3.0	2.0	1.4
Inheritance tax	2.4	2.4	2.6
Stamp duties	7.1	8.2	8.6
Social security contributions	63.2	65.5	75.4
Total Inland Revenue (net of tax credits)	217.4	219.1	238.3
<i>Customs and Excise</i>			
Value added tax	61.0	64.5	67.3
Fuel duties	21.9	22.4	23.1
Tobacco duties	7.8	8.2	7.8
Spirits duties	1.9	2.2	2.4
Wine duties	2.0	1.9	1.9
Beer and cider duties	3.1	3.1	3.1
Betting and gaming duties	1.4	1.3	1.3
Air passenger duty	0.8	0.8	0.8
Insurance premium tax	1.9	2.1	2.2
Landfill tax	0.5	0.5	0.7
Climate change levy	0.6	0.9	0.9
Aggregates levy	0.0	0.2	0.4
Customs duties and levies	2.0	2.0	1.9
Total Customs and Excise	104.9	110.1	113.8
Vehicle excise duties	4.2	4.4	4.8
Oil royalties	0.5	0.5	0.0
Business rates ³	17.5	18.0	18.2
Council tax	15.3	16.6	17.8
Other taxes and royalties ⁴	10.1	10.9	12.3
Net taxes and social security contributions⁵	369.8	379.6	405.1
Accruals adjustments on taxes	1.3	-0.6	3.4
<i>less own resources contribution to EC budget</i>	<i>-3.6</i>	<i>-3.0</i>	<i>-2.4</i>
<i>less PC corporation tax payments</i>	<i>-0.1</i>	<i>-0.2</i>	<i>-0.2</i>
Tax credits ⁶	0.8	1.2	0.6
Interest and dividends	4.7	4.1	4.1
Other receipts ⁷	17.7	18.6	19.7
Current receipts	390.7	399.7	430.3
<i>Memo:</i>			
North sea revenues ⁸	5.2	4.9	4.5

¹ National Accounts measure: gross of enhanced and payable tax credits.

² Includes enhanced and payable company tax credits.

³ Includes district council rates in Northern Ireland paid by business.

⁴ Includes money paid into the National Lottery Distribution Fund.

⁵ Includes VAT and 'traditional own resources' contributions to EC budget. Cash basis.

⁶ Excludes Children's Tax Credit and other tax credits which score as a tax repayment in the National Accounts.

⁷ Includes gross operating surplus and rent; net of oil royalties.

⁸ Consists of North Sea corporation tax, petroleum revenue tax and royalties.

Table B13: Net taxes and social security contributions 2002-03

	£ billion			Percentage change on 2001-02		
	Outturn ¹ Apr–Oct	Estimate Nov–Mar	2002–03	Outturn ¹ Apr–Oct	Nov–Mar	Full year
<i>Inland Revenue</i>						
Income tax and capital gains tax ²	60.6	52.3	112.9	0.9	2.6	1.7
Corporation tax ³	20.0	9.0	29.0	–14.0	–1.0	–10.3
Petroleum revenue tax	0.6	0.6	1.1	–35.0	30.8	–13.5
Inheritance tax	1.4	1.0	2.4	–0.1	6.5	2.5
Stamp duties	4.7	3.5	8.2	5.9	30.1	15.1
Social security contributions	37.4	28.2	65.5	1.7	6.5	3.7
Total Inland Revenue (net of tax credits)	124.6	94.5	219.1	–1.7	4.4	0.8
<i>Customs and Excise</i>						
Value added tax	37.8	26.7	64.5	5.1	6.3	5.6
Fuel duties	13.0	9.4	22.4	0.9	4.0	2.1
Tobacco duties	4.9	3.2	8.2	7.2	2.1	5.1
Alcohol duties	4.2	3.1	7.3	5.4	3.4	4.5
Other Customs duties and levies	4.5	3.3	7.8	8.5	8.4	8.5
Total Customs and Excise	64.3	45.8	110.1	4.6	5.5	5.0
Vehicle excise duties	2.5	1.9	4.4	–2.8	16.9	4.7
Oil royalties	0.2	0.3	0.5	–38.4	9.3	–15.9
Business rates	13.8	4.3	18.0	9.4	–13.2	3.1
Council tax	11.1	5.5	16.6	9.4	6.6	8.5
Other taxes and royalties ⁴	6.6	4.3	10.9	15.5	–2.2	7.9
Net taxes and social security contributions⁵	223.1	156.5	379.6	1.6	4.1	2.6

¹ Provisional.² Net of personal tax credits.³ Net of company tax credits.⁴ Includes money paid into the National Lottery Distribution Fund.⁵ Includes VAT and 'traditional own resources' contributions to EC budget. Cash basis.

B44 After 2002-03, the projected growth in wages and salaries is marginally higher than assumed in Budget 2002. Slightly less of this growth is assumed to derive from employment growth and slightly more from growth in average earnings, mainly reflecting the results of the 2001 Census and new population projections. This increases the effective tax rate on wages and salaries, while the lower indexation factors used to uprate personal allowances and tax bands have a similar effect in 2004-05. The average tax rate is also assumed to recover slowly from the fall in 2002-03, as financial companies' profits recover from their current low levels. Mainly as a result of these effects, receipts at the end of the period are only about £³/₄ billion a year lower than in Budget 2002.

Non-North Sea corporation tax

B45 Non-North Sea corporation tax receipts in 2002-03 are expected to be £26 billion, almost £4 billion lower than projected in Budget 2002. This downward revision is largely based on instalment payments received in July and October – the first and second instalments paid in respect of 2002 for companies with calendar year accounting periods, together with the first instalments in respect of 2002-03 for companies with fiscal year accounting periods. Much of the observed shortfall relates to financial companies as their instalment payments suggest that the companies' own estimates of their profitability in 2002 are around 20 per cent lower

than assumed in Budget 2002. Most financial companies have calendar year accounting periods and the impact of transitional provisions associated with the Budget 1998 reforms, coupled with falling profits, means that receipts were particularly low in October 2002, and much lower than in October 2001. Receipts over the remainder of 2002-03 are likely to be only slightly lower than in the corresponding period in 2001-02.

B46 After 2002-03, non-financial company profits are assumed to recover to a slightly higher level than assumed in Budget 2002. Coupled with lower than previously projected interest payments and investment levels, this would result in slightly higher projected receipts. However, these effects are broadly offset by other fiscal forecasting changes reflecting new data, notably on the stock of capital allowances available to companies. Financial companies' profits are also projected to be much lower in 2003-04 than expected at the time of the Budget, but to recover over the projection period to slightly lower levels than assumed earlier in the year. As discussed in paragraph B36, lower equity prices will have adverse effects on life insurers' profits which derive largely from capital gains. Receipts from life insurers are therefore projected to be between £1 and £1½ billion a year lower than expected in Budget 2002. In total, non-oil corporation tax receipts are expected to be lower than in Budget 2002, by around £5¾ billion in 2003-04, and by declining amounts in later years.

Tax credits **B47** The tables in this section show the amounts of tax credits classified as negative tax in line with OECD Revenue Statistics guidelines (see paragraph B41). The public expenditure amounts are included in Table B17. Since Budget 2002, the estimated split of total tax credits between that scored as tax and that scored as public expenditure has been revised, with the negative tax element now about £2 billion a year higher from 2003-04 onwards. These revisions are balanced by changes in the public expenditure element of tax credits. Similar changes, though smaller and acting in the opposite direction, have been made to earlier years to reflect revisions to the negative tax - public expenditure split of WFTC. This has no overall impact on the current balance or net borrowing.

