Budget 2008

March 2008

Stability and opportunity: building a strong, sustainable future

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Stability and opportunity: building a strong, sustainable future

Economic and Fiscal Strategy Report and Financial Statement and Budget Report

March 2008

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HM Treasury contacts

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

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

Tel: 020 7270 4558
Fax: 020 7270 4861
E-mail: public.enquiries@hm-treasury.gov.uk

This and other government documents can be found on the Internet at:

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

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Economic and Fiscal Strategy Report

1 Overview

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

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

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

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

Meeting global economic challenges

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

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

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

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

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

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

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

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

Resilience of the UK economy

1.4 As set out in Box 1.1 and Chapter B, over the past decade the UK economy has become increasingly resilient to shocks. This has led to an unprecedented period of economic stability and growth with record levels of employment. Key to developing greater resilience has been the Government's macroeconomic framework and promotion of open and flexible labour, product and capital markets. This resilience puts the UK in a strong position to deal with the current global economic uncertainties.

Budget 2008

I.5 This Budget sets out the action the Government is taking to support the economy in the short term, ensure the resilience of the past decade continues, combined with action to make further progress against its long-term goals of:

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

MAINTAINING MACROECONOMIC STABILITY

I.6 The Government's long-term goal is to maintain macroeconomic stability in order to achieve its objective of a fair society where there is security and opportunity for all. Chapter 2 sets out how the government is working to achieve this objective and summarises prospects for the UK economy and public finances, details of which are set out in Chapters B and C of the Financial Statement and Budget Report (FSBR).

The policy framework

I.7 The Government's macroeconomic framework and promotion of flexible and open labour, product and capital markets continue to deliver sustained economic growth with low inflation. The monetary policy framework seeks to deliver low and stable inflation by ensuring that interest rates are set in a forward looking manner to meet the Government's symmetric inflation target. Fiscal policy is determined by clear objectives and two rules to ensure fiscal policy can support monetary policy. The fiscal rules underpin the Government's public spending framework which facilitates long-term planning and provides departments with the flexibility and incentives they need to increase the quality of public services and deliver specified outcomes.

Economic prospects

I.8 The UK economy continued to perform strongly in 2007, growing 3 per cent on a year earlier, the fastest growth rate among the G7 economies. Employment reached a record high and claimant count unemployment fell to a 32 year low. The UK is the only G7 economy to have avoided any single quarter of negative growth over the past decade. The flexibility and resilence of the UK economy provides a solid platform from which to face the global economic shocks from the continued disruption in global financial markets and the increase in energy and commodity prices. UK GDP growth is forecast to slow from 3 per cent in 2007 to 1¾ to 2¼ per cent in 2008, before picking up to 2¼ to 2¾ per cent in 2009 and 2½ to 3 per cent in 2010.

The public finances

I.9 Despite the impact of financial market disruption on the public finances, the Budget 2008 projections show that the Government is meeting its strict fiscal rules:

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

Table 1.1 – meeting the fiscal rules

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

[1] *Debt at end March; GDP centred on end March*

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

SUSTAINABLE GROWTH AND PROSPERITY

Budget 2008 policy decisions

Productivity growth, alongside high and stable levels of employment, is central to long-term economic performance. The UK has made good progress over the last decade in improving productivity and levels of employment have risen to record highs. The Government's strategy is structured around the drivers of productivity: competition, innovation, investment, skills and enterprise. The Government's actions have ensured that the UK is one of the best places in the world to do business[1].

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

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

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

- **further implementation of the Leitch[2] and Sainsbury[3] Reviews** to build on improvements in the UK skills base and to provide a world-class science base and innovation framework;
- **exploring options to make better use of transport infrastructure, on top of the major programme of investment** announced in the 2007 Comprehensive Spending Review;
- **progress on business support simplification and measures to ensure better access to Government procurement for small firms;** and
- **a study of public service markets and a new framework for infrastructure procurement.**

FAIRNESS AND OPPORTUNITY FOR ALL

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

Budget 2008 policy decisions

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

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

[2] *Leitch Review on skills, prosperity for all in the global economy – world-class skills*, HM Treasury, December 2006.
[3] *The race to the top: A review of Government's science and technology policies*, Lord Sainsbury of Turville, October 2007.

STRONGER COMMUNITIES AND EFFECTIVE PUBLIC SERVICES

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

Budget 2008 policy decisions

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

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

AN ENVIRONMENTALLY SUSTAINABLE WORLD

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

Budget 2008 policy decisions

1.17 The Stern Review on the Economics of Climate Change[4] concluded that the costs of reducing emissions to levels that avoid the worst risks of climate change are significant but manageable, whereas delay will be costly and dangerous. Budget 2008 takes action to bring about reductions in the emissions from the transport, energy, business and household sectors. The Budget announces:

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

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

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

BUDGET MEASURES AND THE IMPACT ON HOUSEHOLDS

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

Table 1.2: Budget 2008 policy decisions

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

Table 1.2: Budget 2008 policy decisions (continued)

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

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

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

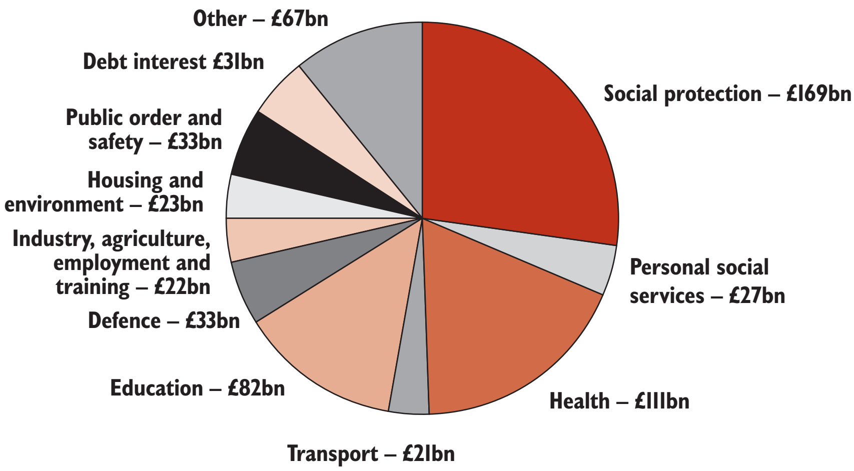
- households will be, on average, £1,250 a year better off;
- families with children will be, on average, £2,000 a year better off; and
- families with children in the poorest fifth of the population will be, on average, £4,500 better off.

GOVERNMENT SPENDING AND REVENUE

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

Chart 1.1: Government spending by function

Total managed expenditure: £618 billion

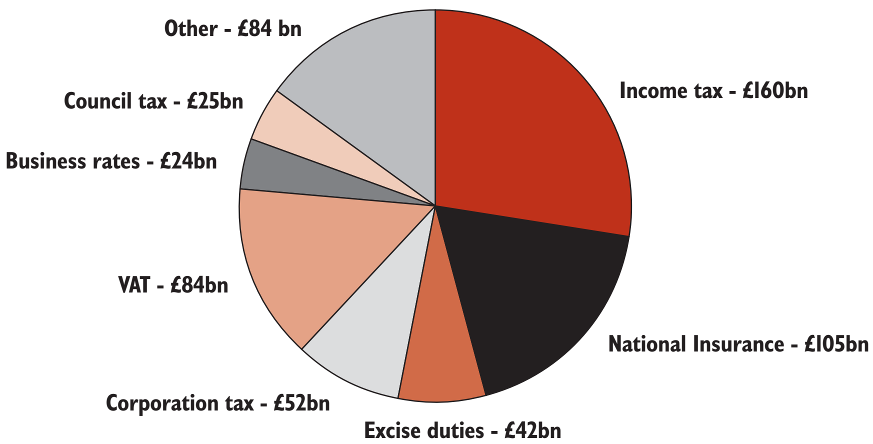


Source: HM Treasury 2008-09 near-cash projections. Spending re-classified to functions compared to previous presentations and is now using methods specified in international standards. Other expenditure includes spending on general public services: recreation, culture, media and sport; international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

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

Chart 1.2: Government receipts

Total receipts: £575 billion



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

2 MAINTAINING MACROECONOMIC STABILITY

The world economy is facing a more challenging environment than was apparent at the time of the 2007 Pre-Budget Report, with continued disruption in global financial markets. The UK is well placed to meet these challenges thanks to the resilience and stability engendered by the Government's macroeconomic framework and a decade of reform promoting open and flexible labour, product and capital markets.

In 2007 the UK economy continued to perform strongly, growing 3 per cent on a year earlier, the fastest growth rate among the G7 economies. Inflation returned to close to target in the second half of 2007. Employment growth picked up during the year, with employment reaching a record high of almost 29½ million; unemployment continued to fall, and the claimant count reached a 32-year low.

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

- **the current budget shows an average surplus as a percentage of GDP over the economic cycle which began in 1997-98, ensuring the Government is meeting the golden rule. The current budget moves clearly into surplus from 2010-11 onwards; and**
- **public sector net debt is projected to remain low and stable over the forecast period, stabilising below the 40 per cent ceiling set in the sustainable investment rule.**

The reclassification of Northern Rock to the public sector will bring its assets and liabilities temporarily into the public finances. In line with the *Code for Fiscal Stability*, while Northern Rock remains in the public sector the Government will measure performance against the sustainable investment rule using figures excluding its impact.

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

2.1 The Government's macroeconomic framework is designed to maintain long-term economic stability. The monetary policy framework seeks to ensure low and stable inflation. The fiscal policy framework seeks to maintain sound public finances in the medium term, while allowing fiscal policy, and in particular the automatic stabilisers, to help smooth the path of the economy. Both parts of the framework work together in an integrated way to support growth and stability, providing the flexibility to respond to changes in the economic environment, and the context for ongoing policy reforms to address future strategic challenges.[1]

[1] For the Government's updated analysis of the strategic challenges facing the economy see *UK economy: analysis of long-term performance and strategic challenges*, HM Treasury, March 2008

REVIEW OF MAIN DEVELOPMENTS

2.2 In July 2007 problems related to the US sub-prime mortgage market triggered disruption in global financial markets which has spread swiftly across countries and markets. In the 2007 Pre-Budget Report, the forecast for growth in 2008 was reduced by ½ percentage point compared with the Budget 2007 forecast, on the assumption that there would be some feed-through from financial market disruption to tighter credit conditions and to household and company spending in the short term. Adjustments were made to the fiscal projections to reflect the impact on receipts from the financial sector. Given the uncertainties, this adjustment was in line with the Government's prudent approach to fiscal management, and as the detailed analysis of the fiscal position below shows, proved to be a reasonable adjustment for 2007-08.

2.3 The fiscal policy response at the time of the 2007 Pre-Budget Report was to accommodate the impact of financial market disruption, with modest discretionary fiscal loosening in 2007-08 and 2008-09, followed by fiscal policy tightening in the medium term. This was in line with the Government's objectives for fiscal policy, of ensuring sustainable public finances in the medium term and smoothing the path of the economy in the short term.

2.4 Since then, the disruption in financial markets has continued. Concerted action by the world's major central banks has helped somewhat to ease pressures in money markets, but conditions in credit markets deteriorated and a number of markets remain effectively closed. There has been further evidence of developments in financial markets feeding through to tighter credit conditions facing households and companies. The Budget 2008 forecast assumes the negative impact on growth from these developments will be somewhat larger and more prolonged than expected in the 2007 Pre-Budget Report.

2.5 Inflation is currently close to target, but significant increases in global agricultural commodity and energy prices are expected to lift inflation in the short term. In addition, the recent depreciation of sterling will exert continued upward pressure on prices. As a result, inflation is expected to pick up in the near term, before falling back by the end of 2008, returning to target in 2009 and remaining on target thereafter.

