

The interim projections for the public finances published in this Pre-Budget Report and Comprehensive Spending Review show that the Government is meeting its strict fiscal rules over the economic cycle:

- the current budget since the start of the economic cycle in 1997-98 shows an annual average surplus throughout the projection period, ensuring that the Government is meeting the golden rule on the basis of cautious assumptions. By 2009-10, the current budget moves clearly into surplus; and
- public sector net debt is projected to remain low and stable over the forecast period, stabilising below 39 per cent of GDP, and so meeting the sustainable investment rule.

The 2007 *End of year fiscal report* is published alongside this Pre-Budget Report, underlining the Government's commitment to transparency in fiscal policy by providing detailed information on the public finances in 2005-06 and 2006-07.

INTRODUCTION

B.1 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 meeting the fiscal rules. This chapter explains the latest outturns and the fiscal projections in more detail.¹ It includes:

- five-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;
- detailed analyses of the outlook for government receipts and expenditure; and
- a discussion of long-term fiscal sustainability given the long-term socio-economic challenges that will be faced in coming decades.

B.2 The fiscal projections continue to be based on deliberately cautious key assumptions audited by the National Audit Office (NAO).

B.3 This Pre-Budget Report updates the projections of the public finances contained in Budget 2007, to take account of subsequent developments in both the public finances and the world and UK economies.

B.4 As described in Chapter 2, the 2007 *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 2005-06 and 2006-07, including their performance against the fiscal rules and published forecasts and plans. The information set out in the 2007 *End of year fiscal report* supplements the historical and provisional outturn data published in this Annex.

¹ For further detail see 2007 *Pre-Budget Report and Comprehensive Spending Review: the economy and public finances – supplementary charts and tables*. This includes charts and tables on public expenditure, sub-sector and economic category analyses, and historical series data.

MEETING THE FISCAL RULES

B.5 Table B1 shows five-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 cyclically-adjusted fiscal balances, are also shown.

B.6 As explained in Chapter 2, the Government's judgment is that 1997-98 represented the beginning of a new economic cycle. The latest National Accounts data and the Treasury's trend output assumptions imply that output passed through trend towards the end of 2006. However, it is too soon to assess whether or not the economic cycle has ended.

Table B1: Summary of public sector finances

	Per cent of GDP							
	Outturn		Estimate	Projections				
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Fairness and prudence								
Surplus on current budget	-1.1	-0.4	-0.6	-0.3	0.2	0.6	0.8	1.1
Average surplus since 1997-1998	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.2
Cyclically-adjusted surplus on current budget	-0.9	-0.2	-0.7	-0.2	0.3	0.6	0.8	1.1
Long-term sustainability								
Public sector net debt ¹	36.1	36.7	37.6	38.4	38.8	38.9	38.8	38.6
Core debt ¹	35.3	35.8	36.9	37.6	38.0	38.1	38.1	37.9
Net worth ²	27.7	26.0	25.3	24.1	23.4	22.8	22.5	22.4
Primary balance	-1.4	-0.7	-1.0	-0.9	-0.4	-0.1	0.2	0.3
Economic impact								
Net investment	1.9	2.0	2.1	2.2	2.2	2.3	2.3	2.3
Public sector net borrowing (PSNB)	3.0	2.3	2.7	2.5	2.0	1.7	1.5	1.3
Cyclically-adjusted PSNB	2.8	2.2	2.8	2.4	1.9	1.7	1.5	1.3
Financing								
Central government net cash requirement	3.3	2.8	2.7	2.6	2.4	2.0	2.0	1.6
Public sector net cash requirement	3.2	2.7	2.4	2.4	2.3	1.8	1.8	1.5
European commitments								
Treaty deficit ³	3.0	2.6	2.9	2.8	2.4	2.1	1.8	1.6
Cyclically-adjusted Treaty deficit ³	2.8	2.4	3.0	2.7	2.3	2.1	1.8	1.6
Treaty debt ratio ⁴	42.5	43.4	43.9	44.8	45.1	45.3	45.2	44.9
Memo: Output gap	-0.5	-0.1	0.2	-0.3	0.0	0.0	0.0	0.0

¹ Debt at end March; GDP centred on end March.

² Estimate at end December; GDP centred on end December.

³ General government net borrowing on a Maastricht basis.

⁴ General government gross debt measures on a Maastricht basis.

The golden rule B.7 The economy appears to have passed through trend in the final quarter of 2006. On this basis, and on the basis of cautious assumptions, the Government would have met the golden rule with a margin of £18 billion, higher than estimated at Budget 2007.

B.8 The Pre-Budget Report projections show that the current budget moves into surplus in 2009-10, with the surplus rising to 1.1 per cent of GDP by 2012-13. At this early stage, and based on cautious assumptions, the Government is therefore on course to meet the golden rule in the next economic cycle. The cyclically-adjusted surplus, which allows a clearer view of underlying or structural trends in the public finances by removing the estimated effects of the economic cycle, also shows a rising surplus from 2009-10.

The sustainable investment rule **B.9** The Government's primary objective for fiscal policy is to ensure sound public finances in the medium term. This means maintaining public sector net debt at a low and sustainable level. Public sector net debt remains below 39 per cent of GDP throughout the projection period, and starts to decline by 2012-13, reaching 38.6 per cent of GDP. Therefore, the Government meets its sustainable investment rule while continuing to fund increased long-term capital investment in the public services. The projections for core debt, which exclude the estimated impact of the economic cycle, rise to a maximum of 38.1 per cent of GDP. This is consistent with the fiscal rules, and with the key objective of intergenerational fairness that underpins the fiscal framework.

Net worth **B.10** Net worth is the approximate stock counterpart of the current budget. Modest falls in net worth are expected for the remainder of the projection period from the high level of 26 per cent of GDP in 2006-07. At present, net worth is not used as a key indicator of the public finances, mainly due to difficulties involved in accurately measuring many government assets and liabilities.

Net investment **B.11** Public sector net investment has increased rapidly in recent years from 1¼ per cent of GDP in 2003-04 to 2 per cent of GDP in 2006-07. As a result of decisions taken in the 2004 Spending Review and in this Comprehensive Spending Review, net investment will increase further, and then remain at around 2¼ per cent of GDP from 2008-09 onwards.

Net borrowing **B.12** Public sector net borrowing fell sharply from 3.0 per cent of GDP in 2005-06 to 2.3 per cent in 2006-07. It is expected to rise in 2007-08 but then fall in every year of the forecast period from 2.7 per cent of GDP in 2007-08 to 2.5 per cent in 2008-09, and then to 1.3 per cent of GDP by 2012-13.

Financing **B.13** The central government net cash requirement was 2.8 per cent of GDP in 2006-07. It is projected to be around 2.7 per cent in 2007-08, and to fall to 1.6 per cent of GDP by 2012-13, mirroring the profile of net borrowing.

European commitments **B.14** Table B1 shows the Treaty measures of debt and deficit used for the purposes of the Excessive Deficit Procedure – Article 104 of the Treaty. These Pre-Budget Report projections meet the EU Treaty reference value for general government gross debt (60 per cent of GDP) by a considerable margin. The treaty deficit in 2006-07 was 2.6 per cent of GDP. The deficit rises to 2.9 per cent of GDP in 2007-08 and then falls in each year of the forecast. The projections are therefore consistent with the Government's prudent interpretation of the Stability and Growth Pact.

CHANGES TO THE FISCAL BALANCES

B.15 Table B2 compares the latest estimates for the main fiscal balances with those in Budget 2007.

Table B2: Fiscal balances compared with Budget 2007

	Outturn ¹	Estimate ²	Projections			
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Surplus on current budget (£ billion)						
Budget 2007	-9.5	-4.3	3	6	9	13
Effect of revisions and forecasting changes	4.7	-3.6	-6 1/2	-4	-1 1/2	-1
Effect of discretionary changes	0.0	-0.4	- 1/2	1	1 1/2	1 1/2
2007 Pre-Budget Report	-4.7	-8.3	-4	3	9	14
Net borrowing (£ billion)						
Budget 2007	35.0	33.7	30	28	26	24
Changes to current budget	-4.7	4.0	7	2 1/2	0	-1
Changes to net investment	0.8	0.4	0	0	2	2
2007 Pre-Budget Report	31.0	38.0	36	31	28	25
Cyclically-adjusted surplus on current budget (per cent of GDP)						
Budget 2007	-0.5	-0.3	0.2	0.4	0.6	0.8
2007 Pre-Budget Report	-0.2	-0.7	-0.2	0.3	0.6	0.8
Cyclically-adjusted net borrowing (per cent of GDP)						
Budget 2007	2.5	2.4	2.0	1.8	1.6	1.4
2007 Pre-Budget Report	2.2	2.8	2.4	1.9	1.7	1.5
Net debt (per cent of GDP)						
Budget 2007	37.2	38.2	38.5	38.8	38.8	38.6
2007 Pre-Budget Report	36.7	37.6	38.4	38.8	38.9	38.8

¹ The 2006-07 figures were estimates in Budget 2007.

² The 2007-08 figures were projections in Budget 2007.

2006-07 outturn B.16 The outturn for the current budget in 2006-07 shows a deficit of £4.7 billion, £4.7 billion lower than expected at Budget 2007 and an improvement of £9.3 billion relative to the deficit in 2005-06. The changes since Budget 2007 reflect higher central government receipts, largely VAT, lower central government current expenditure, and a lower-than-forecast deficit across the rest of the public sector. The 2006-07 outturn for net borrowing is £3.9 billion lower than the Budget 2007 estimate, slightly less than the fall in the current deficit, due to slightly higher-than-expected net investment.

2007-08 estimate B.17 The downward revisions to the public sector current budget in this Pre-Budget Report from 2007-08 onwards are largely due to falls in receipts, driven in part by the expected impact of recent financial market disruption on receipts and changes to the economic forecast in 2008. Further details of these changes are given in the receipts section of this Annex.

FORECAST DIFFERENCES AND RISKS

B.18 The fiscal balances represent the difference between two large aggregates of expenditure and receipts, and forecasts are inevitably subject to wide margins of uncertainty. Over the past ten years, the average absolute difference between 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 and uncertainties increase accordingly. A full account of differences between the projections made in Budget 2005 and Budget 2006, and the subsequent outturns is provided in the 2007 *End of year fiscal report*, published alongside this 2007 Pre-Budget Report.