North Sea revenues **B48** North Sea revenues in 2002-03 are expected to be just under £5 billion, around £½ billion lower than forecast in Budget 2002, of which around half is North Sea corporation tax. Much of this reflects lower than expected production. The very different growth rates shown for petroleum revenue tax in Table B13 reflect the interactions between oil price changes and the payment regime. Oil prices were much lower in the second half of 2001 than in the first half, but the pattern reversed in 2002.

B49 The production forecast underlying the projection in future years is around 5 per cent lower than that underpinning the Budget projections, largely reflecting outturns this year. This accounts for much of the downward revision in projected revenues after this year. While the projections are based on a starting oil price of \$25.10 – almost 15 per cent higher than in Budget 2002 – the projections for sterling have strengthened against the dollar by almost as much, leaving the sterling oil price little changed. As a result, the impact of oil price changes on receipts has been small.

Capital taxes **B50** Receipts of capital taxes are expected to be £4½ billion in 2002-03, marginally higher than projected in Budget 2002. Capital gains tax receipts in 2002-03 are based on gains realised in 2001-02, and are therefore unaffected by recent movements in asset prices. The upward revision largely reflects new information on tax receipts and also the mix of assets upon which chargeable gains are realised. Inheritance tax receipts respond to asset prices with a lag, so that recent changes in asset prices have little effect on receipts in 2002-03.

B51 In later years, capital tax receipts are about £¼ billion a year lower than in the Budget 2002 forecast. The impact of lower equity prices on inheritance tax is offset almost entirely by the effect of higher house prices, leaving projected receipts little changed since Budget 2002. However, the equity price changes have a bigger impact on capital gains tax than house price

changes, because gains arising from the sale of main residences are exempt from tax. The full impact does not take effect until 2004-05, partly because the largest falls in share prices occurred part of the way through 2002-03, and partly because of the time lag before tax is paid.

Stamp duty B52 Receipts of stamp duty are expected to be £8 billion in 2002-03, unchanged from Budget 2002. Around two-thirds of stamp duty receipts relate to land and property transactions; the remainder is derived from shares. The unchanged projection for 2002-03 partly reflects the offsetting nature of the changes in the assumptions for house prices and equity prices. The growth rate relative to 2001-02 is expected to increase in the latter part of 2002-03 because of the quarterly pattern of house price increases. Outturns for the year to date suggest that stamp duty on land has responded less strongly than would have been expected given the strength of house prices and transactions in the housing market. Commercial property accounts for about one third of the yield from land and property and prices in this sector have not risen nearly as fast as house prices. There is also some evidence that the prices of cheaper houses have risen more rapidly than more expensive ones, which, given the differing rates charged, has reduced the average tax rate. On the equity side, the volume of equity transactions observed so far in 2002-03 has been higher than expected, partly offsetting the effect of lower prices.

B53 Stamp duty receipts are also expected to be unchanged from Budget 2002 projections in 2003-04 and about £¼ billion lower in 2004-05. The larger reduction relative to 2002-03 reflects the impact of a full year of lower equity prices, together with an assumption that housing and equity market transactions revert to more normal levels.

Social security contributions B54 Receipts from social security contributions are expected to be just over £65 billion in 2002-03, around £½ billion higher than projected in Budget 2002. The bonus changes and other distributional effects described in paragraph B43 have less effect on national insurance contributions than on income tax collected under PAYE, and changes in the timing of personal pension repayments suggest that growth will be higher in the remaining months of 2002-03 than observed for April to October. In later years, the upward revision to the accrual in 2002-03 increases the projection slightly, as do the small increases in projected wages and salary growth compared with Budget 2002.

VAT receipts B55 VAT receipts in 2002-03 are expected to be about £0.5 billion higher than projected in Budget 2002, largely reflecting stronger than expected receipts in the first half of the year. The forecast of VAT revenues from 2003-04 onwards continues to be governed by an NAO audited assumption, which stipulates that the ratio of VAT receipts to consumers' expenditure should decline gradually, by 0.05 percentage points a year, after the effects of VAT policy decisions are taken into account. This assumption, together with downward revisions to consumers' expenditure in 2003-04 and the upward revisions to receipts in 2002-03, has a broadly neutral effect on receipts in 2003-04 compared with Budget 2002. However, the combined effect increases VAT receipts in all other forecast years.

B56 The VAT forecast also takes into account additional VAT receipts resulting from the introduction of a new strategy for tackling VAT fraud and avoidance, which is expected to produce more than £2 billion a year in additional revenues by 2005-06. This is the Government's aim, but in line with the audited, cautious approach underlying the public finances, a lower figure of £1.4 billion a year by 2005-06 has been included in the public finance forecast. Scoring of any extra revenue in future forecasts will be subject to further evidence that the strategy is working. The strategy itself is described in Chapter 5, and in *Protecting indirect tax revenues*, published alongside this Pre-Budget Report.

Excise duties B57 Excise duties in 2002-03 are expected to be around £0.3 billion lower than forecast in Budget 2002, and £0.9 billion lower than forecast in 2003-04. This is mainly due to a downward revision in the forecast for fuel duties of around £0.7 billion for 2002-03 and of about £0.9 billion for 2003-04. This partly reflects higher oil prices, lower GDP and lower forecasts for the RPI, which is used to uprate duty rates. Table B13 shows that although fuel duty receipts were only marginally higher in the first half of 2002-03 than in 2001-02, they are expected to be around 2 per cent higher for the year as a whole. This is because the current forecast for 2002-03 assumes that duty rates will be increased in line with inflation in March 2003, and that there will be corresponding forestalling by oil companies that will result in a surge in receipts in March 2003. There was no such behaviour in March 2002 because of the late Budget in 2002, and therefore receipts in the second half of 2002-03 are expected to be higher than in the second half of 2001-02.

B58 The impact of the revision to fuel duty receipts is partly offset by higher tobacco duties, which have been revised up in 2002-03 by around £0.4 billion, mainly on account of stronger than expected receipts in the first half of the year.

B59 The tobacco forecast is determined in part by an NAO audited assumption governing the proportion of additional revenue that should be included in the fiscal forecast resulting from HM Customs and Excise's tobacco anti-smuggling strategy. This assumption has been revised and now specifies that the forecast should take account of existing indirect effects, as well as direct effects. The revised assumption, combined with downward revisions to RPI figures and the impact of new indicative levels for bringing cigarettes and tobacco into the UK from the EU, results in projections that are close to Budget 2002 levels in 2003-04, and about £0.2 billion higher in later years. Alcohol duties are broadly as forecast in Budget 2002.

Other receipts B60 Receipts from business rates in all years are expected to be around £0.5 billion lower than in Budget 2002, largely reflecting lower than expected net increases to rateable property values and lower indexation. The impact on total receipts is more than offset by higher than expected VAT refunds to central government and local authorities, although these refunds are balanced by offsetting changes in current expenditure.

PUBLIC EXPENDITURE

B61 Table B14 shows projections for public expenditure through to 2005-06, the last year covered by the 2002 Spending Review. The projections cover the whole of the public sector, using the National Accounts aggregate Total Managed Expenditure (TME). TME is split into Departmental Expenditure Limits (DEL) – firm three year limits for departments' programme spending – and Annually Managed Expenditure (AME) – spending that is not easily subject to firm multi-year limits.

B62 The 2002 Spending Review was the first to be conducted on a full resource basis. Resource accounting and budgeting (RAB) replaces the previous approach of planning and controlling public expenditure on a cash basis and applies the best financial and disclosure practices of commercial accounting to central government finances. Resource budgeting was introduced in two stages, and prior to the 2002 Spending Review budgets were set on a 'near cash' basis – a hybrid of resource budgeting and the previous cash management system. Table B14 tracks changes to DEL, AME and TME from Budget 2002 through the 2002 Spending Review to the projections set out in this Pre-Budget Report. As the table shows, the move to full resource budgeting does not affect TME, but does lead to changes within DEL and AME.