2.6 The Budget 2008 public finance estimates show the deficit on the current budget in 2007-08 to be in line with the 2007 Pre-Budget Report projections. The estimated outturns for borrowing and debt in 2007-08 are lower than expected at the Pre-Budget Report, with debt just over 1 per cent of GDP lower than the Budget 2007 projection. This comes in the context of low and stable borrowing delivered by the fiscal framework, and a reduction in debt over the cycle from 41.3 per cent in 1997-98 to 36.6 per cent in 2006-07.

2.7 The public finance projections from 2008-09 onwards are affected by the continuation of financial market disruption, by lower asset prices, with global stock markets lower, and by the impact of tighter credit conditions. The expected short-term increase in inflation and social security payments also increase spending. As a result, there is an increase in borrowing concentrated in the years in which tighter credit conditions are assumed to have their largest negative impact on the economy. This increase in borrowing supports economic stability, in line with one of the key purposes of the fiscal framework. The Government is also taking action in Budget 2008 to maintain sound public finances in the medium term. On the basis of cautious forecast assumptions, outlined in more detail below, the Government is meeting its strict fiscal rules throughout the projection period.

THE MACROECONOMIC FRAMEWORK

2.8 The design of the macroeconomic framework introduced in 1997 recognises that the discretion necessary for effective economic policy – short-term flexibility to meet credible long-term goals – is possible only within an institutional framework that constrains the government to deliver clearly defined long-term policy objectives with maximum openness and transparency.

2.9 The monetary policy framework seeks to deliver low and stable inflation by ensuring that interest rates are set in a forward-looking manner to meet the Government's symmetrical inflation target. The *Code for fiscal stability* sets out a clear framework and set of obligations constraining how Government conducts fiscal policy, including the requirement for the Government to set out its fiscal policy objectives and the rules through which policy will be operated.[2] The fiscal rules are also the foundation of the Government's public spending framework, which facilitates long-term planning and provides departments with the flexibility and incentives they need to increase the quality of public services and deliver specified outcomes.

2.10 Both the monetary and fiscal policy frameworks allow for action in the face of economic shocks while safeguarding the Government's commitment to long-term stability. These frameworks have ensured low interest rates, low inflation and allowed the UK to be the only major economy to have achieved continuous positive growth over the past decade. This strong performance was achieved despite several significant economic shocks, including the Asian crisis of 1997, the Long-Term Capital Management hedge fund collapse and Russian debt crisis of 1998, the bursting of the dotcom bubble in 2000, and the impact of the terrorist attacks of 11 September 2001 and the sustained increase in oil prices since 2002.

2.11 A decade after the introduction of the macroeconomic framework, and following continued reforms to promote flexible and open product, labour and capital markets, there is clear evidence that the UK economy is more resilient than in the past, as illustrated in Box 2.1 and discussed in Box B4 in Chapter B. The benefits have been seen in much enhanced macroeconomic stability, as noted by the IMF: "Wide-ranging structural reforms over the past two-and-a-half decades have increased the economy's openness and flexibility, paving the way for reaping important benefits from globalization. Macroeconomic policies have contributed to growth and stability, encouraging households and businesses to plan for the long term and positioning the economy well to respond to shocks."[3]

[2] *Code for fiscal stability*, HM Treasury, 1998.

[3] From the latest IMF staff report on the UK economy: *United Kingdom Article IV Staff Report*, International Monetary Fund, March 2007.

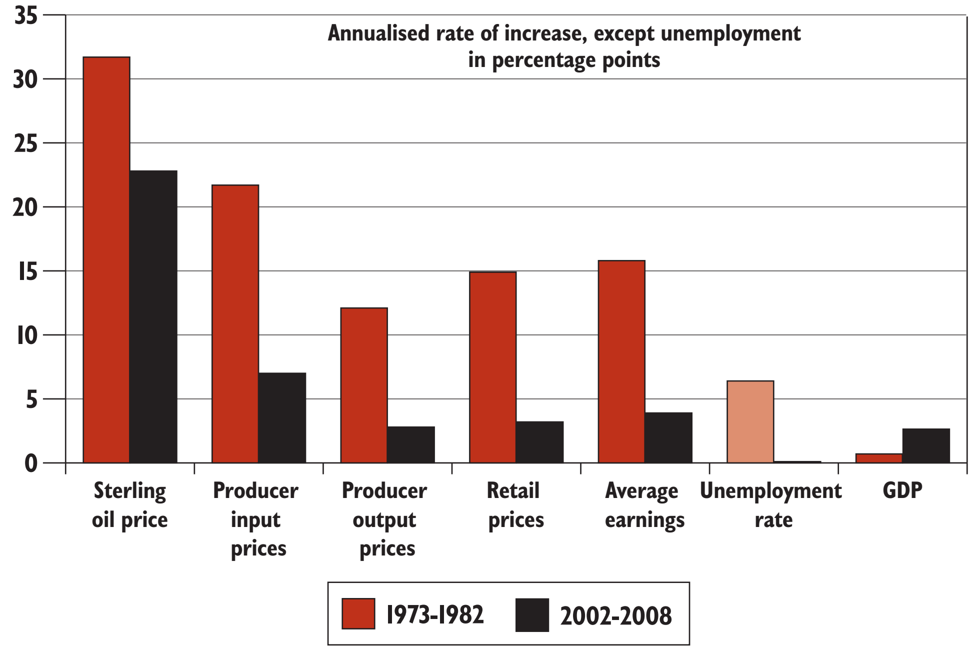
Box 2.1: The macroeconomic framework, market flexibility and macroeconomic stability

Since 2002, the sterling price of crude oil has more than trebled, significantly increasing energy costs for UK businesses and consumers. Despite this, inflation has remained close to target and growth strong and stable. Comparing the six years to January 2008 with the nine years to January 1982, a period spanning the two oil price shocks of the 1970s, demonstrates how improvements in the flexibility of UK product and labour markets and the operation of monetary and fiscal policy has helped to improve macroeconomic performance.

In the nine years to 1982, sterling oil prices increased at an annualised rate of 32 per cent, lifting producer input prices at a rate of 22 per cent. That increase generated 12 per cent increases in producer output prices, 14 per cent increases in retail prices, and finally 15 per cent increases in average earnings. Reflecting the product and labour market rigidities of the late 1970s, unemployment increased to more than 10 per cent, GDP growth averaged less than 1 per cent and contracted sharply in both 1974-75 and 1980-81.

By contrast, in the six years to 2008, while the rise in oil prices has been almost as fast, at an annualised rate of 23 per cent, measures of inflation at the various stages of the production process point to producers and retailers absorbing cost increases in margins: the annualised rate of producer input price inflation has been 7 per cent, of producer output price inflation 3 per cent, of RPI inflation 3 per cent and of CPI inflation 2 per cent. Improved labour market flexibility has meant that despite higher fuel and energy costs, average earnings growth has remained subdued and unemployment low and stable. Against this backdrop, GDP growth has continued uninterrupted at an annualised rate of 2¾ per cent.

Rising oil prices and the effect on inflation, the labour market and growth



Source: ONS and Ecowin.

MONETARY POLICY FRAMEWORK AND PERFORMANCE

2.12 The monetary policy framework is based on four key principles:

- clear and precise objectives. The primary objective of monetary policy is to deliver price stability. The adoption of a single, symmetrical inflation target ensures that outcomes below target are treated as seriously as those above, so that monetary policy also supports the Government's objective of high and stable levels of growth and employment;
- full operational independence for the Monetary Policy Committee (MPC) in setting interest rates to meet the Government's target. **The Government reaffirms in Budget 2008 the target of 2 per cent for the 12-month increase in the Consumer Prices Index (CPI), which applies at all times**;
- openness, transparency and accountability which are enhanced through publication of minutes of MPC meetings and quarterly Inflation Reports; and
- credibility and flexibility to allow the MPC to decide how to react to events, within the constraints of the inflation target and the open letter system.

Performance of the monetary policy framework

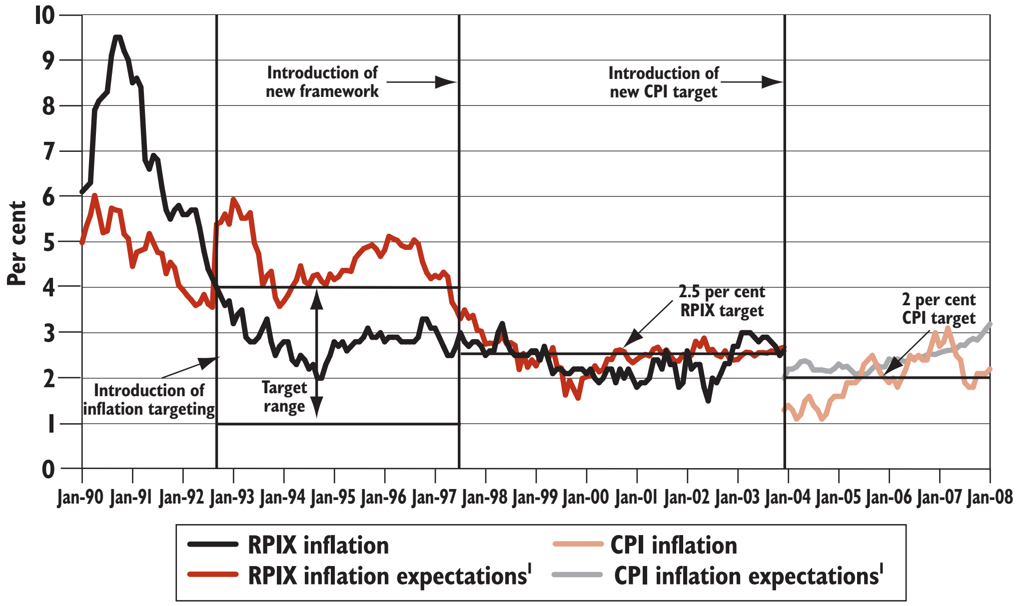
2.13 Since its introduction in 1997, the monetary policy framework has successfully delivered the longest sustained period of low and stable inflation for around fifty years as well as one of the lowest inflation rates in the G7. The Treasury Select Committee recently noted that "the Monetary Policy Committee deserves a significant amount of credit for ensuring that inflation over the last decade has been both lower, and less volatile, than in preceding decades".[4] Under the Government's monetary policy framework:

- CPI inflation has averaged 2 per cent since CPI was made the operational target for monetary policy in December 2003, exactly in line with target;
- UK inflation has been the second lowest in the G7 so far this decade, with only Japan – where there has been a protracted period of deflation – having lower inflation on average. This compares with the period from 1980 to 1997 when UK inflation was the second highest of all G7 economies; and
- UK long-term interest rates have averaged 5 per cent compared with an average of just over 9 per cent in the previous economic cycle.

2.14 With growth above trend for much of 2006 and 2007, the MPC raised Bank Rate by 1¼ percentage points between August 2006 and July 2007. As the disruption in global financial markets took hold in the second half of 2007, and its effect on credit conditions became clearer, the MPC cut Bank Rate by a ¼ percentage point in both December 2007 and February 2008 to the current level of 5¼ per cent. In the press release accompanying its decision in February, the MPC highlighted how "The Committee needs to balance the risk that a sharp slowing in activity pulls inflation below the target in the medium term against the risk that elevated inflation expectations keep inflation above target".[5]

[4] *The Monetary Policy Committee of the Bank of England: ten years on*, Treasury Select Committee, September 2007.
[5] *News release: Bank of England reduces Bank Rate by 0.25 percentage points to 5.25 per cent*, Bank of England, February 2008.