B.19 As explained in Annex A, UK GDP is expected to grow by 3 per cent in 2007, in line with the Budget 2007 forecast. Recent disruption in financial markets has meant economic prospects have become more uncertain. Reflecting higher interest rates than markets expected at the time of Budget 2007, and some assumed feed-through from financial market disruption to tighter credit conditions and to household and company spending in the short term, growth is forecast to slow to 2 to 2½ per cent in 2008, below trend, before returning to trend rates from 2009.

B.20 The use of cautious assumptions audited by the National Audit Office (NAO) builds a margin into the public finance projections to guard against unexpected events. One of the key audited assumptions is that for the trend rate of GDP growth, which is assumed to be ¼ per cent below the neutral view. This means that the rate of economic growth used to forecast the public finances is the bottom end of the projection range. For example, in this Pre-Budget Report, the forecast for economic growth used in the public finances projections over the period 2007-08 to 2012-13 averages 2½ per cent, ¼ per cent below the central case.

B.21 A further important source of potential error results from misjudging the position of the economy in relation to trend output. To minimise this risk, the robustness of the projections is tested against an alternative scenario in which the level of trend output is assumed to be one percentage point lower than in the central case.

B.22 The Government adopts the cautious case and uses NAO-audited assumptions to build a margin in the public finances against unexpected events. Combined with the decision to consolidate the public finances when the economy was above trend, this has resulted in lower debt. As a result, this has allowed the Government to increase investment in priority public services, allow the automatic stabilisers to work fully during a period of global economic uncertainty, and meet in full the UK's international commitments, while continuing to meet the fiscal rules.

ASSUMPTIONS

B.23 The fiscal projections are based on the following assumptions:

- the economy follows the path described in Annex A. The fiscal projections assume that trend growth will be 2½ per cent to 2012-13. In the interests of caution, these projections continue to be based on the assumption that trend output growth will be ¼ percentage point lower than the Government's neutral view;
- rates, thresholds and limits, including for 2008-09, increase in line with projected indexation or announced policy. The 2008-09 rates and allowances for income tax, national insurance contributions, the Working and Child Tax Credits and Child Benefit/Guradian's Allowance will be published after the September RPI becomes available;
- there are no tax or spending policy changes beyond those announced in or before this Pre-Budget Report, and all rates and allowances remain constant in real terms;
- firm Departmental Expenditure Limits (DEL) for 2007-08 are as set out in the 2004 Spending Review, adjusted for the impact of policy decisions and reclassifications;
- total Annually Managed Expenditure (AME) programmes for 2007-08 have been reviewed, and the total has been adjusted for reclassifications and for the cost of spending measures in this Pre-Budget Report;
- DELs from 2008-09 to 2010-11 are as fixed in this Comprehensive Spending Review. AME expenditure from 2008-09 to 2010-11 has been forecast consistent with the economic assumptions and policy decisions included in this report. Total Managed Expenditure (TME) increases by an average of 2.1 per cent a year in real terms over the Comprehensive Spending Review period;
- public sector current expenditure in 2011-12 and 2012-13 is assumed to grow at 2.0 per cent in real terms; and
- net investment is assumed to remain at 2¼ per cent of GDP in 2011-12 and 2012-13, meaning that in real terms, TME will increase by 2½ per cent a year on average over the forecast period.

Table B3: Economic assumptions for the public finance projections

	Percentage changes on previous year						
	Outturn	Estimate	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Output (GDP)	3	3	2	2 3/4	2 1/2	2 1/2	2 1/2
Prices							
CPI	2 1/2	2 1/4	2	2	2	2	2
GDP deflator	2 3/4	3 1/4	2 3/4	2 3/4	2 3/4	2 3/4	2 3/4
RPI ¹ (September)	3 1/2	4	2 3/4	2 3/4	2 3/4	2 3/4	2 3/4
Rossi ² (September)	3	2 1/4	2 1/2	2 1/4	2 1/4	2 1/4	2 1/4
Money GDP ³ (£ billion)	1,323	1,404	1,471	1,550	1,630	1,714	1,802

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.

B.24 The projections for 2007-08 are based on all available data within the Treasury and other government departments involved in producing tax and spending forecasts.

B.25 The key assumptions underlying the fiscal projections are audited by the National Audit Office (NAO) under the three-year rolling review process. Details of the audited assumptions are given in Box B1. None of these assumptions were due for review in this Pre-Budget Report.

Box B1: Key assumptions audited by the NAO^a

Trend GDP growth^f	2½ per cent a year to 2012.
Dating of the cycle^c	The end date of the previous economic cycle was in the first half of 1997.
Composition of GDP^f	Shares of labour income and profits in national income are broadly constant in the medium term.
Consistency of price indices^e	Projections of price indices used to project the public finances are consistent with the CPI.
Oil prices^c	\$68 a barrel in 2008, the average of independent forecasts, and then constant in real terms.
Equity prices^e	FTSE All-share index rises from 3366 (close 4 October) in line with money GDP.
VAT^f	The underlying VAT gap will rise by 0.5 per cent per year from the estimated outturn for the current year.
Tobacco^f	The underlying level of duty paid on consumption of cigarettes will be set at least three per cent per year lower than the estimated outturn for the current year.
UK claimant unemployment^{b, g}	Rising slowly from recent average levels of 0.86 million to 0.92 million at the end of 2009, and then staying constant at this level.
Interest rates^d	3-month market rates change in line with market expectations (as of 28 September).
Funding^f	Funding assumptions used to project debt interest are consistent with the forecast level of government borrowing and with financing policy.
Privatisation proceeds^f	Credit is taken only for proceeds from sales that have been announced.

^a For details of all NAO audits before Budget 2005, see the 2004 *Pre-Budget Report*, 2 December 2004 (Cm 6408).

^b *Audit of Assumptions for Budget 2005*, 16 March 2005 (HC 452).

^c *Audit of Assumptions for the 2005 Pre-Budget Report*, 5 December 2006 (HC 707).

^d *Audit of Assumptions for Budget 2006*, 22 March 2006 (HC 937).

^e *Audit of Assumptions for the 2006 Pre-Budget Report*, 6 December 2006 (HC 125).

^f *Audit of Assumptions for Budget 2007*, 21 March 2007 (HC 393).

^g This is a cautious assumption based on the average of external forecasts and is not the Treasury's central economic forecast.

PRE-BUDGET REPORT POLICY DECISIONS

B.26 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 2007 Pre-Budget Report or since Budget 2007. The fiscal impact of these measures are set out in Table B4.

B.27 Expenditure measures affecting AME and DEL in 2007-08 have been added to total AME and total DEL, respectively. Expenditure measures in the Comprehensive Spending Review period, including announcements with costs in AME, are contained within the spending envelope announced in this report.

B.28 Consistent with the *Code for fiscal stability*, the projections do not take account of decisions where the impact cannot yet be quantified or of measures proposed in this Pre-Budget Report, or where final decisions have yet to be taken. These include:

- further extensions to maternity and paternity leave; and
- further reforms to incapacity benefit.

Table B4: Estimated costs for Pre-Budget Report policy decisions and others announced since Budget 2007¹

	£ million			
	2007-08	2008-09	2009-10	2010-11
Sustainable growth and prosperity				
Tax simplification: increase income tax self assessment payment on account threshold	0	0	-90	0
Fairness and opportunity for all				
Increase in housing benefit disregard ²	-5	-	-	-
Implementing state second pension White Paper reforms	0	0	+290	+440
Modernisation of residence and domicile taxation	0	0	+800	+500
Increase child element of CTC by £25 in April 2008 and a further £25 in April 2010 ³	0	-30	-30	-60
Transferable inheritance tax allowances for married couples and civil partners	-100	-1,000	-1,200	-1,400
Capital gains tax reform: 18% single rate	0	+350	+750	+900
Protecting revenues				
Removal of national insurance contributions exemption	+100	+200	+200	+200
Tackling income shifting	0	+25	+260	+200
Life insurance companies avoidance	0	+35	+45	+45
Countering interest relief exploitation by individuals	+25	+10	0	0
Vehicle excise duty enforcement	0	+10	+20	+25
Protecting the environment				
Aviation duty ⁴	0	-55	+100	+520
Non-car vehicle excise duty rates for 2008-09	0	-5	-5	-10
Fuel benefit charge: revalorisation since 2003	0	+65	+40	+25
Extending the exemption for oils used in electricity generation	-5	-5	-5	-5
Enhanced capital allowances for biofuel plants	0	+30	+20	+35
Other policy decisions				
Addition to the special reserve	-400	0	0	0
TOTAL POLICY DECISIONS	-385	-370	+1,195	+1,415
Additional investment in public services	0	0	0	-2,000

¹ Costings shown relative to an indexed base.

² From 2008-09 onwards, included within the Comprehensive Spending Review settlement.

³ Negative tax costs. AME spending consequences are included within the Comprehensive Spending Review settlement.

⁴ Intention to replace air passenger duty by per plane duty from November 2009.

FISCAL AGGREGATES

B.29 Tables B5 and B6 provide more detail on the projections for the current and capital budgets.

Table B5: Current and capital budgets

	£ billion						
	Outturn	Estimate	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Current budget							
Current receipts	519.1	551	581	616	651	686	724
Current expenditure	506.6	541	566	593	620	650	681
Depreciation	17.2	18	19	20	21	22	24
Surplus on current budget	-4.7	-8	-4	3	9	14	20
Capital budget							
Gross investment ¹	43.5	48	51	54	58	61	66
Less depreciation	-17.2	-18	-19	-20	-21	-22	-24
Net investment	26.3	30	32	34	37	39	42
Net borrowing	31.0	38	36	31	28	25	23
Public sector net debt - end year	500.2	541	580	617	651	682	713
Memos:							
Treaty deficit ²	34.0	41	41	37	34	31	29
Treaty debt ³	574.4	616	658	699	738	774	810

¹ Net of asset sales; for a breakdown see Table 16 in Pre-Budget Report and Comprehensive Spending Review 2007: the economy and public finances - supplementary charts and tables.

² General government net borrowing on a Maastricht basis.