B63 The Pre-Budget Report is an interim report on the public finances. For this purpose, and in line with the usual convention, TME has been increased to accommodate the impact of policy decisions set out in Table B4 but otherwise remains unchanged.

Table B14: Public expenditure aggregates

	£ billion				
	Outturn 2001–02	2002–03	Projections 2003–04 2004–05 2005–06		
Departmental Expenditure Limits (DEL)					
Budget 2002 – near cash basis ¹	211.8	229.5	249.1	—	—
2002 Spending Review – near cash basis	212.4	229.8	252.9	269.1	289.7
2002 Spending Review – resource based allocation	221.8	239.7	263.4	279.8	301.0
Changes since 2002 Spending Review	–0.2	1.6	3.1	3.4	3.6
PBR 2002	221.5	241.3	266.5	283.2	304.6
Annually Managed Expenditure (AME)					
Budget 2002 – near cash basis ¹	180.3	188.9	205.5	—	—
2002 Spending Review – near cash basis	177.7	188.6	201.7	212.4	221.7
2002 Spending Review – resource based allocation	168.3	178.7	191.2	201.7	210.4
Changes since 2002 Spending Review	2.0	–0.2	–3.0	–3.2	–3.4
PBR 2002	170.3	178.5	188.2	198.5	207.0
Total Managed Expenditure (TME)					
Budget 2002	392.1	418.4	454.6	481	511
2002 Spending Review	390.1	418.4	454.6	481.5	511.4
Changes since 2002 Spending Review	1.7	1.4	0.1	0.2	0.2
PBR 2002	391.8	419.8	454.8	481.7	511.6
<i>Memo: PBR 2002 TME (per cent of money GDP)</i>	<i>39.3</i>	<i>40.2</i>	<i>41.5</i>	<i>41.6</i>	<i>41.9</i>

¹ Figures for DEL and AME beyond 2003-04 were not published in Budget 2002.

B64 Departmental Expenditure Limits from 2003-04 to 2005-06 were set in the 2002 Spending Review. DEL for 2002-03 was set in the 2000 Spending Review. These plans have been adjusted to take account of changes to certain public sector pension schemes and other minor classification changes that have no impact on overall public spending. The only other changes to DEL are certain policy changes, as shown in Table B4, which are:

- the decision to reform the Landfill Tax Credit Scheme from April 2003;
- as in previous years, the underspend from 2001-02 has been carried forward and added to total DEL in 2002-03; and
- in 2002-03, the £1 billion special reserve addition.

B65 From 2003-04, departmental budgets will be controlled on a full resource budgeting basis, which means that the full economic cost of departmental activity will be recognised in budgets. Table B15 shows the Departmental Expenditure Limits for resource and capital budgets on this basis for the next three years, and restates budgets for 2001-02 and 2002-03 on the same basis. For 2001-02 and 2002-03, departmental expenditure is controlled on a near cash basis, and Table B16 shows outturn and plans on this basis. Both tables have been updated since the 2002 Spending Review to reflect transfers between departments and programmes.

B66 It is assumed in this Pre-Budget Report that the outturn for 2002-03 will equal total DEL plans. As in previous years it is assumed that, over the course of the year, underspends will offset the drawdown of end-year flexibility.

Table B15: Departmental Expenditure Limits – resource and capital budgets

	£ billion				
	Outturn 2001–02	2002–03	Plans		2005–06
			2003–04	2004–05	
Resource Budget					
Education and Skills	16.9	21.0	22.5	24.2	27.0
Health	50.8	56.7	63.0	68.5	74.7
of which: NHS	49.5	54.1	60.9	66.7	72.9
Transport	4.6	4.9	7.4	7.5	8.4
Office of the Deputy Prime Minister	2.8	4.6	4.7	5.1	5.3
Local Government	36.9	37.4	41.0	43.7	46.8
Home Office	10.4	10.4	11.7	12.0	12.7
Lord Chancellor's Departments	3.1	2.9	3.2	3.4	3.5
Attorney General's Departments	0.4	0.4	0.5	0.5	0.5
Defence	31.7	31.9	33.0	33.8	34.7
Foreign and Commonwealth Office	1.4	1.5	1.4	1.5	1.6
International Development	3.1	3.4	3.7	3.8	4.6
Trade and Industry	4.0	4.7	4.8	5.1	5.6
Environment, Food and Rural Affairs	2.4	2.7	2.7	2.7	2.8
Culture, Media and Sport	1.2	1.4	1.5	1.5	1.6
Work and Pensions ¹	6.5	7.6	7.9	8.0	8.1
Scotland ²	16.0	17.1	18.4	19.4	20.7
Wales ²	8.3	9.0	9.8	10.4	11.2
Northern Ireland Executive ²	5.9	6.2	6.5	6.8	7.2
Northern Ireland Office	1.0	1.2	1.1	1.1	1.2
Chancellor's Departments	4.1	4.5	4.5	4.6	4.8
Cabinet Office	1.6	1.7	1.9	1.9	1.9
Invest to Save Budget	0.0	0.0	0.0	0.0	0.0
Capital Modernisation Fund	0.0	0.0	0.1	0.1	0.1
Policy Innovation Fund	0.0	0.0	0.0	0.0	0.0
Reserve	0.0	0.1	1.0	1.3	1.7
Special reserve addition	0.0	1.0	0.0	0.0	0.0
Allowance for shortfall ³	0.0	-2.1	0.0	0.0	0.0
Total Resource Budget DEL	213.0	230.2	252.4	267.1	286.7
Capital Budget					
Education and Skills	2.1	2.5	3.3	3.8	4.4
Health	1.8	2.4	2.9	3.5	4.5
of which: NHS	1.7	2.3	2.8	3.4	4.4
Transport	2.4	3.6	3.4	3.7	3.4
Office of the Deputy Prime Minister	1.8	1.6	2.0	2.2	2.3
Local Government	0.1	0.3	0.3	0.3	0.3
Home Office	0.6	0.8	0.8	0.9	1.1
Lord Chancellor's Departments	0.1	0.1	0.1	0.1	0.1
Attorney General's Departments	0.0	0.0	0.0	0.0	0.0
Defence	5.5	5.9	6.0	6.3	6.9
Foreign and Commonwealth Office	0.1	0.1	0.1	0.1	0.1
International Development	0.0	0.0	0.0	0.0	0.0
Trade and Industry	0.2	0.5	0.4	0.2	0.1
Environment, Food and Rural Affairs	0.2	0.4	0.3	0.3	0.4
Culture, Media and Sport	0.0	0.1	0.1	0.1	0.1
Work and Pensions ¹	0.2	0.2	0.0	0.2	0.1
Scotland ²	1.6	1.9	2.0	2.1	2.3
Wales ²	0.5	0.7	0.8	0.9	1.0
Northern Ireland Executive ²	0.4	0.3	0.4	0.5	0.5
Northern Ireland Office	0.0	0.1	0.1	0.1	0.1
Chancellor's Departments	0.2	0.3	0.2	0.3	0.3
Cabinet Office	0.2	0.2	0.2	0.2	0.2
Invest to Save Budget	0.0	0.0	0.0	0.0	0.0
Capital Modernisation fund	0.0	0.2	1.1	0.8	0.9
Policy Innovation Fund	0.0	0.0	0.0	0.0	0.0
Reserve	0.0	0.0	0.6	0.8	1.0
Allowance for shortfall ³	0.0	-0.8	0.0	0.0	0.0
Total Capital Budget DEL	18.1	21.3	25.2	27.6	30.1
Depreciation	-9.6	-10.1	-11.1	-11.5	-12.2
Total Departmental Expenditure Limits	221.5	241.3	266.5	283.2	304.6
Total education spending	50.6	53.7	58.6	62.9	68.4

¹ Includes Welfare to Work expenditure financed by the Windfall Tax.² For Scotland and Wales and Northern Ireland, the split between current and capital budgets is decided by the respective executives.³ It is assumed that over the year underspends in total will offset the drawdown of end-year flexibility.