Chart 2.1: Inflation performance and expectations



[1] *Implied expectations of average RPI inflation ten years ahead are derived from the difference between yields on nominal and index-linked government bonds. Implied CPI inflation expectations are derived from these RPI expectations and stylised assumptions about expected differences between RPI and CPI inflation in the medium term, including that the geometric averaging lowers CPI inflation by 0.5 percentage points relative to RPI inflation.*

Source: ONS, Bank of England and HM Treasury.

Developments in the monetary policy framework

2.15 In January 2008, the Chancellor announced further details of reforms to the MPC appointments process. The Government will, as far as is possible, publish a timetable for external MPC appointments before a vacancy becomes available and announce details of who it has decided to appoint in sufficient time to allow pre-commencement hearings by the Treasury Select Committee. Reappointed members will undergo a pre-commencement hearing in the same way that new members will, ensuring that all members are subject to regular Parliamentary scrutiny.

RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS

2.16 The UK economy continued to perform strongly in 2007, growing 3 per cent on a year earlier, the fastest growth rate among the G7 economies. Inflation returned to close to target from mid-2007, and at 2.2 per cent in January 2008 was lower than in the US or the euro area. Annual growth in employment picked up during the year, from around 50,000 during the first half to almost 250,000 during the second half, with employment reaching a record high of almost 29½ million. Unemployment continued to fall, and the claimant count reached a 32-year low. The flexibility and resilience of the UK economy over the past decade provides a solid platform from which to face the economic shocks presented by the continued disruption in global financial markets and the increase in commodity prices.

World economy

2.17 World GDP growth is expected to slow from 4¾ per cent in 2007 to 4 per cent in 2008, with growth forecast to moderate more among advanced than emerging economies. UK export markets growth is forecast to slow, reflecting relative weakness in the euro area and US, which together account for around two-thirds of UK export demand.

Credit conditions

2.18 At the time of the 2007 Pre-Budget Report, the disruption in financial markets was in its early stages and its likely impact on credit conditions facing households and companies was highly uncertain. With only limited evidence available at that time, the forecast assumed some feed-through to tighter credit conditions and hence to household and company spending in the short term. Since then there has been further evidence of developments in financial markets feeding through to tighter credit conditions facing households and companies.

Broader monetary conditions

2.19 During 2008 and early 2009, when the negative effect of tighter credit conditions on output are assumed to be largest, underlying monetary conditions are set to be supportive. Sterling has depreciated since the 2007 Pre-Budget Report, which is forecast to boost export growth in 2008 and 2009. The Bank of England has reduced interest rates by ½ a percentage point since early December 2007, and markets expect some further easing over the coming year. To the extent that these expectations are realised interest rates should support growth from the end of this year. It is, however, possible that the pass-through of interest rate changes will be more muted while the period of disruption in financial markets persists.

2.20 On the assumption that credit conditions start easing during the second half of 2008 and normalise by mid-2009, annual growth is expected to pick up from the first half of 2009. Once financial markets begin to function normally again, the forecast assumes that the natural adjustment processes of a well-functioning market economy will take further hold, helping to sustain output growth at or slightly above trend rates. The recent strength of employment growth, and continuing absence of wage pressures, suggests the labour market will continue to support the economy through 2008 and beyond. GDP growth is forecast to slow from 3 per cent in 2007 to 1¾ to 2¼ per cent in 2008, before picking up to 2¼ to 2¾ per cent in 2009 and 2½ to 3 per cent in 2010.

Rebalancing of demand

2.21 Reflecting credit conditions facing households and companies, growth of consumer spending and business investment are forecast to slow in 2008, and to pick up in 2009 and 2010. Consumer spending growth is expected to remain slightly below whole economy GDP growth, as domestic demand continues to rebalance. With sterling having depreciated by around 7 per cent since the 2007 Pre-Budget Report, the conditions are in place for external demand to contribute more positively to GDP growth over the forecast horizon.

Table 2.1: Summary of UK forecast[1]

		Forecasts		
	2007	2008	2009	2010
GDP growth (per cent)	3	1¾ to 2¼	2¼ to 2¾	2½ to 3
CPI inflation (per cent, Q4)	2	2½	2	2

[1] *See footnote to Table B9 for explanation of forecast ranges.*

Inflation

2.22 Inflation is currently close to target, but significant increases in global agricultural commodity and energy prices are expected to lift inflation in the short term. In addition, the recent depreciation of sterling will exert continued upward pressure on prices. Reflecting the flexibility of UK product and labour markets, similar cost shocks in 2005 and 2006 were largely absorbed by producers in margins, or offset by pressing down on other costs, including wages. Inflation is forecast to fall back to 2½ per cent by the end of 2008, returning to target in 2009 and remaining on target thereafter.

Box 2.2: Inflation, macroeconomic stability and pay

Since the introduction of the new monetary policy framework in 1997, the UK economy has experienced the longest period of sustained low inflation since the 1960s. Low inflation is a key part of the macroeconomic stability that has provided the platform for record employment levels and higher investment, productivity and economic growth.

Recently, inflation has been subject to temporary shocks: increases in energy prices, driven by developments in the oil and wholesale gas markets, and higher food prices, which have been affected by a number of global factors including poor harvests affecting supplies and higher demand from emerging markets and from biofuels. Stripping out some of the short-term influences, underlying 'core' inflation (excluding energy and seasonal food) has remained low and generally under 2 per cent (1.8 per cent in January). The pressures from higher energy and food prices are expected to raise headline inflation over the near term. But consensus forecasts for oil prices in 2008 show analysts expect prices to fall, and in line with the assessment of the UN's Food & Agricultural Organisation,[a] food prices are also expected to moderate this year. As these cost pressures recede, the Budget forecast is for inflation to return to target in 2009, consistent with the March average of independent forecasts.[b] Further analysis of inflation is included in Chapter B.

The stability and credibility of the UK's monetary policy framework has so far contributed to keeping earnings growth across the economy stable and subdued. Nevertheless, there remains a risk of second-round effects of temporarily higher inflation feeding through to higher average earnings growth. It is therefore important that pay settlements are consistent with the achievement of the Government's inflation target of 2 per cent because settlements based on a temporary pick up in inflation would risk converting a temporary increase in inflation into a permanent increase.

To deliver continuing stability, the Government will seek to maintain discipline in pay setting and agree multi-year pay settlements where appropriate. The Government's public sector pay policy therefore supports wider economic stability through:

- **focusing on the labour market conditions of workforces, particularly their recruitment and retention position, with multi-year settlements where appropriate;**
- **delivering settlements that are affordable and value for money; and**
- **delivering settlements consistent with achievement of the inflation target of 2 per cent.**

[a] *OECD – FAO Agricultural Outlook 2007-2016*, OECD-FAO, 2007.
[b] *Forecasts for the UK economy: A comparison of independent forecasts*, HM Treasury, 12 March 2008.

Property markets

2.23 Annual house price inflation has slowed, from above 10 per cent in August 2007 to around 2½ per cent in February 2008, and commercial property prices in the UK have fallen. In addition, the effective closure of markets for securitised assets has put added strain on banks' funding positions. This could affect house price inflation in coming months, and seems likely to reduce the volume of activity in property markets.

The economic cycle

2.24 Evidence from the cyclical indicators monitored by the Treasury, and the latest National Accounts data, suggest that the economy passed up through trend in the second half of 2006. The small positive output gap at the beginning of 2008 is forecast to turn negative during 2008, to stand at around ½ a per cent in the first half of 2009. With output judged to be close to trend at the end of 2007, growth forecast to slow to below trend rates in 2008 and 2009, and prospective National Accounts revisions, it remains too soon to assess whether the second half of 2006 marks the end of the economic cycle that is judged to have started in the first half of 1997.

Risks **2.25** The Budget 2008 economic forecast is made against the backdrop of considerable uncertainty related to the continued disruption in global financial markets and its potential impact on the global and domestic economy. Assessing the likely response of banks and other credit issuers to developments in financial markets, and of companies and households to developments in credit conditions, represents the principal forecast uncertainty.

2.26 While the impact of tighter credit conditions caused by the continued disruption in global financial markets represents a risk to growth in all economies, that risk is clearly greater in the US, where falling house prices impact on the markets for some financial market instruments. The increasing complexity and interconnectedness of markets has meant that developments in one market can easily be transmitted to others, as shown by the ongoing financial market disruption. This creates new challenges mitigating financial stability risks and protecting consumers, and in ensuring the UK economy has the flexibility to respond to such developments. Box 2.3 outlines the action the Government is taking forward at an international level to address these challenges.

2.27 For world trade, risks to the multilateral trading system remain, especially from the proliferation of bilateral and regional trade agreements and, increasingly, from protectionist trade policies. A firm stance against protectionism can help to ensure that trade continues to improve living standards across advanced and emerging economies.

2.28 While the US current account deficit has started to decline, this has not yet been accompanied by a reduction of the large surpluses of some Asian countries. There remains a risk of disorderly unwinding of global imbalances, with the economic costs such a process would entail. To reduce this risk it is important that major world economies allow a continued rebalancing of demand and flexibility in their exchange rates.

2.29 In the UK, there are upside risks from the weaker exchange rate providing support for export growth and from the strength of the labour market, which could support income growth and consumer spending by more than has been assumed. Recent private business survey indicators suggest that the economy may have carried more momentum into 2008 than the forecast assumes. There are clear downside risks to growth if credit conditions were to deteriorate further, raising the price of and limiting access to finance for companies and households by more or for longer than has been assumed.

2.30 Since the 2007 Pre-Budget Report, commercial property prices in the UK have fallen, annual house price growth has slowed and the volume of property transactions has declined. While this is expected to impact directly on residential investment and the approximately one-third of business investment that comprises buildings and structures, further unanticipated adjustment in the commercial or residential property markets could present risks to the forecasts for business investment or private consumption through effects on confidence or the value of collateral.

Box 2.3: Promoting a stable and prosperous world economy

Disruption in global financial markets has re-emphasised the need for effective global cooperation to address the shared challenges of an increasingly integrated world economy. The UK is playing its full part at EU and international level to promote global prosperity and economic stability by:

- **pursuing reform of the international financial institutions in order to minimise the risks to global economic stability, and strengthen their effectiveness, credibility and legitimacy. The UK is seeking to strengthen the roles of the IMF and Financial Stability Forum to provide a better early warning system for financial system risks. The UK will also seek to improve dialogue on these issues among major economies, including emerging markets, as G20 chair in 2009;**
- **working actively with industry, the Financial Services Authority, the Bank of England and counterparts across the world to understand the causes of the continued disruption to global financial markets, and deliver appropriate actions at EU and international level to strengthen the stability and resilience of markets. The Financial Stability Forum will report to the G7 in April on the underlying causes of the ongoing market turbulence and propose international responses;**
- **continuing to make a strong case for open markets and resist protectionist pressures. This includes working through the WTO to achieve an ambitious and pro-development outcome to the Doha Development Agenda, while ensuring the capacity of poorer countries to trade. The Government is engaging fully with work in the IMF and OECD to develop best practice guidelines for sovereign wealth funds;**
- **promoting economic reform across the EU through the Lisbon Strategy to sustain high levels of growth and social cohesion in Member States. The UK will also pursue reform of the EU budget so that the EU is better equipped to meet the challenges of the 21st century;**
- **ensuring sustainable, reliable and affordable energy supplies by promoting open, transparent and competitive energy markets, through the EU and international fora;**
- **supporting new global negotiations to tackle climate change beyond 2012 by taking forward the Bali Action plan with the aim of agreement by December 2009. Supporting that process, the Government will continue to push for a cost-effective international response to climate change, a global carbon market, and financial assistance for adaptation by developing countries; and**
- **pursuing policies and measures that: promote sustainable economic growth in developing countries, accelerate progress towards the Millennium Development Goals, improve international aid effectiveness, and ensure debt sustainability and implementation of agreed debt relief initiatives.**

FISCAL POLICY FRAMEWORK

2.31 Prior to the introduction of the macroeconomic framework in 1997, fiscal policy contributed to instability with high and volatile borrowing that often amplified rather than reduced the fluctuations of the economic cycle. Fiscal policy decisions were made in the context of an imprecise and changing set of objectives. A clear and tightly defined fiscal policy framework was introduced in 1997, with the *Code for fiscal stability,* underpinned by legislation, setting out key principles for fiscal management, new reporting requirements and a role for the National Audit Office providing independent audit of key assumptions behind the public finances forecast. The Code requires the Government to state clearly its fiscal policy objectives and the rules through which policy will be operated, increasing the transparency and accountability of fiscal decision making.