³ General government gross debt on a Maastricht basis.

Table B6: Current and capital budgets

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Current budget							
Current receipts	39.2	39.2	39.5	39.7	39.9	40.0	40.2
Current expenditure	38.3	38.5	38.5	38.2	38.1	37.9	37.8
Depreciation	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Surplus on current budget	-0.4	-0.6	-0.3	0.2	0.6	0.8	1.1
Capital budget							
Gross investment ¹	3.3	3.4	3.5	3.5	3.6	3.6	3.7
Less depreciation	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Net investment	2.0	2.1	2.2	2.2	2.3	2.3	2.3
Net borrowing	2.3	2.7	2.5	2.0	1.7	1.5	1.3
Public sector net debt - end year	36.7	37.6	38.4	38.8	38.9	38.8	38.6
Memos:							
Treaty deficit ²	2.6	2.9	2.8	2.4	2.1	1.8	1.6
Treaty debt ratio ³	43.4	43.9	44.8	45.1	45.3	45.2	44.9

¹ Net of asset sales; for a breakdown see Table 16 in Pre-Budget Report and Comprehensive Spending Review 2007: the economy and public finances - supplementary charts and tables.

² General government net borrowing on a Maastricht basis.

³ General government gross debt on a Maastricht basis.

B.30 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. These surpluses allowed the Government to use fiscal policy to support monetary policy during the economic slowdown in 2001 and 2002, and as a result the current budget moved into deficit. The current budget is expected to remain in deficit in 2007-08 and 2008-09 and then move back into surplus in 2009-10, with increasingly larger surpluses in later years, reaching 1.1 per cent in 2012-13.

B.31 The current budget surplus is equal to public sector current receipts less public sector current expenditure and depreciation. The reasons for changes in receipts and current expenditure are explained in later sections.

B.32 Table B5 also shows that net investment is projected to increase from 2 per cent of GDP in 2006-07 to 2¼ per cent of GDP from 2008-09 to 2012-13 as the Government seeks to rectify past underinvestment in public infrastructure. These increases are sustainable within the fiscal rules, with debt falling to 38.6 per cent of GDP by the end of the forecast period.

RECEIPTS

B.33 This section analyses the projections for public sector tax receipts in detail. It begins by looking at the main determinants of changes in the overall projections since Budget 2007, before examining changes in the projections of individual tax receipts. Finally, it provides updated forecasts for the tax-GDP ratio.

Changes in total receipts since Budget 2007

B.34 Receipts in all years are affected by a fiscally-neutral reclassification. In June 2007, the ONS changed its treatment of local authorities' Housing Revenue Accounts. In the National Accounts, these are regarded as 'quasi-corporations' and are included in the public corporations sub-sector. The effect of the change was to increase current expenditure of local authorities and receipts of public corporations by equal amounts in each year. The additional receipts increase the gross operating surplus component of the 'other receipts' category and amounted to £1.6 billion in 2006-07, rising thereafter.

B.35 After allowing for the effects of this classification change, overall receipts in 2006-07 were the same as forecast in Budget 2007, with higher central government receipts offset by lower receipts in the rest of the public sector. Central government receipts measured on an accruals basis were £1.2 billion higher, largely because of higher cash VAT receipts at the end of 2006-07 and early in 2007-08, which were scored to 2006-07 accruals. Although the overall current balance of local authorities has improved considerably since Budget 2007, this reflects much lower-than-forecast expenditure, partially offset by lower receipts. Very little outturn information is available on the individual components of local authority receipts and expenditure until five months after the end of the financial year.

B.36 The downward revisions to receipts for 2007-08 onwards are driven in part by the expected impact of recent financial market disruption. Other factors which reduce receipts compared to Budget 2007 are a fall in North Sea revenues, as a result of lower-than-expected oil and gas production, offset by higher oil prices, and changes to the economic forecast in 2008, especially lower wages and salaries growth. Receipts in 2007-08 also reflect lower North Sea gas prices than expected in Budget 2007 and a series of one-off corporation tax repayments.

Tax by tax analysis

B.37 Table B7 shows outturns for cash receipts in the first five months of 2007-08 and estimated receipts for the remainder of the year, along with percentage changes over the corresponding period in 2006-07. These growth rates can vary considerably across the year, partly because of the rules governing payment of each tax and the various time lags. Table B8 contains updated projections for the main components of public sector receipts for 2006-07, 2007-08 and 2008-09, as well as the changes to the projections of individual taxes since Budget 2007.

Table B7: 2007-08 Net taxes and national insurance contributions

	£ billion			Percentage change on 2006-07		
	Outturn ¹	Estimates		Outturn ¹	Estimates	
	Apr-Aug	Sep-Mar	Full year	Apr-Aug	Sep-Mar	Full year
HM Revenue & Customs						
Income tax, NICs and capital gains tax ²	100.1	150.8	250.9	7.0	7.1	7.0
Value added tax	35.1	46.3	81.4	8.4	2.9	5.2
Corporation tax ²	18.4	27.8	46.3	-3.1	10.1	4.4
Petroleum revenue tax	0.4	1.1	1.5	-33.7	-27.8	-29.5
Fuel duties	10.2	14.6	24.9	3.6	6.8	5.5
Inheritance tax	1.7	2.2	3.9	12.3	8.1	9.8
Stamp duties	6.6	8.5	15.1	22.6	6.2	12.8
Tobacco duties	3.4	4.7	8.1	-0.9	-0.2	-0.5
Alcohol duties	3.4	4.8	8.2	2.9	3.9	3.5
Other Customs duties and levies	4.6	5.6	10.1	14.4	14.9	14.7
Total HMRC	184.0	266.5	450.4	6.3	6.3	6.3
Vehicle excise duties	2.4	3.1	5.5	11.2	3.2	6.6
Business rates	11.2	10.7	21.9	4.1	4.8	4.5
Council tax	11.2	12.5	23.7	5.3	8.0	6.7
Other taxes and royalties	5.6	9.6	15.3	-1.2	17.9	10.1
Net taxes and NICs	214.4	302.4	516.8	6.0	6.7	6.4

¹ Provisional.

² Net of tax credits scored as negative tax in net taxes and national insurance contributions.

Table B8: Current receipts

	£ billion			Changes since Budget 2007		
	Outturn	Estimate	Projection	Outturn	Estimate	Projection
	2006-07	2007-08	2008-09	2006-07	2007-08	2008-09
HM Revenue and Customs						
Income tax (gross of tax credits)	147.8	154.1	161.8	0.8	-2.8	-4.2
Income tax credits	-4.4	-4.5	-4.9	0.2	-0.1	0.0
National insurance contributions	87.3	96.5	101.0	-0.7	1.4	0.2
Value added tax	77.4	81.4	85.8	0.0	1.4	0.4
Corporation tax ¹	44.8	46.8	51.5	-0.1	-3.3	-3.0
Corporation tax credits ²	-0.5	-0.5	-0.6	0.0	0.0	0.0
Petroleum revenue tax	2.2	1.5	1.5	0.0	-0.1	-0.2
Fuel duties	23.6	24.9	26.2	-0.1	-0.2	-0.8
Capital gains tax	3.8	4.8	5.4	-0.1	0.2	0.7
Inheritance tax	3.6	3.9	3.3	0.0	-0.1	-0.9
Stamp duties	13.4	15.1	15.8	0.0	0.8	0.6
Tobacco duties	8.1	8.1	7.8	0.0	0.0	0.0
Spirits duties	2.3	2.3	2.3	0.0	0.0	0.0
Wine duties	2.4	2.6	2.8	0.0	0.1	0.1
Beer and cider duties	3.3	3.3	3.4	0.0	-0.1	-0.1
Betting and gaming duties	1.4	1.4	1.4	0.0	0.0	0.0
Air passenger duty	1.0	2.0	2.1	0.0	-0.1	-0.1
Insurance premium tax	2.3	2.4	2.5	0.0	-0.1	0.0
Landfill tax	0.8	0.9	1.1	0.0	0.0	0.0
Climate change levy	0.7	0.7	0.7	0.0	0.0	0.0
Aggregates levy	0.3	0.3	0.4	0.0	0.0	0.0
Customs duties and levies	2.3	2.4	2.3	0.0	0.0	-0.1
Total HMRC	423.7	450.4	473.7	0.1	-3.0	-7.6
Vehicle excise duties	5.1	5.5	5.9	0.0	-0.1	-0.1
Business rates	21.0	21.9	24.1	-0.3	-0.2	0.2
Council tax ³	22.2	23.7	24.9	-0.2	0.2	0.2
Other taxes and royalties ⁴	13.9	15.3	16.0	0.5	0.7	0.5
Net taxes and NICs⁵	485.9	516.8	544.5	0.1	-2.4	-6.8
Accruals adjustments on taxes	4.7	1.5	2.4	1.3	-1.0	0.1
Less own resources contribution to EC budget	-4.6	-4.7	-4.8	0.1	-0.6	-0.3
Less PC corporation tax payments	-0.3	-0.2	-0.2	-0.1	0.0	0.0
Tax credits adjustment ⁶	0.5	0.5	0.6	0.0	0.0	0.0
Interest and dividends	6.3	7.6	7.5	0.3	0.5	0.3
Other receipts ⁷	26.6	29.7	31.0	0.1	1.7	1.8
Current receipts	519.1	551.2	581.0	1.8	-1.8	-4.9
<i>Memo:</i>						
North Sea revenues ⁸	9.0	7.5	9.0	0.0	-0.6	-0.3

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

² Includes enhanced company tax credits.

³ Council tax increases are determined annually by local authorities, not by the Government. As in previous years, council tax figures are projections based on stylised assumptions and are not Government forecasts.

⁴ Includes VAT refunds and money paid into the National Lottery Distribution Fund.

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

⁶ Tax credits which are scored as negative tax in the calculation of NTNIC but expenditure in the National Accounts.

⁷ Includes gross operating surplus, rent and business rate payments by local authorities.