Table BI6: Departmental Expenditure Limits on a near cash basis – resource and capital budgets

	£ billion	
	Outturn 2001–02	Plan 2002–03
Resource Budget		
Education and Skills	16.5	20.2
Health	48.7	54.1
<i>of which: NHS</i>	47.4	51.5
Transport	2.8	2.9
Office of the Deputy Prime Minister	1.3	2.2
Local Government	36.9	37.4
Home Office	9.6	9.7
Lord Chancellor's Departments	2.9	2.7
Attorney General's Departments	0.4	0.4
Defence	18.9	19.0
Foreign and Commonwealth Office	1.2	1.3
International Development	3.1	3.4
Trade and Industry	3.6	3.8
Environment, Food and Rural Affairs	2.4	2.1
Culture, Media and Sport	1.0	1.2
Work and Pensions ¹	6.5	7.5
Scotland ²	14.3	15.9
Wales ²	7.5	8.3
Northern Ireland Executive ²	4.9	5.3
Northern Ireland Office	1.0	1.1
Chancellor's Departments	3.9	4.2
Cabinet Office	1.3	1.4
Invest to Save Budget	0.0	0.0
Capital Modernisation Fund	0.0	0.0
Policy Innovation Fund	0.0	0.0
Reserve	0.0	0.1
Special reserve addition	0.0	1.0
Allowance for shortfall ³	0.0	-1.9
Total Resource Budget DEL	188.7	203.5
Capital Budget		
Education and Skills	2.5	3.2
Health	1.9	2.5
<i>of which: NHS</i>	1.8	2.4
Transport	4.3	5.5
Office of the Deputy Prime Minister	2.6	3.4
Local Government	0.1	0.3
Home Office	0.8	0.9
Lord Chancellor's Departments	0.1	0.1
Attorney General's Departments	0.0	0.0
Defence	5.6	6.0
Foreign and Commonwealth Office	0.1	0.1
International Development	0.0	0.0
Trade and Industry	0.7	1.0
Environment, Food and Rural Affairs	0.5	0.6
Culture, Media and Sport	0.1	0.2
Work and Pensions ¹	0.2	0.2
Scotland ²	2.2	2.6
Wales ²	0.9	1.0
Northern Ireland Executive ²	0.6	0.6
Northern Ireland Office	0.0	0.1
Chancellor's Departments	0.2	0.3
Cabinet Office	0.2	0.2
Invest to Save Budget	0.0	0.0
Capital Modernisation fund	0.0	0.2
Policy Innovation Fund	0.0	0.0
Reserve	0.0	0.0
Allowance for shortfall ³	0.0	-1.0
Total Capital Budget DEL	23.7	27.9
Total Departmental Expenditure Limits	212.3	231.4
Total education spending	50.6	53.7

¹ Includes Welfare to Work expenditure financed by the Windfall Tax.² For Scotland and Wales and Northern Ireland, the split between current and capital budgets is decided by the respective executives.³ It is assumed that over the year underspend in total will offset the drawdown of end-year flexibility.

Table B17: Total Managed Expenditure 2001-02 to 2005-06

	£ billion				
	Outturn 2001-02	2002-03	Projections 2003-04 2004-05 2005-06		
Departmental Expenditure Limits					
Resource Budget	213.0	230.2	252.4	267.1	286.7
Capital Budget	18.1	21.3	25.2	27.6	30.1
less depreciation	-9.6	-10.1	-11.1	-11.5	-12.2
Total Departmental Expenditure Limits	221.5	241.3	266.5	283.2	304.6
Annually Managed Expenditure					
Social security benefits ¹	101.4	104.9	110.1	115.6	121.1
Tax credits ¹	8.6	10.0	11.7	12.3	12.7
Housing Revenue Account subsidies	4.5	4.3	4.2	4.2	4.1
Common Agricultural Policy	3.8	2.3	2.3	2.4	2.5
Net public service pensions	4.9	5.1	2.5	2.3	2.6
National Lottery	1.7	2.0	2.2	1.9	1.5
Non-cash items in AME	4.6	4.8	5.1	5.4	5.5
Other departmental expenditure	0.7	1.5	0.6	1.1	0.9
Net payments to EC institutions ²	0.8	1.6	2.2	3.0	3.3
Locally financed expenditure	20.3	21.0	22.3	23.4	24.7
Central government gross debt interest	22.2	20.8	21.6	23.8	23.9
Public corporations' own-financed capital expenditure	1.9	2.5	2.8	2.6	2.7
Total AME before margin and accounting adjustments	175.4	180.8	187.5	198.1	205.4
AME margin	0.0	0.1	1.8	0.5	0.5
Accounting adjustments ³	-5.1	-2.3	-1.1	-0.1	1.2
Annually Managed Expenditure	170.3	178.5	188.2	198.5	207.0
Total Managed Expenditure	391.8	419.8	454.8	481.7	511.6
of which:					
Public sector current expenditure	369.6	391.4	420.5	444.3	471.3
Public sector net investment	8.8	14.3	19.6	21.9	24.1
Public sector depreciation	13.4	14.1	14.7	15.4	16.2

¹ For 2001-02 to 2004-05, child allowances in Income Support and Jobseekers' Allowance, which, from 2003-04, are paid as part of the Child Tax Credit, have been included in the tax credits line and excluded from the social security benefits line. This is in order to give figures for both of these lines on a consistent definition over the forecast period.

² Net payments to EC Institutions exclude the UK's contribution to the cost of EC aid to non-Member States (which is attributed to the aid programme).

Net payments therefore differ from the UK's net contribution to the EC Budget, latest estimates for which are (in £ billion):

	2001-02	2002-03	2003-04	2004-05	2005-06
	1.5	2.4	3.1	3.6	3.9

The trended forecast for 2002-03 is £2.9 billion.

³ Excludes depreciation.

B67 Table B17 shows Total Managed Expenditure from 2001-02 to 2005-06 and new projections for individual AME programmes. Excluding additional spending on measures from 2003-04 onwards and reclassifications between DEL and AME, total AME is unchanged from the Spending Review. In line with the convention adopted in previous Pre-Budget Reports, changes to AME programmes have been offset in the AME margin.

B68 The main economic assumptions underpinning projections of AME are set out in Table B3. In particular, it is assumed that UK claimant unemployment will increase slightly from its recent level of 0.94 million (the average of the three months ending in October) to 0.99 million in 2005-06, in line with the average of independent forecasts.

B69 Table B18 shows changes to DEL and AME since the 2002 Spending Review. Of these changes, £3.0 billion, £3.3 billion and £3.5 billion in 2003-04 to 2005-06 respectively are accounted for by switches of expenditure from AME to DEL, which have no net effect on TME. The major part of this switch reflects a change in the way employers in the teachers and NHS pension schemes are charged superannuation contributions. In future these charges will be based on the full cost of pensions (including price indexation) not just the basic pension as in the past. DEL has been increased to cover these higher charges, though these are offset by higher pension scheme receipts in AME. The remaining changes to DEL and AME reflect increases to TME as a result of the measures set out in Table B4.