2.32 The Government's fiscal policy objectives are:

- over the medium term, to ensure sound public finances and that spending and taxation impact fairly within and between generations; and
- over the short term, to support monetary policy and, in particular, to allow the automatic stabilisers to help smooth the path of the economy.

2.33 These objectives are implemented through two strict fiscal rules, against which the performance of fiscal policy can be judged. The fiscal rules are:

- the golden rule: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
- the sustainable investment rule: public sector net debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level. Other things being equal, net debt will be maintained below 40 per cent of GDP over the economic cycle.

2.34 Boxes 2.4 and 2.6 provide more detail on the purpose of the fiscal rules and how they work together to achieve the Government's fiscal objectives. Box 2.5 illustrates the success of the rules in ensuring sustained increases in public sector net investment.

PERFORMANCE OF THE FISCAL POLICY FRAMEWORK

2.35 Since 1997, fiscal policy has resulted in low and stable borrowing, in contrast to previous UK experience. In the 1986-87 to 1997-98 economic cycle, net borrowing reached nearly 8 per cent of GDP, and averaged 3.1 per cent of GDP. During the economic cycle which began in 1997-98, net borrowing has averaged 1.0 per cent of GDP and at its peak reached just 3.3 per cent of GDP. The fiscal framework has successfully supported economic stability by allowing the automatic stabilisers to operate, as illustrated by Chart 2.5. The fiscal framework has also protected an historically unprecedented increase in public sector net investment, while net debt has been maintained at a low and sustainable level.

2.36 Table 2.2 presents the key fiscal aggregates based on the five themes of fairness and prudence, long-term sustainability, economic impact, financing and European commitments. The table shows that, after allowing for non-discretionary changes to receipts and spending and taking into account the Budget decisions, the Government is meeting both of its strict fiscal rules. Details of the recent fiscal trends and outlook that underpin these projections are set out later in the chapter.

Table 2.2: Summary of public sector finances

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Fairness and prudence							
Surplus on current budget	–0.3	–0.6	–0.7	–0.2	0.3	0.6	1.0
Average surplus since 1997-98	0.1	0.1	0.0	0.0	0.0	0.1	0.1
Cyclically-adjusted surplus on current budget	–0.3	–0.7	–0.5	0.1	0.5	0.8	1.0
Long-term sustainability							
Public sector net debt[1]	36.6	37.1	38.5	39.4	39.8	39.7	39.3
Core debt[1]	35.9	36.6	37.7	38.4	38.6	38.5	38.2
Net worth[2]	26.0	25.3	23.7	22.2	21.3	20.7	20.9
Primary balance	–0.6	–0.9	–1.3	-0.9	–0.3	0.1	0.4
Economic impact							
Net investment	1.9	2.0	2.2	2.2	2.3	2.2	2.3
Public sector net borrowing (PSNB)	2.3	2.6	2.9	2.5	2.0	1.6	1.3
Cyclically-adjusted PSNB	2.2	2.7	2.7	2.2	1.8	1.5	1.2
Financing							
Central government net cash requirement	2.8	2.7	4.0	3.2	2.5	2.3	1.8
Public sector net cash requirement	2.7	2.3	2.8	2.9	2.1	1.9	1.4
European commitments							
Treaty deficit[3]	2.6	2.8	3.2	2.8	2.3	1.9	1.6
Cyclically-adjusted Treaty deficit[3]	2.5	3.0	3.0	2.5	2.1	1.8	1.5
Treaty debt ratio[4]	43.3	43.8	46.1	46.9	47.2	47.0	46.6
Memo: Output gap	*0.0*	*0.3*	*–0.5*	*–0.4*	*–0.3*	*–0.1*	*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 on a Maastricht basis.

Box 2.4: Purpose of the golden rule

The golden rule, that over the economic cycle the Government will borrow only to invest and not to fund current spending, is designed to work alongside the sustainable investment rule to:

- **protect intergenerational fairness. It ensures that current generations pay for the public services that they consume, rather than funding consumption through borrowing that will have to be repaid by future generations; and**
- **eliminate the bias against capital spending. The rule draws a distinction between current and capital spending, recognising that both have important roles to play in the provision of public services and that decisions on all spending must be considered on a value for money basis. The success of the rule in eliminating this bias is assessed in Box 2.5.**

A key feature of the golden rule is that it is measured over the economic cycle - rather than every year – to allow fiscal policy the flexibility to respond in support of monetary policy to accommodate shocks and smooth the path of the economy.

The automatic stabilisers are a feature of the tax and spending system that serve to dampen the impact of shocks on output. As the economy strengthens incomes tend to rise resulting in, for example, higher income and corporation tax receipts and lower social security spending. The budget balance will therefore tend to rise when output is above trend and fall when it is below. These movements support monetary policy by dampening economic cycles without putting at risk the long-term sustainability of fiscal policy.

The economic impact of fiscal policy will also be determined by other non-discretionary factors: for example, a decline in tax revenues caused by a fall in asset prices, in the face of an economic shock, would be a non-discretionary fiscal loosening that acts to support the economy.

Against the backdrop of continued financial market disruption, fiscal policy in Budget 2008 supports the economy with the automatic stabilisers and other non-discretionary changes having the greatest positive impact while the economy is below trend. By the end of the projection period, borrowing returns to its Budget 2007 levels, as the economy returns to trend.

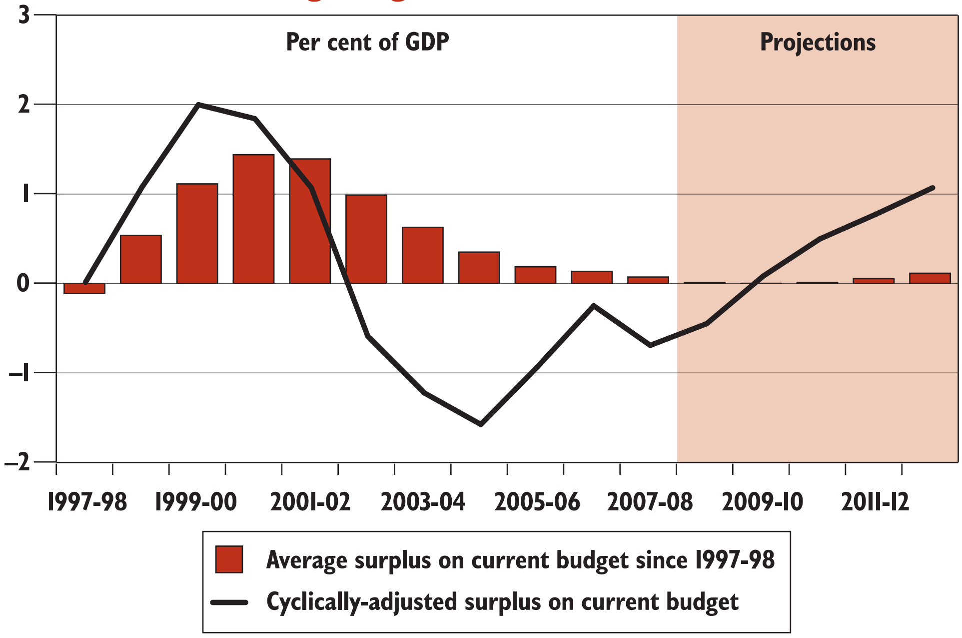
Golden rule

2.37 The current budget balance represents the difference between current receipts and current expenditure, including depreciation. It measures the degree to which current taxpayers meet the cost of paying for the public services they use and it is therefore an important indicator of intergenerational fairness. The golden rule allows early and forward-looking action in fiscal policy. The current budget strengthens through the projection period, returning to surplus in 2010-11, showing a surplus of 1.0 per cent of GDP by 2012-13.

2.38 The golden rule is set over the economic cycle to allow fiscal policy to support monetary policy in maintaining stability including through the operation of the automatic stabilisers. Progress against the rule is measured by the average annual surplus on the current budget as a percentage of GDP since the cycle began.

2.39 The golden rule is met over the economic cycle which began in 1997-98. Fiscal policy accommodates the impact on the public finances of continued disruption in global financial markets, reducing the surplus on the current budget in the early years of the forecast. The current balance reaches surplus in 2010-11 and returns towards the Pre-Budget Report forecast by 2012-13, ensuring that the Government is on track to meet the golden rule in the next cycle.

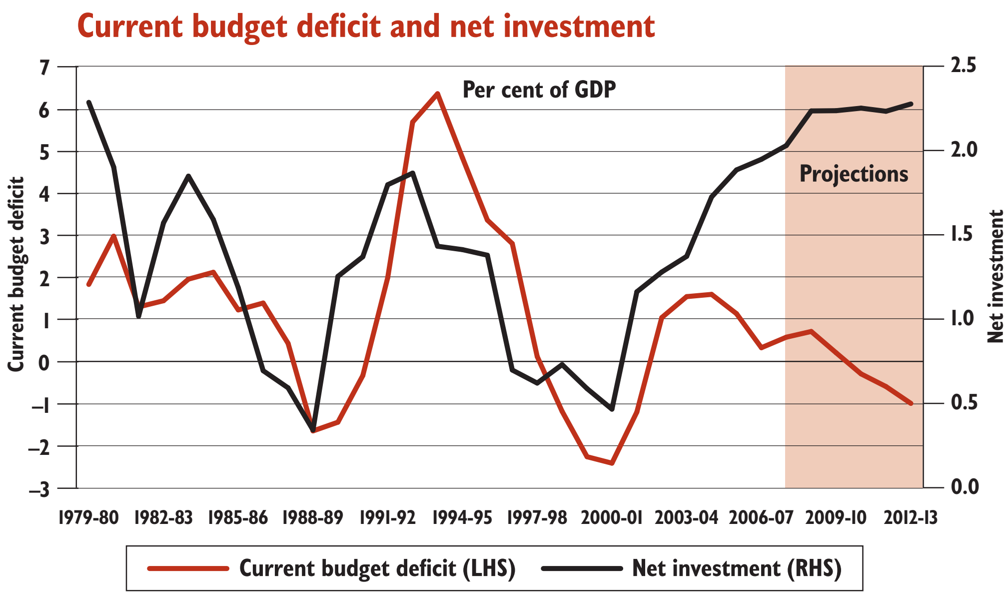
Chart 2.2: Meeting the golden rule



Source: HM Treasury.

Box 2.5: Protecting investment

The fiscal framework is designed to remove the bias against capital spending by making a distinction between capital and current spending. Historically, it has been extremely rare for public investment to grow during periods of fiscal consolidation, and prior to the introduction of the macroeconomic framework, it had not happened for 40 years. The effectiveness of the golden rule in eliminating this historic bias against capital spending is illustrated by the break in the relationship between borrowing for current spending and borrowing for investment illustrated in the chart below. As the chart shows, this pattern of reducing borrowing while maintaining net investment will continue in the coming years. Public sector net investment is now over three times higher as a share of the economy than it was in 1997-98, having risen from 0.6 per cent to 2 per cent of GDP this year.



Source: HM Treasury.

Sustainable investment rule

2.40 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. To meet the sustainable investment rule with confidence, net debt will be maintained below 40 per cent of GDP in each and every year of the current economic cycle.