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

Income tax and national insurance contributions **B.38** Cash receipts of income tax and national insurance contributions (NICs) in 2007-08 are expected to be £1.4 billion below their Budget 2007 projection, from a combination of the impact of the recent financial market disruption and higher than expected income tax repayments. In the first five months of 2007-08, Pay As You Earn (PAYE) and NIC receipts remained robust despite lower average earnings growth. This reflected strong growth in receipts from both the financial and business services sectors. These sectors were the fastest growing sectors of the economy in the first half of 2007 with a year-on-year growth rate of 5 per cent, as well as having a larger proportion of higher rate taxpayers than other parts of the economy.

B.39 The 2007 Pre-Budget Report forecast allows for lower receipts from bonuses in 2007-08 and 2008-09. With average earnings growth more modest than expected in recent months, the economic forecast assumes slower earnings growth than previously assumed in the Budget for 2008-09. This affects income tax and NICs receipts.

Non-North Sea corporation tax **B.40** Non-North Sea corporation tax has been lower-than-expected in the first five months of 2007-08. However, much of this change is due to much higher-than-expected repayments relating to previous years accounting periods. Net repayments are expected to be £1.3 billion higher in 2007-08 than in 2006-07, but this rise is expected to be mainly a one-off, in part reflecting HMRC efforts to finalise tax liabilities relating to historic accounting periods. The first instalment payments of corporation tax on 2007 profits made by many firms in July were consistent with continued sustained profit growth in the industrial and commercial sector and strong profit growth in the financial sector in the first half of 2007.

B.41 Over the remainder of 2007-08, the forecast assumes that corporation tax receipts from the industrial and commercial sector continue to benefit from the current momentum in the economy. However, financial market disruption is likely to have an impact on receipts from the sector. Although the extent of the impact on receipts is highly uncertain, the forecast for 2007-08 and 2008-09 takes this impact into account.

B.42 Thereafter, the forecast assumes that the financial sector recovers, consistent with the sector maintaining its international competitiveness and capacity for innovation.

North Sea revenues **B.43** Dollar oil prices during 2007 are likely to average around \$68 a barrel in 2007, some \$10 a barrel higher than assumed in the Budget 2007 forecast. However, North Sea revenues in 2007-08 have been revised down by around £0.6 billion in light of weaker-than-expected receipts from petroleum revenue tax and the first corporation tax instalment payments by North Sea firms on their 2007 profits. The impact from higher dollar oil prices has been offset by a variety of factors. In the first half of 2007, increased imports and a mild winter lowered gas prices and led some companies to rein back on production. There were also offsetting effects from continued cost pressures on the operating and capital expenditure of North Sea firms and the continued appreciation of sterling against the dollar.

B.44 With oil and gas prices now much higher than earlier in the year, North Sea revenues are expected to improve during the remainder of 2007-08. This is in contrast with 2006-07 when they deteriorated in the latter part of the year as prices fell. The differing pattern helps explain why the forecast for overall corporation tax assumes a stronger year-on-year growth rate for the remainder of 2007-08. The projections for North Sea revenues use the NAO-audited assumption on oil prices. In line with the average of independent forecasts, oil prices are expected to be \$68 a barrel in 2008, just under \$10 a barrel higher than in the Budget 2007 projection. However, there are likely to be a variety of offsetting effects from the strength of sterling against the dollar, higher costs and production levels that are expected to be lower going forward than assumed in Budget 2007.

Capital gains tax B.45 Capital gains tax is due in the final quarter of the financial year following the year in which the gains were realised. The forecast assumes a further year of robust growth in receipts in 2007-08 reflecting the rise in equity and housing markets in 2006-07. Thereafter, receipts will be affected by the reforms announced in this Pre-Budget Report and slower asset price growth than in recent years going forward. The path of equity prices over the forecast period is expected to be close to the Budget 2007 projection.

Stamp duties B.46 Both stamp tax on land and property and stamp duty on shares have shown robust year-on-year growth in the first five months of 2007-08. Stamp tax on land and property has been boosted by continued growth in house prices and property transactions. Stamp duty on shares has benefited from the year-on-year rises in both equity prices and volumes. However, growth in stamp duty receipts is expected to slow in the final months of 2007-08 and into 2008-09, as the drivers of recent growth lose some momentum.

VAT receipts B.47 Cash receipts of VAT in 2007-08 are expected to be £1.4 billion above the Budget 2007 forecast, helped by the continuing success of the government's strategy for tackling Missing Trader Intra-Community (MTIC) fraud and a stronger-than-expected rise in nominal consumer spending in the first half of 2007. Consumer spending accounts for around two-thirds of the VAT base and the stronger growth reflected both higher inflation and real spending growth, above the Budget 2007 forecast range.

B.48 After 8.4 per cent year-on-year growth in cash receipts of VAT in the first five months of 2007-08, annual growth is expected to slow over the remainder of the year. This in part reflects the fact that the annual comparison will be against a period in which MTIC fraud had fallen to a low level. In addition, more VAT is likely to be repaid over the remainder of 2007-08 and into 2008-09 than in the first five months of the financial year. This follows last year's judicial rulings relating to the 3-year cap for making claims of previously overpaid or underclaimed VAT. The Government is appealing these decisions and, if successful, taxpayers would subsequently be required to repay these claims. No allowance is made in the forecast for any such recoveries.

B.49 Growth in VAT receipts in 2008-09 will be affected by a slowdown in nominal consumer spending growth. Inflation has already fallen back sharply from its March peak and is expected to remain close to target going forwards, while real consumer spending is expected to grow below the growth of the economy as a whole in 2008.

Excise duties B.50 Fuel duties are expected to be £0.2 billion lower in 2007-08 than forecast in Budget 2007. This reflects the impact of increased pump prices, due to higher oil prices, on the demand for fuel. In a full year, the higher oil prices are expected to take around £0.3 billion off receipts. The stronger year-on-year growth in fuel duties expected in the second half of 2007-08 reflects the Budget 2007 measure to raise main fuel duties by 2 pence per litre from 1 October.

B.51 The forecast for tobacco receipts is close to the Budget 2007 projection. As in Budget 2007, the forecast allows for the impact of the smoking ban in enclosed workplaces. Tobacco receipts in 2007-08 are likely to be marginally down from 2006-07, despite the revalorisation of duties in Budget 2007. Alcohol receipts are also expected to be close to their Budget 2007 forecast.

Council tax B.52 Council tax increases are determined annually by local authorities, not by the government. The council tax projections are based on stylised assumptions and are not government forecasts. The council tax figures for 2008-09 onwards are based on the arithmetic average of council tax increases over the past three years. Since changes to council tax are broadly balanced by changes to locally financed expenditure, they have little material impact on the current balance or on net borrowing.

Tax-GDP ratio

B.53 Table B9 shows projections of receipts from major taxes as a per cent of GDP. Table B10 sets out projections of the overall tax-GDP ratio, based on net tax and national insurance contributions. The tax-GDP ratio is expected to be lower throughout the forecast than in Budget 2007 projections. A key factor is higher money GDP, reflecting 2007 Blue Book revisions and higher-than-expected GDP deflator inflation in the first half of 2007.

Table B9: Current receipts as a proportion of GDP

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Income tax (gross of tax credits)	11.2	11.0	11.0	11.1	11.3	11.4	11.6
National insurance contributions	6.6	6.9	6.9	6.9	6.9	7.0	7.0
Non-North Sea corporation tax ¹	2.9	2.9	3.0	3.1	3.2	3.3	3.3
Tax credits ²	-0.4	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3
North Sea revenues ³	0.7	0.5	0.6	0.6	0.6	0.6	0.5
Value added tax	5.8	5.8	5.8	5.8	5.8	5.8	5.7
Excise duties ⁴	3.0	2.9	2.9	2.8	2.8	2.7	2.7
Other taxes and royalties ⁵	6.9	7.1	7.2	7.2	7.2	7.2	7.1
Net taxes and NICs⁶	36.7	36.8	37.0	37.3	37.4	37.5	37.6
Accruals adjustments on taxes	0.4	0.1	0.2	0.2	0.2	0.2	0.3
Less EU transfers	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Other receipts ⁷	2.5	2.7	2.6	2.6	2.6	2.6	2.6
Current receipts	39.2	39.2	39.5	39.7	39.9	40.0	40.2

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

² Tax credits scored as negative tax in net taxes and national insurance contributions.

³ Includes 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 Mainly gross operating surplus and rent

Table B10: Net taxes and national insurance contributions¹

	Per cent of GDP						
	Outturn ²	Estimate ³	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Budget 2007	37.2	37.7	38.0	38.1	38.1	38.1	
2007 Pre-Budget Report	36.7	36.8	37.0	37.3	37.4	37.5	37.6

¹ Cash basis. Uses OECD definition of tax credits scored as negative tax.

² The 2006-07 figures were estimates in Budget 2007.

³ The 2007-08 figures were projections in Budget 2007.

PUBLIC EXPENDITURE

B.54 This section looks in detail at the projections for public expenditure consistent with the Comprehensive Spending Review. It includes provisional outturns for 2006-07, the latest estimates for 2007-08 and, for the first time, public expenditure plans for 2008-09 to 2010-11. The spending projections cover the whole of the public sector, using the National Accounts aggregate Total Managed Expenditure (TME).

B.55 For fiscal aggregates purposes, TME is split into National Accounts components covering public sector current expenditure, public sector net investment and depreciation. For budgeting and other purposes, TME is split into DEL (firm three-year limits for departments' programme expenditure) and AME (expenditure that is not easily subject to firm multi-year limits). Departments have separate resource budgets for current expenditure and capital budgets for investment.

B.56 Table B11 sets out projected spending on DEL and the main components of AME to the end of the 2007 Comprehensive Spending Review period in 2010-11. Table B12 shows changes since Budget 2007.

Changes in TME since Budget 2007

B.57 TME in all years is higher than at Budget 2007 because of a fiscally-neutral classification change introduced by the ONS in June 2007. This change added £1.6 billion to both receipts and expenditure in 2006-07 and is described in more detail in paragraph B.34.

B.58 After taking account of this reclassification change, the provisional outturn for TME in 2006-07 was lower than estimated in Budget 2007. Current expenditure was lower by £4.0 billion, mainly because of lower local authority spending net of current grants from central government, and net investment was higher by £0.8 billion. Aside from the classification change, there are no forecasting changes to TME in 2007-08 since Budget 2007. Forecasts for individual AME components have been revised but all changes have been absorbed within the AME margin.