Table B18: Changes in Total Managed Expenditure since the 2002 Spending Review

	£ billion				
	Outturn 2001-02	2002-03	Projections 2003-04 2004-05 2005-06		
Departmental Expenditure Limits					
Resource Budget	-0.1	1.6	3.1	3.4	3.6
Capital Budget	-0.2	0.0	0.0	0.0	0.0
less depreciation	0.1	0.0	0.0	0.0	0.0
Total Departmental Expenditure Limits	-0.2	1.6	3.1	3.4	3.6
Annually Managed Expenditure					
Social security benefits	-0.4	-0.4	-0.5	-0.6	-0.1
Tax credits	0.3	0.6	-1.7	-1.8	-2.0
Housing Revenue Account subsidies	0.0	-0.3	-0.2	0.0	0.1
Common Agricultural Policy	-0.8	0.0	-0.1	0.0	0.0
Net public service pensions	0.4	0.0	-2.9	-3.4	-3.6
National Lottery	0.0	-0.3	-0.1	0.1	0.0
Non-cash items in AME	0.0	0.0	0.0	0.0	0.0
Other departmental expenditure	0.1	1.0	0.3	0.4	-0.1
Net payments to EC institutions	0.0	-0.6	-0.1	0.2	0.2
Locally financed expenditure	-0.2	0.2	0.3	0.2	0.2
Central government gross debt interest	0.0	-0.1	-1.4	0.9	1.1
Public corporations' own-financed capital expenditure	-0.1	0.2	0.5	0.6	0.8
Total AME before margin and accounting adjustments	-0.8	0.3	-5.9	-3.5	-3.3
AME margin	0.0	-1.2	0.8	-1.5	-2.5
Accounting adjustments ¹	2.8	0.7	2.2	1.8	2.5
Annually Managed Expenditure	2.0	-0.2	-3.0	-3.2	-3.4
Total Managed Expenditure	1.7	1.4	0.1	0.2	0.2

¹ Excludes depreciation.

B70 In 2001-02, TME was £1.7 billion higher than expected at the time of the 2002 Spending Review, with DEL £0.2 billion lower, and AME £2.0 billion higher. The total underspend on DEL in 2001-02 was £0.4 billion, taking into account reclassifications between DEL and AME.

B71 Changes to AME programmes reflect a combination of factors discussed below. With the exception of 2003-04, forecasts for AME programmes are higher than those published in the 2002 Spending Review. As total AME – excluding DEL/AME reclassifications and policy decisions – is unchanged, this results in a lower margin in each year than at the 2002 Spending Review. In 2003-04 expenditure on AME programmes is lower, resulting in an AME margin £0.8 billion higher than at the 2002 Spending Review.

B72 The social security expenditure forecast is lower than in the 2002 Spending Review. This reflects lower forecasts for inflation, which affect the uprating of benefits in 2003-04 and, in particular 2004-05, than at the Budget. Falling numbers of lone parents on benefits also contributes to the reduced forecast. However, these factors are increasingly offset over the forecast period by higher expenditure on the Minimum Income Guarantee/Pension Credit and Disability Living Allowance.

B73 Revisions to the breakdown of tax credits between negative tax and public expenditure, described in paragraph B47, mean that projected tax credit expenditure in AME is approximately £2 billion a year lower from 2003-04 to 2005-06 than expected at the time of the 2002 Spending Review.

B74 Compared with the Spending Review, central government gross debt interest payments are lower in 2002-03 and 2003-04 but higher in 2004-05 and 2005-06. The reduced forecast this year and next is mainly the result of lower market interest rate expectations and, in 2003-04, the impact of a lower accrued uplift on index-linked gilts due to a lower forecast for inflation. In the latter two years, the effect of lower interest rate expectations is offset by the effect of higher borrowing than forecast in Budget 2002.

B75 Public corporations' own-financed capital expenditure is higher than forecast at the time of the 2002 Spending Review. This is primarily because the London Underground Public Private Partnership is now expected to be included on London Underground's balance sheet and hence that projected investment under this project will count towards public sector net investment. Forecasts for other departmental expenditure are also higher, from 2002-03 to 2004-05, than in the 2002 Spending Review, due to increased projections of payments to former British Coal miners under the coal health compensation scheme.

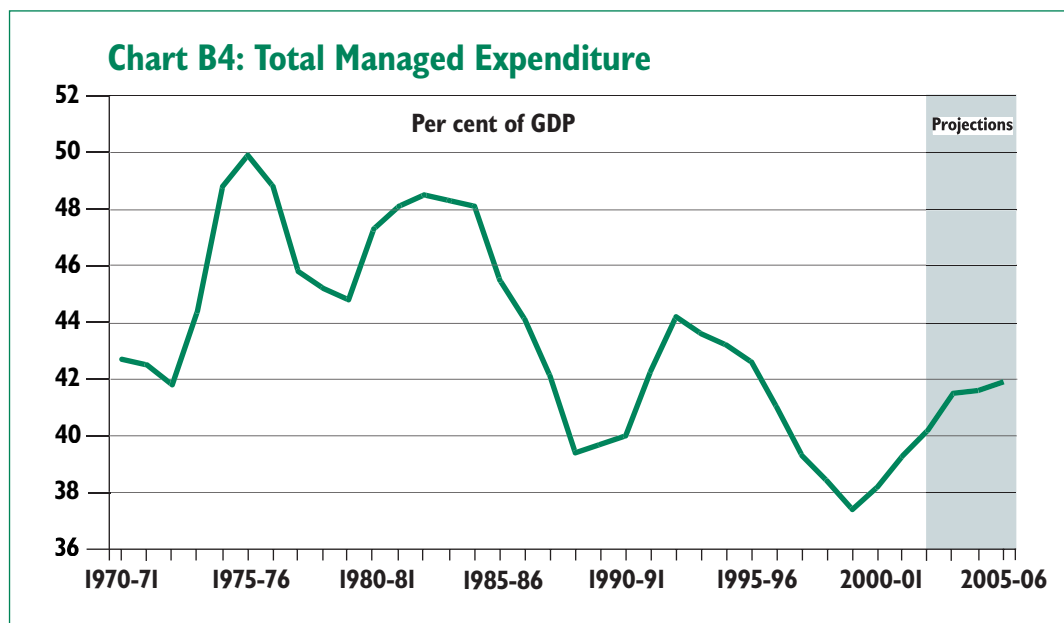
B76 Increases to the accounting adjustments are mainly the result of higher forecasts for VAT refunded on general government expenditure, due to higher than expected outturn data for last year and for the year to date. Increased VAT refunds are offset by equivalent changes in receipts. The main accounting adjustments, which comprise those items within TME but outside DEL and AME main programmes, are shown in Table B19.

Table B19: Accounting adjustments

	£ billion				
	Outturn 2001–02	2002–03	Projections 2003–04 2004–05		2005–06
Removal of non-cash spending in DEL ¹	-11.2	-9.6	-10.3	-10.5	-11.1
Financial transactions in DEL	-1.7	-1.4	-1.7	-1.3	-1.4
Removal of non-cash spending in AME	-4.6	-4.8	-5.1	-5.4	-5.5
Financial transactions in AME	0.0	-0.5	0.3	0.3	0.7
Adjustments for public corporations	3.5	2.9	3.3	3.3	3.5
Central government non-trading capital consumption	8.3	8.7	9.1	9.5	10.0
VAT refunded on general government expenditure	7.8	9.0	10.0	10.7	11.6
EC contributions	-6.1	-4.7	-4.6	-4.3	-4.2
Tax credits	0.8	1.3	0.8	0.8	0.8
Intra-general government debt interest	-3.0	-3.4	-2.6	-2.9	-2.9
Other accounting adjustments	1.2	0.2	-0.2	-0.1	-0.3
Total accounting adjustments	-5.1	-2.3	-1.1	-0.1	1.2

¹ Excluding depreciation in resource DEL.