2.41 Net debt in 2007-08 is ½ per cent of GDP lower, at 37.1 per cent of GDP, than expected at the 2007 Pre-Budget Report and around 1 per cent lower than expected at Budget 2007. In the later years of the projection period, net debt is higher than at the 2007 Pre-Budget Report as fiscal policy supports monetary policy and the Government fulfils its commitment to protecting the sustained rises in public sector investment. Chart 2.3 shows that net debt remains below 40 per cent of GDP, and starts to decline at the end of the projection period reaching 39.3 per cent in 2012-13. Therefore the Government meets its sustainable investment rule while continuing to borrow to fund increased long-term capital investment in public services. Chart 2.3 also illustrates projections for core debt, which excludes the estimated impact of the economic cycle on public sector net debt.

Box 2.6: Purpose of the sustainable investment rule

The sustainable investment rule is designed to work with the golden rule, described in Box 2.4, to achieve two key objectives:

- **to protect intergenerational fairness. The level of public debt represents the costs imposed by past decisions on future taxpayers, and maintaining it at a stable and prudent level ensures those costs remain fair. Imposing a limit on net debt recognises that future generations will have to forego current spending to service the debt that today's taxpayers incur. Borrowing for investment is compatible with intergenerational fairness as it allows a better match of the costs and benefits of large long-lived capital projects; and**
- **to ensure the sustainability of public finances. The sustainable investment rule requires debt to be held at a stable and prudent level. Maintaining net debt at a prudent level protects against the costs of high levels of public debt – including increased exposure to shocks like interest rate changes, a risk premium on interest rates, and efficiency losses due to the higher tax rates needed to service debt for a given level of public spending.**

To put these objectives into operation, the Government chose to assess performance using a public sector net debt (PSND) measure, which the independent Office for National Statistics publish every month. Net debt, which subtracts the value of liquid financial assets from the gross debt measure, was chosen as this is a fairer reflection of the government's immediate solvency. The value of other financial assets is not netted off in the net debt measure. Instead of general government debt, which just measures the liabilities of central and local government, the fiscal framework uses a public sector debt measure, as this adds in the debt of public corporations, capturing more fully the liabilities which will accrue to future taxpayers.

The purpose of the sustainable investment rule, to protect intergenerational fairness and ensure sound public finances, provides the context for measurement decisions. The impact of Northern Rock on public sector net debt provides a good example. Northern Rock is temporarily in public ownership and its liabilities are fully backed by other financial assets held by the company, and therefore its impact on PSND does not reflect future calls on the taxpayer or affect sustainability. PSND does not take account of temporary ownership or net off all financial assets. As the sustainable investment rule aims to capture the burden of debt that will fall on future taxpayers, it would not be appropriate to include the liabilities of Northern Rock in the measure of performance against the rule. The *Code for fiscal stability* provides for such circumstances. The Government remains committed to best practice fiscal reporting, and to improving the assessment of fairness and sustainability where further opportunities arise, maintaining the integrity of the constraints set by the fiscal framework.

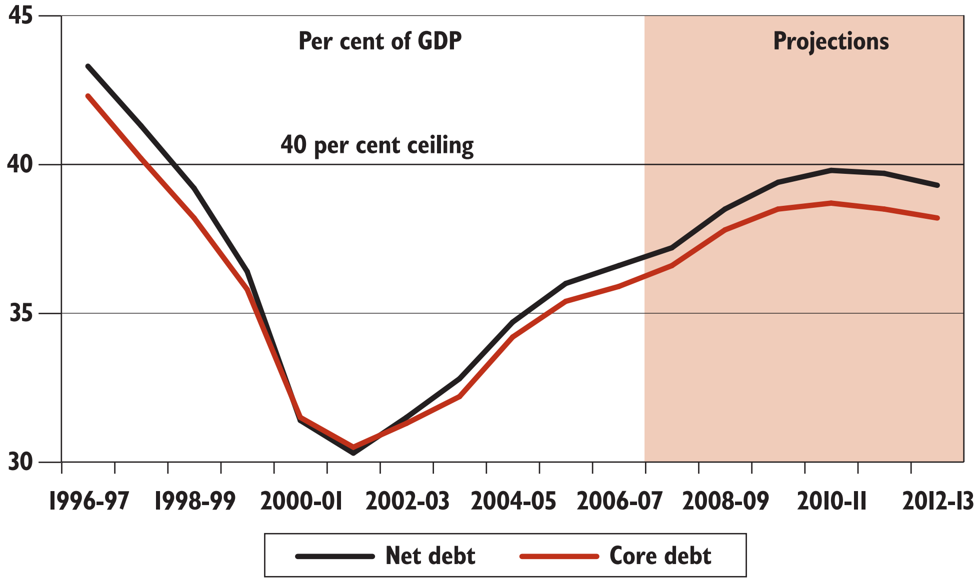
Northern Rock and the sustainable investment rule

2.42 The Office for National Statistics (ONS) announced on 7 February 2008 its intention to classify Northern Rock as a public corporation with effect from 9 October 2007. This will increase public sector net debt (PSND) by the company's gross liabilities to the private sector net of its liquid assets. The ONS have not yet completed the work required to compile an estimate of the change.

2.43 The Government will report on PSND both including and excluding Northern Rock in any future Budgets and Pre-Budget Reports in which the company remains classified as a public corporation. As set out in Box 2.6, the sustainable investment rule ensures sound public finances and fairness by protecting future generations from bearing the costs of debt incurred by this generation. Northern Rock is temporarily in public ownership and its liabilities are fully backed by other financial assets held by the company, and therefore its impact on PSND does not reflect future calls on the taxpayer. For the purpose of measuring performance against the sustainable investment rule, the Government will use a measure of PSND excluding Northern Rock's assets and liabilities.

2.44 The *Code for fiscal stability* provides for such circumstances. While Northern Rock remains in temporary public ownership, operating at arms length from Government, the Treasury will provide financing to the company and continue to provide guarantee arrangements where appropriate. It will continue to record a contingent liability for these arrangements. Any economic profit or loss will be included within both measures of PSND (and thus within the sustainable investment rule) when that profit or loss crystallises for central government.

Chart 2.3: Meeting the sustainable investment rule



Source: ONS and HM Treasury.

Financing The forecast for the central government net cash requirement (CGNCR) for 2007-08 is £37.7 billion, an increase of £0.4 billion from the 2007 Pre-Budget Report forecast of £37.3 billion. The projection for the CGNCR in 2008-09 is £59.3 billion, including the impact of refinancing the Bank of England's loan to Northern Rock. Following the decision to take Northern Rock into a period of temporary public ownership, the Government will during 2008-09 replace the Bank of England's loan to Northern Rock with direct Treasury funding, in order to comply with restrictions in the Treaty Establishing the European Community on central bank financing of government undertakings. Given that under current arrangements the Treasury has indemnified the Bank of England in the event it is unable to recover its full loan, this refinancing does not change the Government's economic exposure. The loan will remain secured against the assets of the company. The net amount outstanding of the Treasury loan as at 31 March 2009 is currently projected to be £14 billion, but this amount is subject to revision and will be updated at the 2008 Pre-Budget Report.

2.45 Gross gilt redemptions are £17.3 billion and National Savings and Investments' net contribution to financing is estimated to be £4.0 billion. The net financing requirement in 2008-09 also includes the impact of the partial repayment in 2007-08 of £6 billion of the Ways and Means Advance from the Bank of England. The forecast for the net financing requirement in 2008-09 is £78.8 billion. The Government's decision to repay up to £7 billion of the remaining balance of its Ways and Means Advance is not reflected in the net financing requirement in 2008-09 but is included as a planned change in the short-term debt level. The financing requirement will be met by:

- gross gilt issuance of £80.0 billion;
- an increase in the Treasury bill stock of £5.8 billion to £22.0 billion.

2.46 Full details and a revised financing table can be found in Chapter C. Further details can be found in the *Debt and reserves management report 2008-09* which is published alongside the Budget.

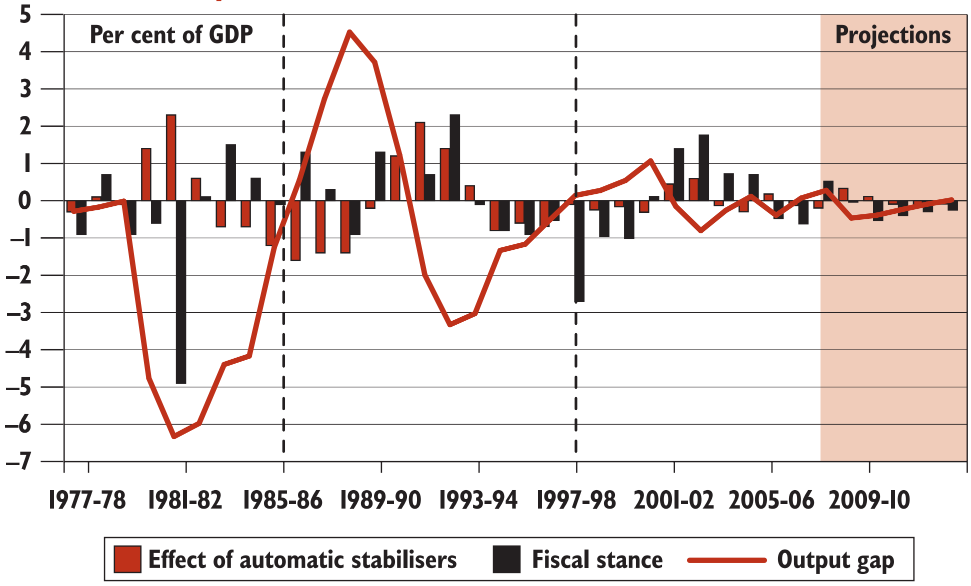
European commitments

2.47 The Government supports a prudent interpretation of the Stability and Growth Pact, as described in Box B3 and as reflected in reforms to the Pact agreed in March 2005. This takes into account the economic cycle, the long-term sustainability of the public finances and the important role of public investment. The public finance projections set out in Budget 2008, which show the Government is meeting its fiscal rules over the cycle, maintaining low debt and sustainable public finances, combined with sustainable increases in public investment, are fully consistent with a prudent interpretation of the Pact.

Economic impact

2.48 While the primary objective of fiscal policy is to ensure sound public finances, fiscal policy also affects the economy and plays a role in supporting monetary policy over the cycle. The overall impact of fiscal policy on the economy can be assessed by examining changes in public sector net borrowing (PSNB). This measure captures the net effect of changes in the Government's spending and receipts on economic activity.

Chart 2.4: Fiscal policy supporting monetary policy over recent economic cycles



Note: The fiscal stance equals the annual change in the cyclically-adjusted PSNB. The effect of the automatic stabilisers equals the change in the cyclical component of PSNB, i.e. the difference between PSNB and the cyclically-adjusted PSNB.
Source: HM Treasury.

2.49 Before 1997 fiscal policy contributed to instability with high and volatile borrowing that often amplified rather than reduced the fluctuations of the economic cycle. Since the introduction of the fiscal rules, fiscal policy has supported economic stability, as shown in Chart 2.4. During the late 1990s, fiscal policy tightened at a time when the economy was above trend. As the economy moved below trend in 2001, fiscal policy, both via the automatic stabilisers and the fiscal stance, supported the economy, with the degree of support moderating as the economy moved back towards trend.

2.50 The fiscal policy setting in Budget 2008 continues to support economic stability in 2007-08 and 2008-09, in line with the economy moving below trend. PSNB then begins to fall, in the context of a pick up in growth as the economy returns to trend.