B.59 Discretionary changes to TME since the Budget 2007 forecast reflect the addition of £0.4 billion to the special reserve in 2007-08 and the £2 billion addition to public investment in 2010-11, as set out in Table B4.

Table B11: Total Managed Expenditure 2006-07 to 2010-11

	£ billion				
	Outturn	Estimate	Projections		
	2006-07	2007-08	2008-09	2009-10	2010-11
CURRENT EXPENDITURE					
Resource Departmental Expenditure Limits	291.2	310.8	324.3	338.8	354.6
of which:					
Near-cash Departmental Expenditure Limits	272.3	290.0	303.4	316.5	330.6
Non-cash	18.9	20.8	20.9	22.3	24.0
Resource Annually Managed Expenditure	215.4	230.4	241.7	253.7	265.7
of which:					
Social security benefits ¹	131.8	139.0	145.9	152.3	158.2
Tax credits ¹	16.3	16.7	18.2	18.8	19.3
Net public service pensions ²	1.2	2.2	2.7	2.9	3.5
National Lottery	0.8	0.8	0.7	0.6	0.7
BBC domestic services	3.2	3.3	3.4	3.6	3.7
Other departmental expenditure	3.2	2.9	1.7	1.3	1.1
Net expenditure transfers to EC institutions ³	4.7	5.6	5.5	5.7	6.6
Locally-financed expenditure ⁴	25.5	25.3	26.2	27.4	29.1
Central government gross debt interest	27.6	30.0	29.1	31.2	32.9
AME margin	0.0	0.1	0.9	1.8	2.7
Accounting adjustments	1.2	4.5	7.4	8.1	7.9
Public sector current expenditure	506.6	541.2	566.0	592.5	620.3
CAPITAL EXPENDITURE					
Capital Departmental Expenditure Limits	39.1	44.7	48.1	50.7	55.3
Capital Annually Managed Expenditure	4.4	3.3	3.4	3.4	2.7
of which:					
National Lottery	0.8	0.9	0.8	1.0	0.9
Locally-financed expenditure ⁴	5.1	3.6	4.0	3.9	2.9
Public corporations' own-financed capital expenditure	5.7	4.9	5.0	5.1	5.2
Other capital expenditure	-0.5	-0.4	0.4	0.6	0.8
AME margin	0.0	0.9	0.1	0.2	0.3
Accounting adjustments	-6.8	-6.5	-6.9	-7.4	-7.4
Public sector gross investment	43.5	48.0	51.4	54.1	58.0
less public sector depreciation	-17.2	-18.3	-19.1	-20.2	-21.2
Public sector net investment	26.3	29.7	32.3	33.9	36.7
TOTAL MANAGED EXPENDITURE⁵	550.1	589.2	617.4	646.6	678.3
of which:					
Departmental Expenditure Limits	320.4	344.6	361.1	377.5	396.9
Annually Managed Expenditure	229.7	244.6	256.4	269.2	281.4

¹ For 2006-07 to 2008-09, child allowances in Income Support and Jobseekers' Allowance have been included in the tax credits line and excluded from the social security benefits line.

² Net public service pensions expenditure is reported on a National Accounts basis.

³ AME spending component only. Total net payments to EU institutions also include receipts scored in DEL, VAT based contributions which score as negative receipts and some payments which have no effect on the UK public sector in the National Accounts. Latest estimates for total net payments, which exclude the UK's contribution to the cost of EU aid to non-Member States (which is attributed to the aid programme), and the UK's net contribution to the EC Budget, which includes this aid, are (in £ billion):

	2006-07	2007-08	2008-09	2009-10	2010-11
Net payments to EC institutions	2.9	4.3	3.3	4.8	5.7
Net contribution to EC Budget	3.5	5.0	4.1	5.7	6.5

⁴ This expenditure is mainly financed by council tax revenues. See footnote to table B8 for an explanation of how the council tax projections are derived.

⁵ Total Managed Expenditure is equal to the sum of public sector current expenditure, public sector net investment, and public sector depreciation

Table B12: Changes to Total Managed Expenditure since Budget 2007

	£ billion	
	Outturn 2006-07	Estimate 2007-08
CURRENT EXPENDITURE		
Resource Departmental Expenditure Limits	-2.2	0.8
<i>of which:</i>		
Near-cash Departmental Expenditure Limits	-2.1	0.7
Non-cash	-0.1	0.1
Resource Annually Managed Expenditure	-0.1	1.8
<i>of which:</i>		
Social security benefits	-0.2	-0.2
Tax credits	0.1	0.1
Net public service pensions	0.1	0.5
National Lottery	0.1	0.0
BBC domestic services	0.0	0.1
Other departmental expenditure	-0.1	0.1
Net expenditure transfers to EC institutions	0.0	0.6
Locally-financed expenditure	1.6	-0.6
Central government gross debt interest	0.1	0.9
AME margin	0.0	-0.8
Accounting adjustments	-1.9	1.0
Public sector current expenditure	-2.4	2.5
CAPITAL EXPENDITURE		
Capital Departmental Expenditure Limits	0.3	0.4
Capital Annually Managed Expenditure	0.0	-0.4
<i>of which:</i>		
National Lottery	-0.1	0.1
Locally-financed expenditure	3.0	1.7
Public corporations' own-financed capital expenditure	1.5	0.3
Other capital expenditure	-0.8	-0.9
AME margin	0.0	0.8
Accounting adjustments	-3.6	-2.3
Public sector gross investment	0.3	0.0
less public sector depreciation	0.5	0.4
Public sector net investment	0.8	0.4
TOTAL MANAGED EXPENDITURE	-2.1	2.5
<i>of which:</i>		
Departmental Expenditure Limits	-1.3	0.9
Annually Managed Expenditure	-0.8	1.6

Central government spending in 2007-08

B.60 In-year monthly spending information is only available for central government. Provisional outturn for current expenditure in the first five months of 2007-08 is 7.4 per cent higher than in the corresponding period of 2006-07. Growth is higher in the year to date than the Pre-Budget Report estimate for the year as a whole, as a result of factors which affect the pattern of debt interest spending across the year.

B.61 Debt interest payments for the year to date are 19 per cent higher than the same period last year, largely because of the impact of higher RPI inflation on the accruing uplift of index-linked gilts payments. Although debt interest payments are expected to grow more strongly than in the Budget 2007 forecast, this growth is not expected to continue because the pattern of RPI increases as they affect the uplift in 2007-08 differs from that which affected 2006-07.

B.62 Provisional outturn data for all other current expenditure for the first five months of 2007-08 show growth of 5.7 per cent over the same period in 2006-07, lower than the 6.2 per cent increase forecast for the year as a whole.

DEL and AME analysis

B.63 The detailed allocation of resource and capital DEL is shown in Table B13, including the final CSR07 DEL allocations. The departmental groupings have been updated to reflect the machinery of government changes announced in June 2007, and outturn years restated on the basis of current departmental responsibilities. A full list of the individual departments within each group is given at the end of this document. Further details of departmental DEL settlements are given in Annex C.

B.64 The latest figures include a number of classification and budgetary changes, which have no impact on National Accounts definitions or TME. The main changes are:

- a reclassification of Nuclear Decommissioning Authority expenditure from resource to capital DEL to align with the treatment in the National Accounts;
- a movement from capital to resource DEL for the Ministry of Defence in 2007-08 offset in the accounting adjustments;
- the movement of international debt write-offs from resource to capital DEL; and
- the reclassification of interest received on student loans from DEL to AME, increasing DEL and reducing AME.

Table B13: Departmental Expenditure Limits - resource and capital budgets

	£ billion				
	Outturn 2006-07	Estimate 2007-08	2008-09	Plans 2009-10	2010-11
Resource DEL					
Children, Schools and Families	42.1	45.0	46.9	49.2	51.9
Health	80.3	89.7	94.0	99.9	106.4
<i>of which: NHS England</i>	78.4	87.6	92.6	98.5	104.8
Transport	6.9	6.7	6.4	6.5	6.7
Innovation, Universities and Skills	14.4	16.1	16.9	17.6	18.7
CLG Communities	3.6	4.3	4.4	4.5	4.7
CLG Local Government	22.5	22.8	24.7	25.6	26.4
Home Office	8.3	8.6	9.0	9.3	9.6
Justice	8.4	8.9	9.3	9.4	9.4
Law Officers' Departments	0.7	0.7	0.7	0.7	0.7
Defence	33.5	33.2	33.6	35.2	36.7
Foreign and Commonwealth Office	1.8	1.8	1.6	1.6	1.6
International Development	4.2	4.6	4.9	5.5	6.4
Business, Enterprise and Regulatory Reform	2.2	2.4	2.3	2.2	2.2
Environment, Food and Rural Affairs	3.2	3.0	2.9	3.0	3.0
Culture, Media and Sport	1.5	1.6	1.6	1.7	1.8
Work and Pensions	7.6	7.8	7.6	7.4	7.1
Scotland	22.4	23.6	24.5	25.4	26.5
Wales	11.6	12.5	13.0	13.6	14.2
Northern Ireland Executive	7.1	7.6	7.9	8.2	8.5
Northern Ireland Office	1.2	1.1	1.2	1.2	1.2
Chancellor's Departments	5.0	4.9	4.8	4.6	4.5
Cabinet Office	1.7	1.9	2.1	2.3	2.5
Independent Bodies	0.7	0.8	0.8	0.9	1.0
Moderisation Funding	-	-	0.5	0.4	0.1
Reserve	-	0.6	2.5	2.8	3.0
Unallocated special reserve ¹	-	0.8	-	-	-
Total resource DEL	291.2	310.8	324.3	338.8	354.6
Capital DEL					
Children, Schools and Families	4.1	5.8	6.0	6.4	7.6
Health	3.3	4.3	4.7	5.5	6.2
<i>of which: NHS England</i>	3.2	4.2	4.6	5.4	6.1
Transport	6.5	6.6	7.3	7.6	8.1
Innovation, Universities and Skills	1.9	1.9	2.0	2.2	2.3
CLG Communities	5.4	5.9	7.0	7.3	7.5
CLG Local Government	0.2	0.1	0.1	0.1	0.1
Home Office	0.6	0.8	0.9	0.8	0.9
Justice	0.5	0.7	0.7	0.8	0.7
Law Officers' Departments	0.0	0.0	0.0	0.0	0.0
Defence	7.1	7.1	7.9	8.2	8.9
Foreign and Commonwealth Office	0.2	0.1	0.2	0.2	0.2
International Development	0.8	0.7	0.9	1.4	1.6
Business, Enterprise and Regulatory Reform	1.1	1.2	1.2	1.2	1.2
Environment, Food and Rural Affairs	0.9	0.9	1.0	1.1	1.2
Culture, Media and Sport	0.3	0.4	1.0	0.4	0.6
Work and Pensions	0.2	0.1	0.1	0.1	0.1
Scotland	3.0	3.1	3.1	3.3	3.6
Wales	1.3	1.6	1.6	1.7	1.8
Northern Ireland Executive	0.8	1.0	1.0	1.1	1.2
Northern Ireland Office	0.1	0.1	0.1	0.1	0.1
Chancellor's Departments	0.3	0.3	0.3	0.3	0.3
Cabinet Office	0.3	0.3	0.4	0.4	0.4
Independent Bodies	0.1	0.1	0.0	0.0	0.0
Reserve	-	1.5	0.7	0.7	0.8
Total capital DEL	39.1	44.7	48.1	50.7	55.3
Depreciation	9.9	10.8	11.3	12.1	13.0
Total Departmental Expenditure Limits	320.4	344.6	361.1	377.5	396.9
Total Education spending	70.5	77.7	81.8	86.1	92.0