B77 Chart B4 shows TME as a per cent of GDP from 1970-71 to 2005-06.



B78 Table B20 gives a breakdown of public sector capital expenditure.

Table B20: Public sector capital expenditure

	£ billion				
	Outturn	2002–03	Projections		
	2001–02		2003–04	2004–05	2005–06
Capital Budget DEL	18.1	21.3	25.2	27.6	30.1
Locally financed expenditure	1.7	1.8	1.7	1.7	1.6
National Lottery	0.9	1.0	1.1	1.0	0.6
Public corporations' own-financed capital expenditure	1.9	2.5	2.8	2.6	2.7
Other capital spending in AME	–0.4	1.9	3.3	4.4	5.3
AME margin	0.0	0.0	0.2	0.0	0.1
Public sector gross investment¹	22.2	28.4	34.3	37.3	40.3
Less depreciation	13.4	14.1	14.7	15.4	16.2
Public sector net investment	8.8	14.3	19.6	21.9	24.1
Proceeds from the sale of fixed assets ²	4.3	3.8	3.8	3.8	3.8

¹ This and previous lines are all net of sales of fixed assets.

² Projections of total receipts from the sale of fixed assets by public sector.

B79 Table B21 shows estimated receipts from loans and sales of assets from 2001-02 to 2005-06. The Government's existing credit facility for British Energy (BE) of £650 million will expire on 29 November 2002. The Secretary of State for Trade and Industry will therefore make an announcement about the outcome of the Government's discussions with the company shortly. The Government expects the loan facility to be managed within the planned totals for Departmental Expenditure Limits and the financial implications of any restructuring to be consistent with the forecast of the public finances and performance against the fiscal rules published in this Pre-Budget Report.

Table B21: Loans and sales of assets

	£ billion				
	Outturn	2002–03	Projections		
	2001–02		2003–04	2004–05	2005–06
Sales of fixed assets					
Central government	0.7	1.0	1.0	1.0	1.0
Local authorities	3.6	2.8	2.8	2.8	2.8
Total sales of fixed assets	4.3	3.8	3.8	3.8	3.8
Total loans and sales of financial assets	–1.9	–2.8	–2.1	–1.8	–1.3
Total loans and sales of assets	2.4	0.9	1.6	1.9	2.4

FINANCING REQUIREMENT

B80 Table B22 presents projections of the net cash requirement by sector, giving details of financial transactions that do not affect net borrowing (the change in the sector's net financial indebtedness) but do affect its financing requirement.

Table B22: Public sector net cash requirement

£ billion								
	2001–02				2002–03			
	General government				General government			
	Central government	Local authorities	Public corporations	Public sector	Central government	Local authorities	Public corporations	Public sector
Net borrowing	1.2	0.5	-0.5	1.2	17.0	1.8	1.3	20.1
<i>Financial transactions</i>								
Net lending to private sector and abroad	2.5	0.2	-0.5	2.2	3.0	-0.1	0.0	2.9
Cash expenditure on company securities	-0.4	-0.3	0.1	-0.7	-0.1	0.0	0.0	-0.1
Accounts receivable/payable	0.5	-0.4	0.7	0.8	0.5	0.0	0.0	0.5
Adjustment for interest on gilts	-0.4	0.0	0.0	-0.4	-1.5	0.0	0.0	-1.5
Miscellaneous financial transactions	0.5	-0.3	0.3	0.5	-0.9	0.0	-0.3	-1.2
Own account net cash requirement	3.9	-0.4	0.1	3.6	17.9	1.7	1.1	20.7
Net lending within the public sector	-1.0	0.1	0.8	0.0	0.8	1.5	-2.3	0.0
Net cash requirement ¹	2.9	-0.3	0.9	3.6	18.7	3.2	-1.2	20.7

¹ Market and overseas borrowing for local government and public corporation sectors.

B81 Table B23 updates the financing arithmetic for 2002-03 to allow for the latest forecast of the central government net cash requirement. The Debt and Reserves Management Report 2002-03 (DRMR), published on 14 March 2002, outlined how the Government planned to finance its net financing requirement in 2002-03.

B82 The forecast for the central government net cash requirement for the financial year 2002-03 has now been revised up from £13.5 billion to £18.7 billion. In addition, National Savings and Investments have increased their forecast for their net contribution by £0.5 billion to minus £1.0 billion. This means that the net financing requirement for 2002-03 is now £37.1 billion, an increase of £5.0 billion from the forecast published in Budget 2002.

B83 In order to meet this increased financing requirement, the Debt Management Office's gilt remit has been revised and they are now instructed to:

- increase gross gilts issuance by £3.8 billion to £26.2 billion; and
- increase the planned rundown of their net cash position by a further £1.2 billion to £6.6 billion.

B84 Full details of these measures and a complete financing table for 2002-03 can be found on the Debt Management Office's website (www.dmo.gov.uk).

Table B23: Financing requirement forecast

£ billion	2002–03		
	Original remit ¹ March 2002	Revised remit April 2002	Pre-Budget Report
Central government net cash requirement	13.6	13.5	18.7
Expected gilt redemptions	17.2	17.0	17.0
Debt buy-backs	0.0	0.0	0.3
Gross financing requirement	30.8	30.5	36.0
<i>Less assumed net National Savings and Investments' contribution</i>	–1.5	–1.5	–1.0
<i>Less change in DMO balance at the Bank of England</i>	0.0	–0.1	–0.1
Net financing requirement	32.3	32.1	37.1
Contingencies			
<i>Less change in Ways and Means facility</i>	0.0	0.0	0.0
<i>Less increase in planned Treasury bill stock</i>	4.3	4.3	4.3
<i>Less change in other net short-term debt²</i>	5.0	5.4	6.6
Planned gross gilt sales	23.0	22.4	26.2
Gilt sales to date (April–October 2002)			14.2
<i>of which:</i>			
Short conventionals (1–7 years)			3.0
Medium conventionals (7–15 years)			5.5
Long conventionals (> 15 years)			2.2
Index-linked			3.5
Further planned gilt sales			
Short conventionals (1–7 years)			5.5
Medium conventionals (7–15 years)			0.0
Long conventionals (> 15 years)			5.5
Index-linked			1.0

Note: Figures may not sum due to rounding.

¹ The Debt and Reserves Management Report 2002–03 was published on 14 March 2002 in advance of Budget 2002 to comply with the Code for fiscal stability.

² Excluding DMO cash deposit at the Bank of England.

ANALYSIS BY SUBSECTOR AND ECONOMIC CATEGORY

B85 Table B24 shows a breakdown of general government transactions by economic category for 2001-02 to 2005-06. Table B25 shows a more detailed breakdown for public sector transactions by sub-sector and economic category for 2001-02 to 2003-04.