2.51 Table 2.3 separates out the overall impact of fiscal policy since Budget 2007 on the economy into changes in:

- the automatic stabilisers – that part of the change in PSNB resulting from cyclical movements in the economy; and
- the fiscal stance – that part of the change in PSNB that is not a result of cyclical movements in the economy (as measured by changes in cyclically-adjusted PSNB).

2.52 The fiscal stance can be further split into:

- discretionary changes – Budget or other policy changes affecting borrowing; and
- non-discretionary changes – other changes in borrowing resulting for example from shocks in the economy that are not captured by cyclical adjustments, or

from structural changes to tax receipts or public spending that the government chooses not to offset.

2.53 Table 2.3 shows that the overall fiscal impact of changes since Budget 2007 support growth throughout the projection period. Non-discretionary factors play a major role, as the Government accommodates the changes to tax receipts and public spending that result from the impact of the continued disruption in financial markets. Discretionary policy measures in the 2007 Pre-Budget Report and Budget 2008 are neutral in the short term followed by a modest tightening, partially offsetting the stimulus coming from non-discretionary factors, underpinning sustainable public finances as the economy moves back towards trend.

Table 2.3: The overall fiscal impact[1]

	Per cent of GDP					
	Outturn[2]	Estimate[3]	Projections			
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Changes from Budget 2007 to Budget 2008						
Budget changes	0.0	0.0	0.0	-0.1	–0.1	–0.2
+						
non-discretionary factors	–0.3	0.3	0.7	0.4	0.4	0.3
=						
change in fiscal stance	–0.3	0.4	0.7	0.4	0.2	0.1
+						
automatic stabilisers	–0.1	–0.2	0.2	0.3	0.2	0.1
=						
overall fiscal impact	–0.4	0.2	0.9	0.7	0.4	0.2

[1] *All numbers represent the impact of changes on PSNB, so that a positive number represents fiscal loosening compared with Budget 2007.*
[2] *The 2006-07 figures were estimates in Budget 2007.*
[3] *The 2007-08 figures were projections in Budget 2007.*

Taking account of uncertainty

2.54 Forecasts for the public finances are subject to a considerable degree of uncertainty, in particular the fiscal balances, which represent the difference between two large aggregates. The Budget 2008 economic forecast is made against the backdrop of considerable uncertainty related to the continued disruption in global financial markets.

Cautious assumptions

2.55 The use of cautious assumptions audited by the NAO builds a safety margin into the public finance projections to guard against unexpected events. It decreases the chance that, over the medium term, unforeseen economic or fiscal events will require changes in plans for taxation or spending. A complete list of these assumptions is set out in Chapter C of the Financial Statement and Budget Report.

2.56 For Budget 2008, the Comptroller and Auditor General has audited the assumption relating to unemployment, which requires projections to be based on outside forecasts. He concluded that the assumption proved to be cautious in the later part of the Rolling Review period since Budget 2005, though in the earlier part actual unemployment in the initial parts of the projections exceeded the level projected by outside forecasters. He concluded that the assumption draws on a wide range of external views of the future and is a reasonable one to have used and to continue to use.

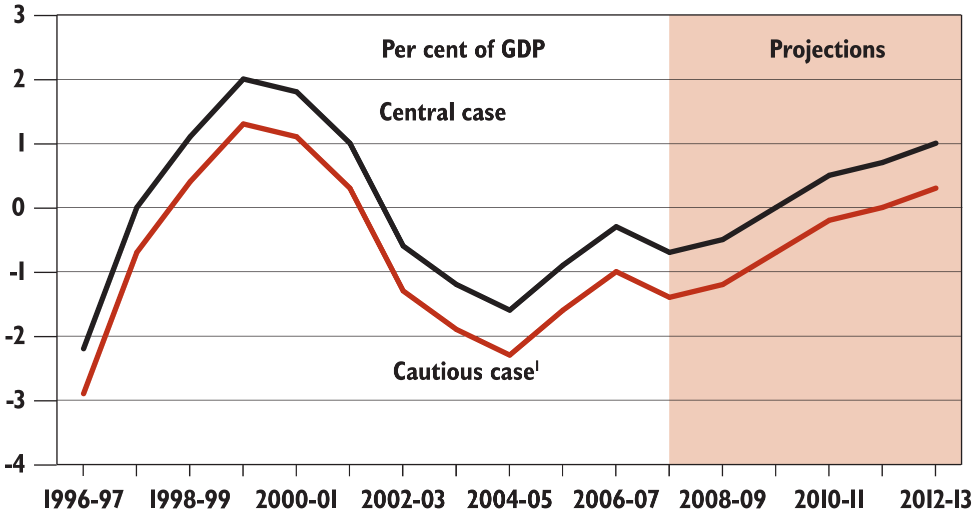
2.57 The degree of caution in the assumptions underpinning the public finance projections increases over the projection period. For example, the Government bases its public finance projections on a trend growth assumption that is a ¼ percentage point lower than its neutral view, to accommodate potential errors arising from misjudgements about the trend rate of growth of the economy in the medium term. This implies that the level of GDP used in the public finance forecast is 1¼ per cent below the neutral view by 2012-13.

The cautious case

2.58 A second 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. Chart 2.5 illustrates the projections for this cautious case.

2.59 The Government is, on the basis of cautious, independently-audited assumptions, meeting the golden rule in the central case. In the cautious case, Chart 2.5 shows that the cyclically-adjusted balance will be in surplus at the end of the projection period.

Chart 2.5: Cyclically-adjusted surplus on current budget



[1] Cautious case assumes trend output one percentage point lower in relation to actual output than the central case.

Source: HM Treasury.

RECENT FISCAL TRENDS AND OUTLOOK

2.60 Budget 2008 presents the Government's annual fiscal forecast and updates the 2007 Pre-Budget Report interim projections.

Outturn for 2006-07

2.61 The revised outturn for 2006-07 shows the deficit on the current budget to be £0.4 billion lower than in the 2007 Pre-Budget Report, and £5.2 billion lower compared with Budget 2007. With net investment lower by £0.5 billion, the outturn for net borrowing in 2006-07 is £1.0 billion lower than in the Pre-Budget Report. Net borrowing is £4.9 billion lower than the estimate in Budget 2007.

Estimate for 2007-08

2.62 The Budget 2008 estimates of key fiscal aggregates are in line with the 2007 Pre-Budget Report projections:

- the estimated outturn for the public sector current budget is a deficit of £7.9 billion, in line with the projected deficit of £8.3 billion in the 2007 Pre-Budget Report. It is higher than the Budget 2007 projection of a £4.3 billion deficit, which was made prior to the onset of financial market disruption in July 2007;

- for public sector net borrowing the estimated 2007-08 outturn is £36.4 billion, slightly lower than the estimate of £38.0 billion projected in the 2007 Pre-Budget Report. Borrowing is slightly higher than the estimate of £33.7 billion projected in Budget 2007;
- public sector net investment in 2007-08 is lower, at £28.5 billion, than projections in the 2007 Pre-Budget Report and Budget 2007 of £29.7 billion and £29.4 billion respectively; and
- the estimated outturn for public sector net debt in 2007-08 is 37.1 per cent of GDP. This is ½ per cent of GDP lower than expected at the 2007 Pre-Budget Report, and just over 1 per cent of GDP lower than the Budget 2007 projection.

2.63 The cyclically-adjusted fiscal aggregates for 2007-08 are largely unchanged compared with the Pre-Budget Report estimates. Cyclically-adjusted net borrowing for 2007-08 is 2.7 per cent of GDP, compared with 2.8 per cent at the Pre-Budget Report. The cyclically-adjusted deficit on the current balance is the same, at 0.7 per cent of GDP, as at the Pre-Budget Report.

Non-discretionary changes in receipts from 2008–09 onwards

2.64 While the continued disruption in financial markets is expected to affect GDP growth in 2008 and 2009 somewhat more than was forecast in the Pre-Budget Report, financial market developments are expected to have a more significant impact on particular areas of receipts from 2008-09 onwards. For example, the slow down in house price inflation and the effective closure of the mortgage-backed securities market is expected to feed through to fewer property transactions and to reduce expected stamp duty land tax receipts. As equity prices in the audited assumption are around 14 per cent lower than at the time of the Pre-Budget Report, forecast stamp taxes on shares are reduced. Lower equity prices also impact on projected corporation tax, capital gains tax and inheritance tax receipts.

2.65 The forecast for VAT and excise duties has been revised down compared to the 2007 Pre-Budget Report, partly due to a change in the composition of spending towards zero-rated and lower rate goods, reflecting developments in food and energy inflation in 2008-09 and in line with the ongoing rebalancing of the UK economy away from domestic consumption. North Sea revenues are broadly in line with expectations, with higher oil prices offset by higher expenditure and lower production.

Non-discretionary changes in spending from 2008-09

2.66 Social security spending and interest payments on index-linked gilts will be affected by higher forecasts for inflation. Forecasts for social security benefits and tax credits are also affected by an increase in the expected number of births over the projection period.

Forecasting assumptions

2.67 The Budget 2008 fiscal projections are based on an assumption of growth in current spending of 1.8 per cent per year in real terms over 2011-12 and 2012-13. The assumption for capital spending keeps net investment at 2¼ per cent of GDP in 2011-12 and 2012-13. Taken together these prudent assumptions mean Total Managed Expenditure (TME) grows by 1.9 per cent per year over 2011-12 and 2012-13

Budget decisions

2.68 The Budget is the definitive statement of the Government's desired fiscal policy settings. In making its Budget decisions the Government has considered:

- the need to ensure that, over the economic cycle, the Government will continue to meet its strict fiscal rules;

- its fiscal policy objectives, including the need to ensure sound public finances and that spending and taxation impact fairly both within and between generations; and
- how fiscal policy can best support monetary policy over the economic cycle.

Discretionary changes

2.69 Against this backdrop, the discretionary fiscal measures set out in Chapter 1 allow for a fiscal policy stance that protects economic stability in the short term, and takes action to maintain sound public finances in the medium term. Budget changes are fiscally neutral in 2008-09 and 2009-10. As the economy returns to trend, discretionary tightening reduces the deficit in later years of the projection period.

Medium-term fiscal projections

Estimates for 2008-09 onwards

2.70 Taking both non-discretionary factors and policy decisions together, the Budget 2008 estimates of key fiscal aggregates for 2008-09 onwards are as follows:

- with some receipts and areas of spending affected by the impact of the ongoing disruption in financial markets, the deficit on the current budget increases in 2008-09. Even with fiscal policy supporting the economy in the near term, the current budget moves into surplus in 2010-11. The surplus strengthens over the projection period, and returns to levels broadly in line with the 2007 Pre-Budget Report projections by 2012-13;
- similarly, net borrowing in 2007-08 is broadly in line with projections in the 2007 Pre-Budget Report, then rises in 2008-09. Net borrowing falls from 2008-09 year-on-year and by 2012-13 is, at £23 billion, also back in line with projections at the Pre-Budget Report; and
- net investment rises so that by 2010-11 it reaches £37 billion, more than accounting for borrowing (£32 billion).

2.71 The cyclically-adjusted current balance improves across the projection period, falling from a deficit of 1.6 per cent of GDP in 2004-05, and moving into surplus from 2009-10. Cyclically-adjusted net borrowing falls year-on-year from 2008-09.

2.72 Cyclical adjustment cannot take account of non-cyclical temporary shocks to the public finances, nor cyclical shocks with different impacts than those experienced across the 30 year period over which the cyclical adjustment factors are calculated. Therefore to the extent that cyclical adjustment is not taking account of the impact of financial market disruption, structural PSNB may be lower than these Budget projections suggest.

2.73 Table 2.4 compares the projections for the current balance, net borrowing and net debt with those published in Budget 2007 and in the 2007 Pre-Budget Report. It includes the impact of all Budget decisions in accordance with the *Code for fiscal stability*. Further detail is provided in Chapter C of the Financial Statement and Budget Report.