¹ This represents provisions for the costs of military operations in Iraq and Afghanistan, as well as the UK's other international obligations.

B.65 Resource budgets are divided into near-cash and non-cash elements. Near-cash is expenditure that impacts directly on the surplus on the current budget, and includes pay, procurement, and current grants. The near-cash control totals set for each department in the 2007 Comprehensive Spending Review are shown in Table B14.

B.66 Table B15 shows administration budgets by departmental group. Administration budgets are a control total in resource DEL and help drive economy and efficiency in the running of government itself by limiting expenditure on civil service pay, procurement of goods and services including professional services and consultancy, and the resource costs of assets used by civil servants. Administration budgets were reviewed and adjusted in the 2004 Spending Review to better reflect the boundary between frontline and administrative costs and ensure increased resources were focused on frontline public service, as recommended in Sir Peter Gershon's review of public sector efficiency. As part of the 2007 Comprehensive Spending Review some further spending on activities directly supporting frontline delivery has been reclassified into programme expenditure and the outturn years have been restated on the current basis to provide a consistent series. The figures here also reflect the outcome of work announced in the 2006 Pre-Budget Report to ensure departmental spending on consultancy is properly captured by the administration costs regime.

B.67 The Ministry of Defence is set an administration control total for the first time in the 2007 Comprehensive Spending Review, meaning all central government departments are now within the administration control regime.

Table BI4: Near-cash in resource DEL

	£ billion				
	Outturn 2006-07	Estimate 2007-08	2008-09	Plans 2009-10	2010-11
Near-cash in resource DEL					
Children, Schools and Families	42.1	45.0	46.9	49.3	51.9
Health	77.7	85.8	90.8	96.5	102.7
<i>of which: NHS England</i>	75.7	83.7	89.5	95.1	101.2
Transport	6.4	6.2	6.2	6.2	6.1
Innovation, Universities and Skills	13.3	14.5	15.0	15.6	16.5
CLG Communities	3.5	4.1	4.2	4.3	4.4
CLG Local Government	22.5	22.8	24.7	25.6	26.4
Home Office	8.2	8.4	8.8	9.1	9.4
Justice	8.0	8.5	8.7	8.7	8.7
Law Officers' Departments	0.7	0.7	0.7	0.7	0.7
Defence	23.5	22.8	22.9	23.7	24.5
Foreign and Commonwealth Office	1.7	1.7	1.4	1.5	1.5
International Development	4.1	4.5	4.8	5.4	6.3
Business, Enterprise and Regulatory Reform	2.1	2.3	2.2	2.1	2.1
Environment, Food and Rural Affairs	2.6	2.7	2.6	2.6	2.6
Culture, Media and Sport	1.4	1.4	1.4	1.4	1.5
Work and Pensions	7.3	7.6	7.4	7.2	6.9
Scotland	21.4	22.7	23.5	24.4	25.5
Wales	11.3	12.0	12.5	13.0	13.6
Northern Ireland Executive	6.8	7.3	7.6	7.9	8.2
Northern Ireland Office	1.0	0.9	0.9	0.9	0.9
Chancellor's Departments	4.7	4.5	4.4	4.3	4.2
Cabinet Office	1.5	1.6	1.8	1.9	2.1
Independent Bodies	0.6	0.6	0.7	0.7	0.9
Modernisation Funding	-	-	0.5	0.4	0.1
Reserve	-	0.6	2.5	2.8	3.0
Unallocated Special Reserve ¹	-	0.8	-	-	-
Total near-cash in resource DEL	272.3	290.0	303.4	316.5	330.6

¹ This represents provisions for the costs of military operations in Iraq and Afghanistan, as well as the UK's other international obligations.

Table B15: Administration budgets

	£ million				
	Outturn	Estimate	2008-09	Plans	
	2006-07	2007-08		2009-10	2010-11
Administration budgets					
Children, Schools and Families	223	220	218	212	207
Health	277	277	270	264	257
Transport	295	290	282	275	269
Innovation, Universities and Skills	67	72	70	68	67
CLG Communities	294	287	281	274	267
Home Office	399	434	429	419	409
Justice	418	459	448	438	426
Law Officers' Departments ¹	60	72	74	72	72
Defence ²	2,357	2,317	2,261	2,206	2,152
Foreign and Commonwealth Office	351	396	386	377	368
International Development	197	168	163	159	155
Business, Enterprise and Regulatory Reform	401	400	382	373	364
Environment, Food and Rural Affairs	399	437	356	347	339
Culture, Media and Sport	51	50	49	48	47
Work and Pensions	5,867	5,802	5,661	5,524	5,389
Northern Ireland Office	79	79	77	75	73
Chancellor's Departments	4,827	4,702	4,595	4,481	4,369
Cabinet Office	260	347	332	324	316
<i>of which: Security and Intelligence Agencies²</i>	88	89	87	85	83
Total administration budgets	16,823	16,808	16,335	15,935	15,545
Administration budgets as a percentage of Total Managed Expenditure	3.1	2.9	2.6	2.5	2.3

¹ Plans includes additional funding of £3.6m / £3.8m / £4.9m (2008-09 to 2010-11) on top of core administration budgets for the implementation of the Fraud Review.

² The historical data for the MoD and the SIA are estimates. These series will be reviewed for Public Expenditure Statistical Analyses 2008.

AME B.68 The AME forecast for the Comprehensive Spending Review period is set out here for the first time. The main assumptions underpinning the AME projections are set out in Box B1 and Table B3.

B.69 Projections for social security expenditure in 2007-08 are slightly less than at Budget 2007. Downward movements in the NAO-audited unemployment assumption have more than offset other small increases.

B.70 The 2007-08 forecast for expenditure on the Child and Working Tax Credits has increased slightly since Budget 2007. The revised projection incorporates revisions to expected average earnings growth in the population receiving tax credits, and stronger-than-expected growth in childcare costs. The increase in profile between 2007-08 and 2008-09 reflects the effects of the Budget 2007 personal tax package.

B.71 Net public service pensions expenditure is measured on a National Accounts basis, and reports benefits paid less contributions received by central government unfunded public service pension schemes. Forecast expenditure from 2007-08 reflects actuarial advice on the rate and level at which benefits are expected to come into payment, and has been updated in the light of newly available information relating to scheme demographics. The change in forecast in 2007-08 since Budget 2007 is largely due to outturn data on the level of offsetting employer and employee contributions in 2006-07 being lower than expected. The increasing level of net expenditure across the period is largely a feature of payments to pensioners: in

addition to the demographic profile, the forecast includes an increase reflecting the amount of pension commuted into lump sum by those retiring, corresponding with the higher level permitted in the simplified tax regime for pensions introduced in April 2006, as scheme rules are introduced which allow for this from 2007 onwards. This increase in spending in the near-term will be balanced by lower expenditure in the longer-term.

B.72 National Lottery figures reflect the latest view on timing of drawdown by the distributing bodies. The 2007-08 estimate is broadly unchanged from Budget 2007. The forecasts for 2008-09 to 2010-11 are consistent with projections of revenue from ticket sales.

B.73 The decreasing profile of other departmental expenditure across the CSR period largely reflects the downward trend of net expenditure from the coal health liabilities scheme. The scheme is expected to wind down from 2008-09 as the majority of claims have been processed.

B.74 Net expenditure transfers to EC Institutions, which consist of the Gross National Income (GNI) based contribution less the UK abatement, are higher than forecast at Budget 2007 for 2007-08. The main driver is the use of later information provided by the Commission on the 2008 EC Budget. The increase in 2010-11 compared with 2009-10 is due to changes in the calculation of the UK abatement from 2009, budgeted from 2010. Under these arrangements, expenditure on economic development in the new Member States will gradually be disappplied from the abatement calculation.

B.75 Locally financed expenditure mainly consists of local authority self-financed expenditure (LASFE) and Scottish spending financed by local taxation. LASFE is the difference between total local authority expenditure, net of capital receipts, and central government support to local authorities.

B.76 Outturn and forecasts for LASFE have been revised in the light of a definitional change that takes effect from this Pre-Budget Report. This change has removed adjustments that are applied to the local authorities' own data within the National Accounts, and included these adjustments instead within the accounting adjustments line. This means that the LASFE component now only reflects data returned by local authorities to the Department for Communities and Local Government and the Devolved Administrations, and there is a clear distinction between local authorities' own data and the adjustments applied to those data within the National Accounts.

B.77 Movements in forecasts for 2007-08 for LASFE since Budget 2007 reflect minor adjustments in respect of the level of reserves used, capital expenditure financed from the revenue account, and revised forecasts of council tax benefit payments. The main determinant of the LASFE forecast going forward is council tax. Council tax increases are determined by local authorities, not by government, and since changes to LASFE are broadly balanced by changes to council tax, they will have little material impact on the fiscal aggregates. The capital forecast reflects forecasts based on historical information and departmental returns on the use of capital receipts, capital expenditure financed from revenue, prudential borrowing plans, and forecast asset sales. The capital LASFE forecast also includes forecast borrowing by the Greater London Authority (GLA) to part-finance the Crossrail project.