Table B24: General government transactions by economic category

	£ billion				
	Outturn		Projections		
	2001-02	2002-03	2003-04	2004-05	2005-06
<i>Current receipts</i>					
Taxes on income and wealth	145.1	144.4	153.5	170.1	184.2
Taxes on production and imports	136.4	143.9	150.3	158.4	166.9
Other current taxes	18.3	19.7	21.1	22.6	24.3
Taxes on capital	2.4	2.4	2.6	2.9	3.1
Social contributions	63.5	64.5	77.0	81.4	85.8
Gross operating surplus	8.3	8.7	9.1	9.5	10.0
Rent and other current transfers	1.9	2.0	1.6	1.5	1.5
Interest and dividends from private sector and abroad	4.2	3.5	3.4	4.1	4.2
Interest and dividends from public sector	7.0	7.2	7.5	7.9	8.1
Total current receipts	387.2	396.5	426.0	458.5	488.1
<i>Current expenditure</i>					
Current expenditure on goods and services	197.8	211.5	227.7	241.4	259.6
Subsidies	6.0	6.1	6.9	6.9	7.6
Net social benefits	125.1	130.2	136.6	142.9	149.2
Net current grants abroad	-1.9	-0.4	-0.7	-0.8	-0.5
Other current grants	19.9	22.7	26.4	29.2	30.7
Interest and dividends paid	22.5	21.1	21.9	24.1	24.2
AME margin	0.0	0.1	1.6	0.4	0.3
Total current expenditure	369.5	391.3	420.3	444.2	471.0
Depreciation	8.3	8.7	9.1	9.5	10.0
Surplus on current budget	9.4	-3.5	-3.4	4.8	7.0
<i>Capital expenditure</i>					
Gross domestic fixed capital formation	11.6	16.1	20.4	23.5	25.3
Less depreciation	-8.3	-8.7	-9.1	-9.5	-10.0
Increase in inventories	0.0	0.7	0.6	0.4	0.6
Capital grants (net) within public sector	1.8	0.6	0.5	0.4	0.4
Capital grants to private sector	6.9	7.0	9.0	9.8	10.6
Capital grants from private sector	-0.9	-0.5	-0.7	-0.6	-0.6
AME margin	0.0	0.0	0.2	0.0	0.1
Net investment	11.1	15.2	21.0	24.0	26.4
Net borrowing¹	1.7	18.7	24.4	19.2	19.4
<i>of which:</i>					
Central government net borrowing	1.2	17.0	22.7	17.5	18.1
Local authority net borrowing	0.5	1.8	1.6	1.7	1.3

¹ Although this is based on the ESA95 definition of general government net borrowing (GGNB), the forecasts are identical to GGNB calculated on a Maastricht definition.

Table B25: Public sector transactions by sub-sector and economic category

	£ billion			
	2001–02			
	General government		Public corporations	Public sector
Central government	Local authorities			
<i>Current receipts</i>				
Taxes on income and wealth	145.1	0.0	-0.1	145.1
Taxes on production and imports	136.3	0.2	0.0	136.4
Other current taxes	3.0	15.3	0.0	18.3
Taxes on capital	2.4	0.0	0.0	2.4
Social contributions	63.5	0.0	0.0	63.5
Gross operating surplus	4.6	3.7	9.4	17.7
Rent and other current transfers	1.9	0.0	0.6	2.5
Interest and dividends from private sector and abroad	3.4	0.7	0.5	4.7
Interest and dividends from public sector	5.7	1.3	-7.0	0.0
Total current receipts	366.0	21.2	3.5	390.7
<i>Current expenditure</i>				
Current expenditure on goods and services	120.5	77.2	0.0	197.8
Subsidies	5.1	0.9	0.0	6.0
Net social benefits	113.2	11.9	0.0	125.1
Net current grants abroad	-1.9	0.0	0.0	-1.9
Current grants (net) within public sector	72.4	-72.4	0.0	0.0
Other current grants	19.9	0.0	0.0	19.9
Interest and dividends paid	22.2	0.3	0.1	22.6
AME margin	0.0	0.0	0.0	0.0
Total current expenditure	351.5	18.0	0.1	369.6
Depreciation	4.6	3.7	5.1	13.4
Surplus on current budget	9.8	-0.4	-1.7	7.7
<i>Capital expenditure</i>				
Gross domestic fixed capital formation	4.6	7.0	4.3	15.9
Less depreciation	-4.6	-3.7	-5.1	-13.4
Increase in inventories	0.0	0.0	0.1	0.0
Capital grants (net) within public sector	5.7	-3.9	-1.8	0.0
Capital grants to private sector	5.8	1.1	0.3	7.2
Capital grants from private sector	-0.4	-0.5	0.0	-0.9
AME margin	0.0	0.0	0.0	0.0
Net investment	11.0	0.1	-2.3	8.8
Net borrowing	1.2	0.5	-0.5	1.2

Table B25: Public sector transactions by sub-sector and economic category

£ billion				
2002–03				
General government				
Central government	Local authorities	Public corporations	Public sector	
				<i>Current receipts</i>
144.4	0.0	-0.2	144.3	Taxes on income and wealth
143.7	0.2	0.0	143.9	Taxes on production and imports
3.1	16.6	0.0	19.7	Other current taxes
2.4	0.0	0.0	2.4	Taxes on capital
64.5	0.0	0.0	64.5	Social contributions
4.9	3.8	9.4	18.1	Gross operating surplus
2.0	0.0	0.7	2.7	Rent and other current transfers
2.9	0.6	0.6	4.1	Interest and dividends from private sector and abroad
6.0	1.3	-7.2	0.0	Interest and dividends from public sector
374.0	22.5	3.2	399.7	Total current receipts
				<i>Current expenditure</i>
128.9	82.6	0.0	211.5	Current expenditure on goods and services
5.2	0.9	0.0	6.1	Subsidies
118.0	12.2	0.0	130.2	Net social benefits
-0.4	0.0	0.0	-0.4	Net current grants abroad
77.4	-77.4	0.0	0.0	Current grants (net) within public sector
22.7	0.0	0.0	22.7	Other current grants
20.8	0.3	0.1	21.2	Interest and dividends paid
0.1	0.0	0.0	0.1	AME margin
372.6	18.6	0.1	391.4	Total current expenditure
4.9	3.8	5.4	14.1	Depreciation
-3.5	0.0	-2.2	-5.7	Surplus on current budget
				<i>Capital expenditure</i>
5.7	10.3	5.1	21.2	Gross domestic fixed capital formation
-4.9	-3.8	-5.4	-14.1	Less depreciation
0.7	0.0	0.0	0.7	Increase in inventories
6.1	-5.5	-0.6	0.0	Capital grants (net) within public sector
5.8	1.2	0.0	7.0	Capital grants to private sector
0.0	-0.5	0.0	-0.5	Capital grants from private sector
0.0	0.0	0.0	0.0	AME margin
13.5	1.7	-0.9	14.3	Net investment
17.0	1.8	1.3	20.1	Net borrowing

Table B25: Public sector transactions by sub-sector and economic category

	£ billion			
	2003–04			
	General government		Public corporations	Public sector
	Central government	Local authorities		
<i>Current receipts</i>				
Taxes on income and wealth	153.5	0.0	-0.2	153.3
Taxes on production and imports	150.1	0.2	0.0	150.3
Other current taxes	3.4	17.8	0.0	21.1
Taxes on capital	2.6	0.0	0.0	2.6
Social contributions	77.0	0.0	0.0	77.0
Gross operating surplus	5.1	4.0	10.5	19.6
Rent and other current transfers	1.6	0.0	0.7	2.3
Interest and dividends from private sector and abroad	2.8	0.6	0.7	4.1
Interest and dividends from public sector	5.1	2.4	-7.5	0.0
Total current receipts	401.1	24.9	4.3	430.3
<i>Current expenditure</i>				
Current expenditure on goods and services	138.3	89.4	0.0	227.7
Subsidies	5.9	1.0	0.0	6.9
Net social benefits	123.7	12.9	0.0	136.6
Net current grants abroad	-0.7	0.0	0.0	-0.7
Current grants (net) within public sector	83.5	-83.5	0.0	0.0
Other current grants	26.4	0.0	0.0	26.4
Interest and dividends paid	21.6	0.3	0.1	22.0
AME margin	1.6	0.0	0.0	1.6
Total current expenditure	400.2	20.2	0.1	420.5
Depreciation	5.1	4.0	5.6	14.7
Surplus on current budget	-4.1	0.7	-1.5	-4.9
<i>Capital expenditure</i>				
Gross domestic fixed capital formation	8.2	12.2	4.7	25.2
Less depreciation	-5.1	-4.0	-5.6	-14.7
Increase in inventories	0.6	0.0	0.0	0.6
Capital grants (net) within public sector	7.0	-6.5	-0.5	0.0
Capital grants to private sector	7.7	1.3	0.0	9.0
Capital grants from private sector	0.0	-0.7	0.0	-0.7
AME margin	0.2	0.0	0.0	0.2
Net investment	18.6	2.4	-1.4	19.6
Net borrowing	22.7	1.6	0.1	24.5