Table 2.4: Fiscal balances compared with Budget 2007 and the 2007 Pre–Budget Report

	Outturn[1]	Estimate[2]	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
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	–6½	–4	–1½	–1	
Effect of discretionary changes	0.0	–0.4	–½	1	1½	1½	
2007 Pre–Budget Report	**–4.7**	**–8.3**	**–4**	**3**	**9**	**14**	**20**
Effect of revisions and forecasting changes[3]	0.5	0.4	–5½	–7½	–6½	–5	–3½
Effect of discretionary changes	0.0	0.0	0	1	2	2½	2½
Budget 2008	**–4.3**	**–7.9**	**–10**	**–4**	**4**	**11**	**18**
Net borrowing (£ billion)							
Budget 2007	**35.0**	**33.7**	**30**	**28**	**26**	**24**	
Changes to current budget	–4.7	4.0	7	2½	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**	**23**
Changes to current budget	–0.5	–0.4	5½	7	5	2½	1
Changes to net investment	–0.5	–1.2	½	½	0	0	–1
Budget 2008	**30.1**	**36.4**	**43**	**38**	**32**	**27**	**23**
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	1.1
Budget 2008	**–0.3**	**–0.7**	**–0.5**	**0.1**	**0.5**	**0.8**	**1.0**
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	1.3
Budget 2008	**2.2**	**2.7**	**2.7**	**2.2**	**1.8**	**1.5**	**1.2**
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	38.6
Budget 2008	**36.6**	**37.1**	**38.5**	**39.4**	**39.8**	**39.7**	**39.3**

Note: Totals may not sum due to rounding.
[1] The 2006–07 figures were estimates in Budget 2007.
[2] The 2007–08 figures were projections in Budget 2007.
[3] Including changes to forecasting assumptions on spending growth in 2011-12 and 2012-13

LONG-TERM FISCAL SUSTAINABILITY

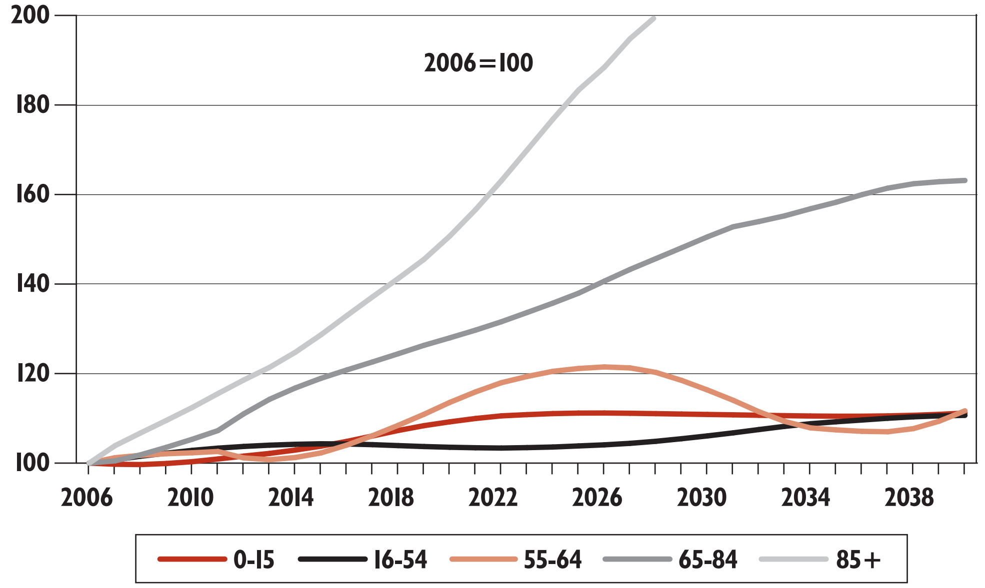
2.74 The primary objective of fiscal policy is to ensure sound public finances. The above analysis sets out how medium-term sustainability is protected by the golden rule and the sustainable investment rule. In addition, the Government must also ensure that policy decisions are fiscally sustainable in the long term. Failure to do so would see financial burdens shifted to future generations, with potential detrimental effects on long-term growth. It would also be inconsistent with the principles of fiscal management set out in the *Code for fiscal stability.*

2.75 A comprehensive assessment of long-term fiscal sustainability is published alongside Budget 2008 in the 2008 *Long-term public finance report*.[6] The report makes an assessment of long-term fiscal sustainability in the light of the challenges arising from projected demographic change over the coming decades. The 2007 Comprehensive Spending Review and *The UK economy: analysis of long-term performance and strategic challenges*, published alongside the Budget, identify additional long-term socio-economic challenges that are likely to have profound effects both on Britain's society and economy over the next decade.[7] These trends are also likely to affect the public finances in the long term through their impacts on both public spending and revenues. This section summarizes the main analysis and conclusions presented in the 2008 *Long-term public finance report*, focusing on the next 30 years.

Latest UK population projections

2.76 The latest official UK population projections were produced by the ONS and published in October 2007. While highly uncertain, the new projections show the size of the UK's population increasing significantly from 60 million today to 67 million by 2020 and around 72 million by the mid 2030s. The population structure is also projected to change substantially, with the ageing of the UK population being one of the key socio-economic challenges that the UK, alongside other developed countries, will face over the coming decades. For example, the 85+ age group is projected to more than triple in size over the next 30 years, while the 0-15 years and 16-54 years age groups grow at a significantly lower rate. Chart 2.6 shows this wide variation between the projected changes in size of different age groups.

Chart 2.6: Population indices by age group



Source: ONS, 2006-based principal population projections.

Taking account of uncertainty

2.77 Any long-term projection is subject to a high degree of uncertainty and the ONS therefore produces a wide range of variants around the principal projections, using alternative fertility, life expectancy and migration assumptions. The variants differ markedly from the principal projections in terms of the projected size and structure of the UK population in the coming decades. To ensure a robust approach to assessing the long-term sustainability of the public finances, the 2008 *Long-term Public Finance Report* therefore includes sensitivity

[6] 2008 *Long-term public finance report: fiscal sustainability with an ageing population*, HM Treasury, March 2008.

[7] *2007 Pre Budget Report and Comprehensive Spending Review*, HM Treasury, October 2007. *The UK economy: analysis of long-term performance and strategic challenges*, HM Treasury, March 2008.

analysis based on a selection of population variants. The different variants have different impacts on the long-term public finances and it is therefore important to monitor how the population develops and prepare for a wide range of potential outcomes.

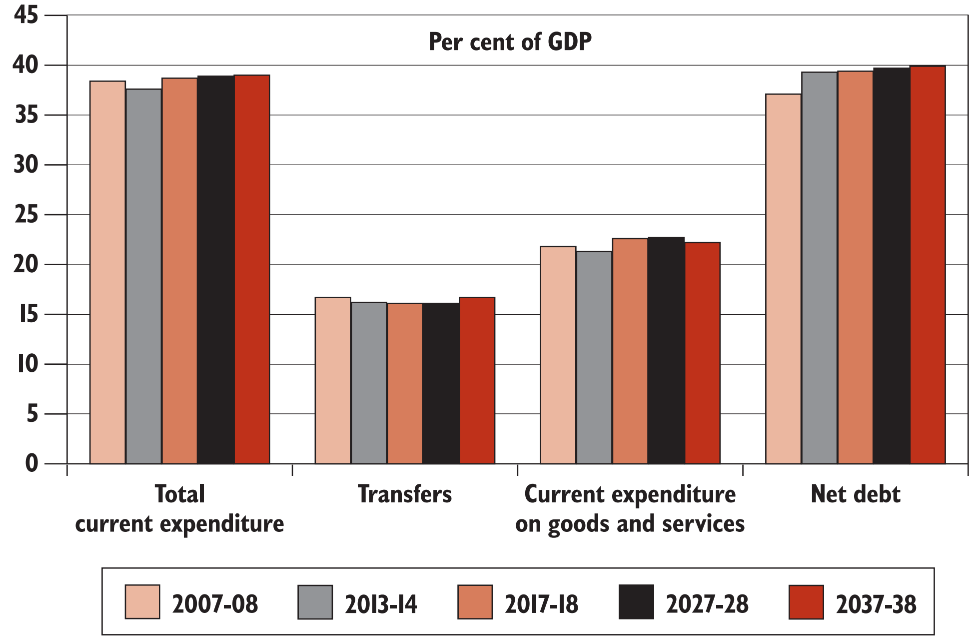
Assessment of fiscal sustainability

2.78 The Government's assessment of long-term fiscal sustainability, published in the 2008 *Long-term Public Finance Report,* is made using three complementary approaches.[8] One of these approaches imposes high-level constraints on the fiscal aggregates by assuming that the Government will meet its two fiscal rules. It then shows by how much current expenditure and net investment will be able to grow, given certain assumptions regarding government revenues, transfer payments and capital depreciation.

Illustrative projections

2.79 The results of this analysis are given by the illustrative fiscal projections in Chart 2.7, which shows first that current public consumption can grow at around the same annual rate as GDP after the medium term while meeting the Government's golden rule; second that public sector net investment can continue to grow at around its current rate, and more or less in line with projected economic growth, without jeopardising the sustainable investment rule; and third, the net debt to GDP ratio is projected to remain below 40 per cent by the end of the 30-year projection period.

Chart 2.7: Illustrative long-term fiscal projections



Source: HM Treasury.

2.80 As set out in the 2008 *Long-term Public Finance Report,* the illustrative long-term fiscal projections complement analysis of how demographic change could affect future spending and revenue, based on current policies and in the absence of any high-level fiscal constraints. These show that total spending, as a share of GDP, is projected to increase to around 43¼ per cent over the next three decades. Spending on health and state pensions are projected to increase the most as result of demographic change, while spending on education is

[8] The three modelling approaches used are historic indicators that illustrate the current position of the public finances, bottom-up projections based on the unconstrained evolution of spending and revenues and top-down projections of the public finances with constraints based on the Government's two fiscal rules. For further explanation of these different modelling approaches and detail on the assumptions on which they are based see the 2008 *Long-term public finance report: fiscal sustainability with an ageing population*, HM Treasury, March 2008, Chapter 3.

projected to increase as a result of demographic changes. The report also shows that revenue is projected to increase as a share of GDP, albeit at a lower rate. Sensitivity analysis based on different population variants illustrate that the different projected demographic structures will affect the rate at which both spending and revenue will change and therefore highlight the importance of monitoring population trends.

2.81 As is widely recognised, there will be a number of challenges arising from demographic change over the coming decades – such as the ageing of the population. While these developments will have profound socio-economic impacts, the analysis published in the 2008 *Long-term Public Finance Report* focuses on the effect that it could have on the public finances. A wide-ranging assessment of the current fiscal position as well as potential future pressures on the public finances shows that the UK is well placed to deal with the challenges arising from demographic change over the coming decades. The Government will continue to be in a position to meet its fiscal rules in the long term, ensuring that the long-term public finances remain sustainable. The UK will therefore be well placed to deal with the potential fiscal impacts arising from other long-term trends.

3 SUSTAINABLE GROWTH AND PROSPERITY

Over the last decade, coinciding with significant reform programmes, UK productivity has improved and levels of employment have risen to record highs. However, at a time of far-reaching change in the global economy, the Government must continue to provide a stable policy framework, so that business has the certainty to plan ahead, while ensuring that policy remains responsive to changing circumstances.