B.78 Forecasts for central government gross debt interest payments have been revised in light of the latest economic determinant assumptions. The 2007-08 projection has increased, largely because of higher RPI inflation affecting the uplift on index-linked gilts and National Savings and Investments savings certificates. Market expectations of interest rates have also risen since Budget 2007, and these have affected the forecast for interest paid on short-term financing instruments. The fall in the level of forecast payments between 2007-08 and 2008-09 is partly the result of lower assumptions for economic determinants, and partly because of redemptions of high-coupon gilts.

B.79 Public corporations' own-financed capital expenditure (PCOFCE) is the amount of capital expenditure by public corporations that is not financed by central government. The profile for PCOFCE falls in 2007-08, largely because of scheduled net increases in government financing already included in departments' budgets.

B.80 The AME margin has been set at £1 billion, £2 billion and £3 billion for the years 2008-09 to 2010-11 respectively.

B.81 The accounting adjustments reconcile the budgeting aggregates DEL and AME with the National Accounts definition of TME, removing items that score in DEL or AME but not in TME, and adding in items included in TME but not in DEL or AME. The forecasts include a new National Accounts adjustment, which the ONS introduced in June 2007 for local authorities' imputed subsidies for the injection of equity into Housing Revenue Accounts (HRAs). This increases TME but is offset by additional HRA gross operating surplus within current receipts, and is therefore neutral across the public finances as a whole. The spending envelope for the CSR07 period has been adjusted to allow for this change, and for changes to forecast depreciation that reduce TME and reduce the public sector's gross operating surplus. The receipts offset is set out in more detail in paragraph B.34. Other changes to accounting adjustments since Budget 2007 include offsets to reflect classification and budgetary change to DELs described in paragraph B.64.

FINANCING REQUIREMENT

B.82 Table B16 presents projections of the net cash requirement by sub-sector, giving details of financial transactions that do not affect net borrowing (the change in the sub-sector's net financial indebtedness) but do affect its financing requirement.

Table B16: Public sector net cash requirement

	£ billion							
	2007-08				2008-09			
	General government			Public sector	General government			Public sector
Central government	Local authorities	Public corporations	Central government		Local authorities	Public corporations		
Net borrowing	38.6	2.7	-3.3	38.0	37.5	3.6	-4.7	36.4
<i>Financial transactions</i>								
Net lending to private sector and abroad	3.1	0.1	-0.3	2.9	0.1	0.1	-0.3	-0.1
Cash expenditure on company securities	-1.9	-2.1	2.1	-1.9	-0.2	-1.8	2.1	0.0
Accounts receivable/payable	-0.1	0.2	0.3	0.4	2.6	0.2	0.3	3.1
Adjustment for interest on gilts	-4.6	0.0	0.0	-4.6	-3.8	0.0	0.0	-3.8
Miscellaneous financial transactions	-0.2	0.0	-0.6	-0.8	-0.2	0.0	0.0	-0.2
Own account net cash requirement	35.0	1.0	-1.9	34.0	36.0	2.1	-2.6	35.5
Net lending within the public sector	2.3	-1.6	-0.7	0.0	1.7	-1.2	-0.5	0.0
Net cash requirement¹	37.3	-0.6	-2.6	34.0	37.6	0.9	-3.1	35.5

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

B.83 In line with the updated fiscal forecasts, the revised financing arithmetic for 2007-08 is shown in Table B17. The central government net cash requirement (CGNCR) for 2007-08 is now forecast to be £37.3 billion, a decrease of £0.3 billion from the Budget 2007 forecast. In addition, the impact of other factors set out below result in a reduction in the net financing requirement (NFR) for 2007-08 of £1.6 billion from Budget 2007, so that the NFR is now forecast to be £58.3 billion.

B.84 In order to meet the decrease in the NFR, the Debt Management Office's (DMO's) remit has been revised. The stock of Treasury bills will be marginally reduced by £0.1 billion instead of the increase of £1.5 billion forecast at Budget 2007. Gilt issuance is unchanged.

B.85 The latest financing arithmetic set out in Table B17 also takes account of the following changes since Budget 2007:

- an increase in the forecast net contribution to financing of £1.4 billion in 2007-08 from National Savings & Investments (NS&I);
- buy-backs of illiquid gilts in the secondary market by the DMO of £0.1 billion; and
- a reduction of £0.1 billion in the planned short-term financing adjustment for 2007-08.

B.86 Details of changes to the financing arithmetic and a revised financing table for 2007-08 together with information on the progress of gilts sales so far this year against the DMO financing remit can be found on the DMO's website at www.dmo.gov.uk

Table B17: Financing requirement forecast

	£ billion		
	Original Remit Budget 2007	Revised Remit April 2007 ¹	2007 Pre-Budget Report
Central government net cash requirement	37.6	37.6	37.3
Gilt redemptions	29.2	29.2	29.2
Financing for the Official Reserves	0.0	0.0	0.0
Buy-backs ²	0.0	0.0	0.1
Planned short-term financing adjustment ³	-4.2	-4.1	-4.1
Gross financing requirement	62.6	62.7	62.5
less			
Assumed net contribution from National Savings and Investments	2.8	2.8	4.2
Net financing requirement	59.8	59.9	58.3
<i>Financed by:</i>			
1. Debt issuance by the Debt Management Office			
(a) Treasury bills	1.4	1.5	-0.1
(b) Gilts	58.4	58.4	58.4
2. Other planned changes in short-term debt⁴			
Change in Ways & Means	0.0	0.0	0.0
3. Unanticipated changes in short-term cash position⁵			
	0.0	0.0	0.0
Total financing	59.8	59.9	58.3
Short-term debt levels at end of financial year			
Treasury bill stock in market hands	17.0	17.1	15.5
Ways & Means	13.4	13.4	13.4
DMO net cash position	0.5	0.5	0.5

¹ The financing arithmetic in Budget 2007 was revised on 24 April 2007 to reflect outturn data for 2006-07.

² Purchases of "rump" gilts which are older, small gilts, declared as such by the DMO and in which Gilt-edged Market Makers (GEMMs) are not required to make two-way markets. The Government will not sell further amounts of such gilts to the market but the DMO is prepared, when asked by a GEMM, to make a price to purchase such gilts.

³ To accommodate changes to the current year's financing requirement resulting from: (i) publication of the previous year's outturn CGNCR; (ii) an increase in the DMO's cash position at the Bank of England; and / or (iii) carry over of unanticipated changes to the cash position from the previous year.

⁴ Total planned changes to short-term debt are the sum of: (i) the planned short-term financing adjustment; (ii) Treasury bill sales; and (iii) changes to the level of the Ways & Means advance.

⁵ A negative (positive) number indicates an addition to (reduction in) the financing requirement for the following financial year.

B.87 In April 2007, the Government announced that it would undertake a feasibility study into the benefits and costs of issuing a wholesale sterling Islamic financial instrument. An update on the progress of the feasibility study is provided in Box B2.

Box B2: Government sukuk issuance

In April 2007, the then Economic Secretary announced a feasibility study, to be undertaken by HM Treasury and the Debt Management Office, on the benefits and costs of the case for the Government to become a sovereign issuer of wholesale sterling Islamic financial instruments and the practical and legal implications of doing so.

The objectives of potential sukuk issuance were set out by the then Economic Secretary in a speech on 23 April 2007^a. He said that ‘We are determined to do everything we can to deliver greater opportunities for British Muslims – and also to entrench London as a leading centre for Islamic finance in the world’.

NS&I is examining separately the feasibility of the Government becoming an issuer of retail Islamic financial products and will report in Spring 2008.

The feasibility study has also considered the implications of any sukuk issuance by the Government for the Government's existing gilt and Treasury bill issuance programmes that are undertaken consistently with the debt management policy objective of minimising long-term cost, taking into account risk.

The Government has identified a number of potential benefits of sukuk issuance flowing to the City of London and to the wider community. London is already growing as a leading global gateway for Islamic financial activity, and Government sukuk issuance could further spur the development of the City as a centre for Islamic finance, boosting its ability to attract further sukuk structuring activity. In addition, it could potentially facilitate the development of a greater range of shariah-compliant retail financial products. These products would be available to all retail customers but would be of particular benefit to those British Muslims who would be otherwise unable to access routine financial services because of their faith.

The Government has also identified a number of potential costs, including the costs of structuring and launching sukuk issuance, and other costs that are dependent on the size and nature of the issuance.

The Government is urgently examining the risks associated with sukuk issuance, particularly the risks relating to price and demand. In this context, the Government is examining the feasibility of issuing sukuk that would have similar characteristics to gilts or Treasury bills. The Government is considering the features that a sukuk would need in order to be issued at the same price as a gilt or Treasury bill.

The feasibility study has identified several important structural issues that need to be resolved prior to any sukuk issuance. These issues include:

- the need for - and content of - any primary legislation to facilitate sukuk issuance;
- the identification of an asset(s) to be transferred to a special purpose vehicle (on the assumption of an ijarah structure) to facilitate sukuk issuance; and
- the tax treatment of assets upon transfer to and from a special purpose vehicle and any other taxation or regulatory issues.

The Government remains of the view that there is real potential, not only for the City of London, but also for addressing wider issues of financial inclusion, in continuing to develop policy in this area. To that end, it will hold further detailed and specific consultation. HM Treasury and the Debt Management Office will publish a consultation document later in the Autumn. Following the consultation, the Government will announce its decision and next steps including the timetable for any primary legislation.

^aSpeech by Ed Balls MP to the FSA's Principles-based Regulation Conference, 23 April 2007

PREPARING FOR LONG-TERM FISCAL CHALLENGES

B.88 The 2007 Comprehensive Spending Review identifies five areas of change that the Government will have to confront in the decade ahead, including the challenges of demographic and socio-economic change. An assessment of the long-term sustainability of the public finances should take into account not only the key challenges of the next ten years, but also look over a still longer time horizon.