Table B26: Historical series of public sector balances, receipts and debt

	Per cent of GDP									
	Public sector current budget	Public sector net borrowing	Cyclically adjusted public sector net borrowing	Public sector net cash requirement	General government net borrowing ¹	Net taxes and social security contributions	Public sector current receipts	Public sector net debt ²	General government gross debt ³	Public sector net worth ⁴
1970–71	6.7	-0.6	-0.8	1.2	-2.1		43.3			
1971–72	4.2	1.1	0.5	1.4	-0.7		41.4			
1972–73	2.0	2.8	2.7	3.6	2.2		39.0			
1973–74	0.3	4.9	5.7	5.9	4.4		39.5			
1974–75	-1.1	6.6	7.2	9.0	4.1		42.3	52.1	60.4	
1975–76	-1.6	7.0	6.5	9.3	4.8		42.9	53.9	58.7	
1976–77	-1.2	5.5	4.8	6.4	4.1		43.3	52.4	59.1	
1977–78	-1.4	4.3	3.8	3.7	3.6		41.5	49.0	57.1	
1978–79	-2.6	5.0	4.8	5.2	4.3	33.3	40.2	47.1	56.2	
1979–80	-1.9	4.1	4.0	4.7	3.0	33.9	40.7	43.9	51.8	
1980–81	-3.0	4.9	2.9	5.2	3.8	35.8	42.4	46.1	52.9	
1981–82	-1.4	2.3	-1.7	3.3	3.3	37.8	45.8	46.1	51.7	
1982–83	-1.5	3.0	-1.1	3.2	3.1	38.0	45.5	44.8	50.4	
1983–84	-2.0	3.8	0.6	3.2	3.8	38.2	44.5	45.3	50.4	
1984–85	-2.2	3.7	1.0	3.1	3.3	38.9	44.4	45.2	50.3	
1985–86	-1.2	2.4	0.9	1.6	2.6	38.1	43.1	43.4	49.5	
1986–87	-1.4	2.1	1.9	0.9	2.3	37.8	42.0	41.1	48.9	
1987–88	-0.3	1.0	2.1	-0.7	1.3	37.6	41.1	36.8	46.5	75.8
1988–89	1.7	-1.3	1.2	-3.0	-0.9	36.9	40.7	30.6	40.6	81.8
1989–90	1.4	-0.2	2.5	-1.3	0.3	36.2	39.9	27.7	35.5	73.5
1990–91	0.4	1.0	2.6	-0.1	1.4	36.3	39.0	26.2	33.3	62.3
1991–92	-1.9	3.8	3.3	2.3	3.7	35.0	38.6	27.4	34.4	54.5
1992–93	-5.6	7.6	5.5	5.9	7.4	34.0	36.6	32.0	40.6	42.1
1993–94	-6.2	7.8	5.5	7.1	7.8	33.0	35.8	37.1	45.9	27.9
1994–95	-4.8	6.3	4.9	5.3	6.5	34.1	36.9	40.8	49.4	26.7
1995–96	-3.4	4.8	4.1	4.3	5.0	34.9	37.8	42.8	51.9	18.6
1996–97	-3.0	3.7	3.2	2.9	3.9	34.9	37.4	43.7	52.1	14.7
1997–98	-0.2	0.8	0.8	0.1	0.9	36.1	38.5	41.5	49.1	10.6
1998–99	1.2	-0.5	-0.2	-0.8	-0.5	36.5	38.8	39.2	46.3	10.2
1999–00	2.2	-1.7	-1.4	-0.9	-1.7	36.5	39.1	36.2	43.2	15.1
2000–01	2.2	-1.7	-1.2	-3.9	-1.7	37.4	39.8	31.2	39.9	21.3
2001–02	0.8	0.1	0.2	0.4	0.2	37.1	39.2	30.4	38.2	26.5

¹ UK National Accounts definition.² At end-March; GDP centred on end-March.³ Maastricht measure from 1993.⁴ At end-December; GDP centred on end-December.

Table B27: Historical series of government expenditure

	£ billion (2001-02 prices)				Per cent of GDP			
	Public sector current expenditure	Public sector net investment	Public sector gross investment ¹	Total Managed Expenditure	Public sector current expenditure	Public sector net investment	Public sector gross investment ¹	Total Managed Expenditure
1970-71	161.2	30.3	49.5	210.8	32.6	6.1	10.0	42.7
1971-72	168.6	26.7	46.4	215.0	33.3	5.3	9.2	42.5
1972-73	176.3	25.7	46.4	222.7	33.1	4.8	8.7	41.8
1973-74	193.8	28.9	52.1	245.9	35.0	5.2	9.4	44.4
1974-75	214.2	30.5	55.4	269.6	38.8	5.5	10.0	48.8
1975-76	219.0	29.9	55.0	274.0	39.9	5.5	10.0	49.9
1976-77	225.0	24.4	50.4	275.4	39.9	4.3	8.9	48.8
1977-78	221.6	16.6	42.5	264.2	38.4	2.9	7.4	45.8
1978-79	228.3	14.4	41.0	269.3	38.4	2.4	6.9	45.2
1979-80	234.0	13.4	40.3	274.3	38.2	2.2	6.6	44.8
1980-81	240.8	10.7	38.0	278.8	40.8	1.8	6.4	47.3
1981-82	251.7	5.5	32.6	284.3	42.6	0.9	5.5	48.1
1982-83	257.5	9.0	35.3	292.8	42.7	1.5	5.9	48.5
1983-84	265.7	11.2	37.3	303.1	42.3	1.8	5.9	48.3
1984-85	273.1	9.8	34.7	307.9	42.6	1.5	5.4	48.1
1985-86	273.1	8.3	30.4	303.5	41.0	1.2	4.6	45.5
1986-87	277.0	4.9	27.4	304.5	40.1	0.7	4.0	44.1
1987-88	280.7	4.8	25.6	306.3	38.6	0.7	3.5	42.1
1988-89	274.4	2.7	24.2	298.5	36.2	0.4	3.2	39.4
1989-90	276.2	9.2	30.8	307.0	35.7	1.2	4.0	39.7
1990-91	277.9	11.1	30.0	307.9	36.1	1.4	3.9	40.0
1991-92	294.6	14.1	30.1	324.7	38.4	1.8	3.9	42.3
1992-93	309.3	15.4	30.3	339.6	40.3	2.0	3.9	44.2
1993-94	319.6	12.6	27.2	346.8	40.1	1.6	3.4	43.6
1994-95	330.8	12.5	27.5	358.3	39.9	1.5	3.3	43.2
1995-96	335.9	12.0	27.2	363.0	39.4	1.4	3.2	42.6
1996-97	339.2	6.0	20.1	359.3	38.7	0.7	2.3	41.0
1997-98	336.6	5.4	19.0	355.6	37.2	0.6	2.1	39.3
1998-99	336.5	6.4	19.9	356.4	36.2	0.7	2.1	38.4
1999-00	341.0	4.6	17.8	358.8	35.6	0.5	1.9	37.4
2000-01	356.1	5.5	18.8	375.0	36.3	0.6	1.9	38.2
2001-02	369.6	8.8	22.2	391.8	37.0	0.9	2.2	39.3

¹ Net of sales of fixed assets.