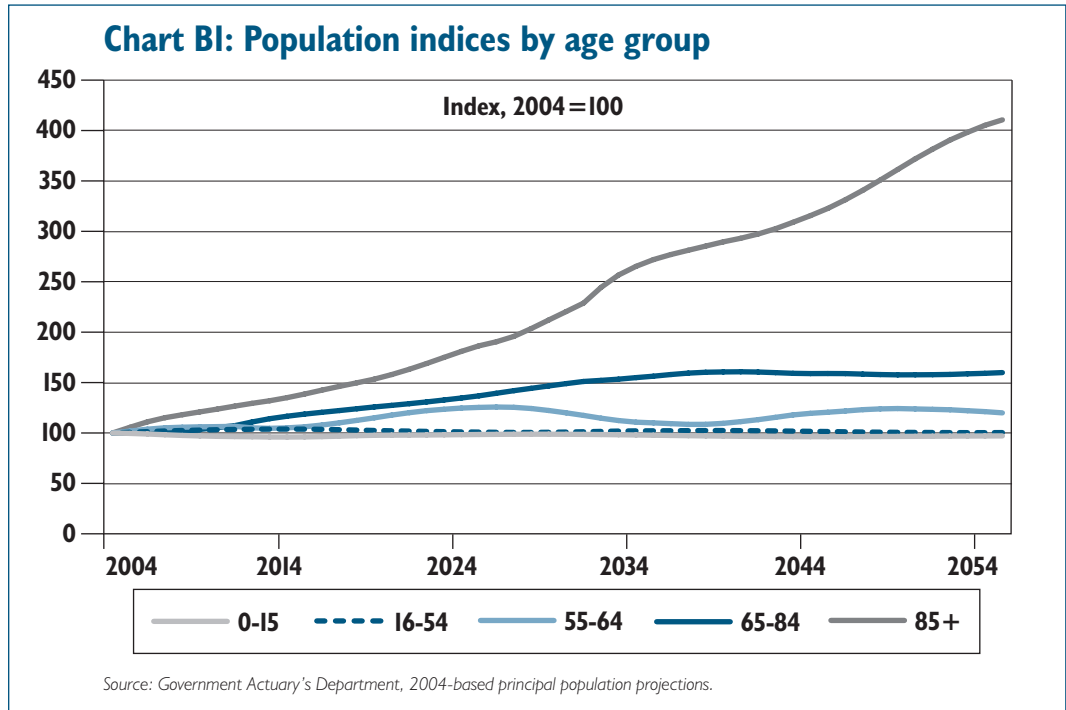
B.89 The Government believes that sustainable public finances are a prerequisite to achieving high and stable rates of long-term economic growth, which are shared by all, and to ensuring that spending and taxation impact fairly between generations.

B.90 Since 2002, the Government has published the Long-term public finance report on an annual basis,² with the intention of providing a comprehensive analysis of long-term socio-economic and demographic developments, and their likely impact on the public finances. The focus of the report is on long-term demographic trends such as the ageing of the population or changes to the overall population size over the coming decades and as such it relies on the latest available population projections for its analysis.

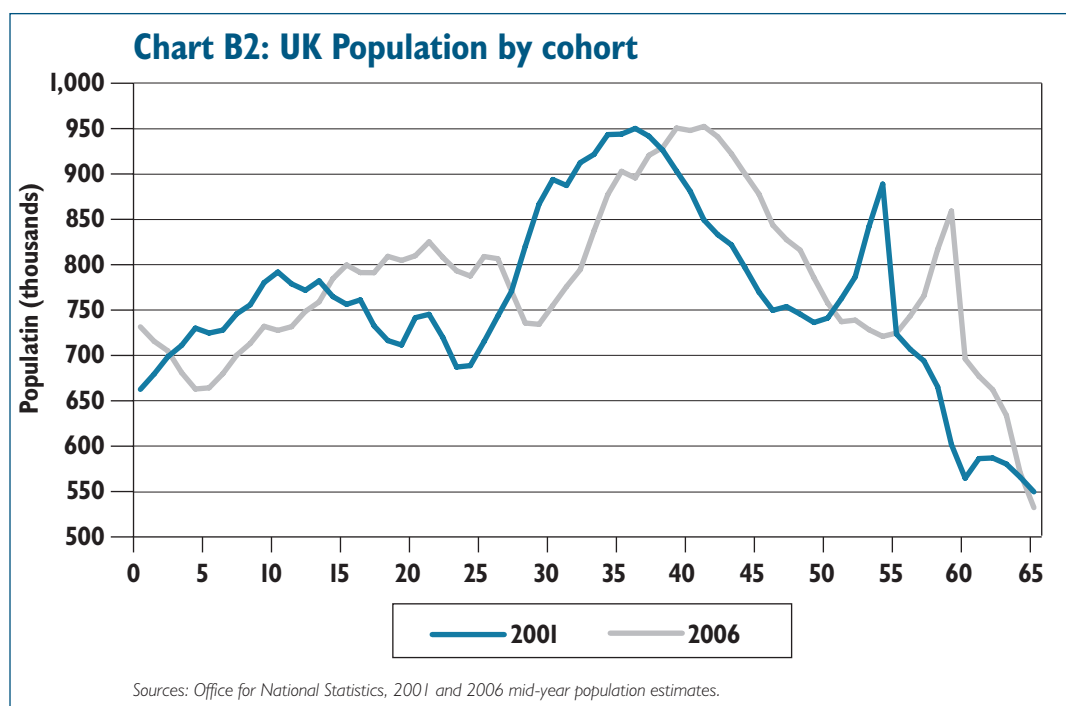
New population projections **B.91** Up to 2005, the Government Actuary's Department (GAD) was the producer of the official population projections for the UK. This responsibility moved to the Office for National Statistics (ONS) in January 2006. The ONS will publish a new set of population projections on 23 October 2007. These projections will be based on the mid-year population estimate for 2006, which the ONS published on 22 August 2007, and on a new set of assumptions regarding the key three vital statistics: fertility, net migration and longevity. Given that ONS will publish its 2006-based population projections on 23 October 2007, the next Long-term public finance report will be published at a later date to ensure it incorporates the most up-to-date data. Updated estimates of the unfunded public service pension liability will be published alongside the next Long-term public finance report.

Long-term socio-economic and other trends **B.92** The Government is committed to updating and regularly reporting on its assessment of long-term fiscal sustainability, based on the most up to date information, so that the Government can make the right strategic policy decisions to address the long-term socio-economic challenges that it will face in the coming decades. For example, the structure of the UK population is projected to change dramatically over the coming decades, with only a fraction of these changes taking place over the next decade. This is illustrated by Chart B1: while the number of people aged 85 years and over is projected to quadruple over the next 50 years using the latest available population projections (GAD's 2004-based projections), the projected increase over the next decade will be much more modest. Similarly, the UK's total population is projected to increase from around 60 million at present, to 63½ million by 2017, but to near 70 million by mid-century. The projected increase over the long term is likely to create its own opportunities and challenges, which the UK will have to deal with in the decades ahead.

² See, for example, the 2006 *Long-term public finance report: an analysis of fiscal sustainability*, HM Treasury, December 2006.



B.93 Chart B2 shows the age distribution of the UK's population in 2001 and 2006. The two most prominent features of the 2001 distribution are the spike around the 55-year age group and the much larger hump around the 35-year groups. The former represents the immediate post-war baby boom, the latter the more sustained and pronounced second baby boom of the 1960s. By 2006, the large cohorts of the two baby booms had aged by five years, as represented by the shift to the right of the profile over these years. Females of the immediate post-war baby boom are now leaving the labour force and entering state pension age, with males following within the next few years. The cohorts of the second baby boom are currently at their prime in the labour market but will reach state pension age in the late 2020s to the early 2030s.



B.94 The 2006 *Long-term public finance report* provided a detailed analysis on how employment might evolve over the coming decades. Using the cohort method of projecting employment trends and GAD's 2004-based principal population projections, the 2006 *Long-term public finance report* projected that periods of employment increases were balanced by periods of employment declines.³ As a result of this, employment changes are projected to have a neutral effect on long-term trend growth, with productivity growth the main source of real GDP growth.

B.95 The 2006 *Long-term public finance report* showed that public spending, as a share of GDP, should increase slightly over the coming decades. A projected increase in total age-related spending explains most of this slight increase. Together, health and long-term care spending were projected to increase the most in absolute terms as a result of an ageing population. Spending on state pensions was projected to grow and public service pension spending was also projected to grow, but by a small amount, driven in part by long-term longevity. The 2006 report also projected that demographic change should lead to an increase in revenue, as a share of GDP, partially offsetting the projected increase in spending.

B.96 The Long-term public finance report uses a range of well-established techniques to assess the sustainability of the public finances. The analysis shows that the public finances are long-term sustainable in the light of demographic change, which puts the Government in a strong position to deal with the potential financial impacts arising from other long-term trends, such as climate change. The 2006 *Long-term public finance report* concluded that the public finances are sustainable in the long term and that the UK is well placed relative to many other developed countries to deal with the fiscal challenges arising from ageing populations in the future.

Table B18: Assumptions for the 2004- and 2006-based principal population projections

	Assumptions	
	2004-based	2006-based
Fertility rate ¹	1.74	1.84
Life expectancy at birth (years) in 2031		
Males	81.4	82.7
Females	85.0	86.2
Long-term annual net migration	145,000	190,000

¹ Long-term average number of children per woman.

Source: GAD, 2004-based principal population projections and ONS, 2006-based principal population projections.

Updated fertility, migration and longevity assumptions

B.97 On 27 September 2007, the ONS published the assumptions it will use for the 2006-based principal population projections. As Table B18 shows, the assumptions are markedly different to those used for the 2004-based population projections. The fertility rate assumption has increased, net migration has also increased from an annual 145,000 to 190,000 and assumed life expectancy at birth is now marginally higher than previously. These changes will be incorporated in the 2006-based population projections, which will be published on 23 October 2007. The next long-term public finance projections will be based on the 2006-based population projections.

³ See 2006 *Long-term public finance report: an analysis of fiscal sustainability*, HM Treasury, December 2006, pages 23 to 27 for a more detailed discussion of the employment trends projected using the cohort method.