Budget 2008 includes short-term measures to enable small and growing businesses to access the resources they need during a time of global financial market disruption. At the same time it builds on progress to date by announcing longer-term measures designed around the levers available to Government to encourage productivity growth. These measures include:

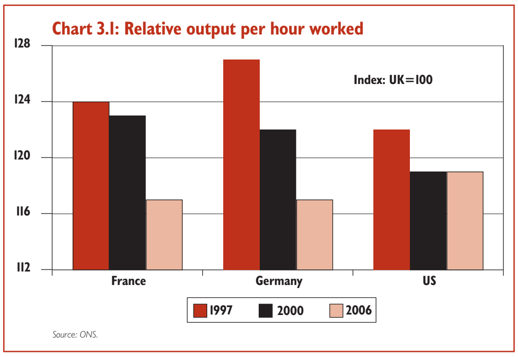
- **access to finance measures including enhancing the Small Firms Loan Guarantee Scheme and Enterprise Capital Funds** to support small firms in accessing the resources they need to start up and grow;
- **a package of reforms on regulation and tax simplification and implementation of the business tax reforms announced in Budget 2007**, including the lowest rate of Corporation Tax in the G7;
- **further implementation of the Leitch[a] and Sainsbury[b] Reviews** to build on improvements in the UK skills base and to provide a world-class science base and innovation framework;
- **exploring options to make better use of transport infrastructure, on top of the major programme of investment** announced in the 2007 Comprehensive Spending Review;
- **progress on business support simplification and measures to ensure better access to Government procurement for small firms**; and
- **a study of public service markets and a new framework for infrastructure procurement**.

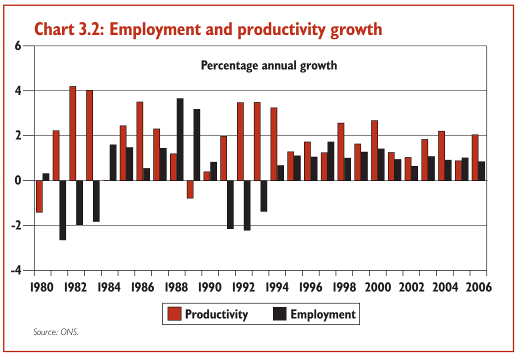
[a] *Leitch Review of skills: Prosperity for all in the global economy – world-class skills*, HM Treasury, December 2006.

[b] *The Race to the Top: A review of Government's science and innovation policies*, Lord Sainsbury of Turville, October 2007.

3.1 The Government's objective of promoting sustainable growth and prosperity depends on continuing improvements in the productivity[1] of the UK economy, alongside growth in employment. Over the last decade, the UK has increased its rate of productivity growth and has narrowed the productivity gap with comparator countries (Chart 3.1), while at the same time maintaining strong employment growth (Chart 3.2). This has been based on maintaining macroeconomic stability and the UK's openness to trade, investment and migration. It has also been driven by a programme of microeconomic reforms.

[1] Supported by the renewed Public Service Agreements on UK productivity growth and regional growth.





3.2 Budget 2008 sets out measures designed around the levers which are available to Government to improve productivity: **taxes and regulation, investing in the workforce and skills, investing in infrastructure, strengthening competition and market frameworks, and improving public sector efficiency**. Alongside Budget 2008, the Government is publishing *Enterprise: Unlocking the UK's talent* and *Innovation nation* which provide more detail on the policy framework that applies to these important drivers of productivity.

RESPONDING TO THE NEEDS OF BUSINESS

3.3 The global economy is in a period of far-reaching transformation. *The UK economy: analysis of long-term performance and strategic challenges*, published alongside Budget 2008, links analysis of the performance of the UK economy over the past decade with recent work on the challenges ahead – demographic change, environmental change, continuing globalisation, and rapid technological change global uncertainty.

Working in partnership

3.4 The new and changing context facing the UK has implications for society as a whole. The Government alone cannot ensure that the UK will meet the challenges and seize the opportunities ahead. The Government will work in partnership with individuals, communities, businesses and government at all levels to address these issues. Firms of all types have a major role to play: seizing opportunities and making the most of favourable and competitive market conditions, working with the Government to identify and develop the future reform priorities and helping to ensure that the implementation of existing policies and reforms is as effective as possible.

3.5 At this time it is even more important for Government to provide a stable policy framework within which business can plan ahead. Evidence[2] shows that the UK is one of the best places in the world to do business. The Government will maintain an environment that encourages investment and growth. Where policy change is necessary to reflect changing circumstances, the Government is committed to work in partnership with business to ensure that policy is responsive to business needs and objectives. As an important part of this, it will continue to consult business wherever possible, building on the increased number of tax consultations over the past year, and will maintain its consultative groups to discuss tax issues with business representatives.

3.6 The Government also recognises the need to respond to short-term challenges swiftly and flexibly. Budget 2008 coincides with a period of disruption in global financial markets. This presents specific challenges to business, particularly around access to finance for small and medium-sized firms (SMEs).

Access to finance

3.7 **Budget 2008 announces an access to finance package to ensure that small and growing firms have access to the resources they need:**

[2] *Doing Business 2008*, World Bank.

- **a temporary 20 per cent increase in the funds available through the Small Firms Loan Guarantee (SFLG);**
- **extending eligibility for SFLG to businesses with growth aspirations over five years old;**
- **support for mezzanine finance provision through additional Enterprise Capital Funds (ECFs);**
- **a new capital fund for female entrepreneurs;**
- **an increase in the investor limit of the Enterprise Investment Scheme (EIS) from £400,000 to £500,000 (subject to state aid approval) and a consultation on how best to simplify the operation of the scheme;** and
- **an increase in the individual option grant limit from £100,000 to £120,000 for the Enterprise Management Incentive scheme (EMI).**

3.8 To secure EIS, EMI, Venture Capital Trusts and the Corporate Venturing Scheme under state aid guidelines, **shipbuilding and coal and steel production will be excluded as qualifying trades.** In order to focus EMI more closely on SMEs and to bring it into line with state aid rules**, only companies with fewer than 250 employees will be able to make new grants of EMI share options.**

3.9 Since introduction in 1981, SFLG has guaranteed £5 billion of lending through around 100,000 loans. EIS has already helped raise over £6.1 billion, invested in over 14,000 smaller, higher-risk, unquoted trading companies. EMI allows smaller, higher-risk companies to grant tax-advantaged share options to their employees. Around 70,000 employees across 7,000 companies currently benefit from it.

Box 3.1 *Enterprise: Unlocking the UK's talent*

Focusing on SMEs, this outlines a new policy framework and sets out how the Government will encourage further business start up and growth. Measures include:

- **improving access to finance for SMEs (see paragraph 3.7 for more detail);**
- **a consultation on the introduction of regulatory budgets, which would cap the new, annually-recurring cost of regulation for business, including whether to pilot this approach for SMEs or a particular sector;**
- **an increased focus on minimising the impact of regulation on SMEs;**
- **an independent review of regulatory guidance to reduce compliance costs;**
- **further development of enterprise education in secondary schools and extension of it, where possible, into primary and further education (underpinned by a £210 million funding package, as agreed at the 2007 CSR); and**
- **establishing a National Enterprise Academy (NEA).**

BUSINESS TAXES AND REGULATION

3.10 The Government has taken steps to ensure that the UK has a world class environment for business investment and growth, by modernising and simplifying the tax system, improving the relationship between large business taxpayers and HMRC,[3] and by bearing down on the regulatory burden faced by business.

[3] *Framework for a better relationship: making a difference. Review of Links with Large Businesses.* HM Revenue and Customs, March 2008.

Better regulation

3.11 *Enterprise: Unlocking the UK's talent*, sets out the next steps on this agenda.

3.12 The Government seeks to provide an effective regulatory system, which enables businesses to start up, grow and stay competitive. It is undertaking radical reform that will deliver genuine reductions in the cost to business while continuing to deliver the necessary regulatory outcomes. It has already committed to a reduction of 25 per cent in the administrative burden through regulation and to ensuring that the benefits of regulation justify the costs. £800 million of savings have already been achieved, with a further £3.5 billion planned by 2010.

A simpler and more competitive tax system

Business tax reforms

3.13 Following extensive consultation on its implementation, the major package of business tax reforms announced in Budget 2007 will take effect from April 2008. The reduction in the main rate of Corporation Tax (CT) to 28 per cent will deliver the lowest ever rate in the UK and the lowest in the G7, improving competitiveness and encouraging investment. The reforms to the capital allowances system will improve economic efficiency by removing distortions to investment decisions. Budget 2008 announces, in response to consultation:

- **the 10 per cent rate of allowance for the new classification of integral features of buildings will apply to both initial and replacement expenditure, from April 2008;** and
- **a measure to allow over 500,000 businesses to write-off small, unrelieved capital allowances pools.** (Further detail in Box 3.5)

Taxation of foreign profits

3.14 Following last spring's discussion document[4] on the taxation of foreign profits, the Government has been engaged in a constructive, ongoing dialogue with business. **Budget 2008 announces that the Government will bring forward proposals and publish a consultation document before summer 2008.** The objective of any reform is to enhance the competitiveness of the UK tax framework, while being broadly revenue neutral.

North Sea fiscal regime

3.15 The Government is determined to ensure that the North Sea fiscal regime promotes investment and production, while ensuring a fair return for the UK taxpayer. Following the publication of the consultation document *Securing a sustainable future* in December 2007, **Budget 2008 announces reforms to the North Sea fiscal regime. These include changes to the treatment of CT losses created by decommissioning, extension of 100 per cent capital allowances to long-life assets and mid-life decommissioning, and reforms to Petroleum Revenue Tax.** These will encourage further investment in the UK Continental Shelf by providing certainty for investors, helping facilitate asset trade, and simplifying the regime. The Government will continue to engage with oil and gas stakeholders on outstanding issues.

Tax simplification reviews

3.16 Building on the Budget 2007 reforms, the 2007 Pre-Budget Report launched a significant programme of tax simplification and announced three simplification reviews. Following discussions with business and tax professionals, Budget 2008 announces the initial outcomes of each review:

- **VAT rules and administration: the Government will consult on simplifying the operation of the partial exemption regime and the capital goods scheme, and explore the need for business to seek permission from HMRC before taxing otherwise VAT-exempt supplies of land and property;**

[4] *Taxation of the foreign profits of companies: a discussion document*, HM Treasury (HMT) and HMRC, June 2007.

- **anti-avoidance legislation: the Government will, as a first step, repeal certain outdated and complex anti-avoidance provisions on bond washing, employment securities and other transactions in securities;** and
- **CT rules for related companies: the Government will, as a first step in simplifying associated companies rules, modify the current rules relating to the small companies rate where a director or shareholder is separately in a partnership.**

3.17 Further work will continue to address other priorities outlined by business.[5] **Budget 2008 announces a new simplification review, which will look at how to simplify CT calculations and returns for smaller companies.**[6] Updates on all four reviews will be announced at the 2008 Pre-Budget Report.

Delivering further simplifications

3.18 **Budget 2008 announces over 20 further tax simplification measures** (see Box 3.5). Alongside Budget 2008, HMRC is publishing details on how it is improving services for small businesses and an update on progress against its administrative burdens reduction targets.[7]

VAT registration threshold

3.19 **From 1 April 2008 the Government will increase the VAT registration threshold in line with inflation from £64,000 to £67,000,** maintaining the highest threshold in Europe and keeping around 6,000 small businesses out of the VAT system.

Financial services

A competitive financial centre

3.20 The Government is committed to ensuring that the City of London remains the world's leading international financial centre. The financial services sector makes a significant contribution to the UK economy, accounting for 9.4 per cent of GDP in 2006, up from 6.2 per cent in 1997, and supporting over 1 million jobs. The continued prosperity of the sector is vital to the UK's national economic interest.

Working collaboratively

3.21 The Government recognises the importance of working collaboratively with the financial services industry to ensure its continued competitiveness. The Chancellor's High Level Group on financial services remains a key forum for senior-level engagement between the Government and this industry and will next meet on 14 May 2008. The Government is working closely with industry experts to frame and lead the international community's response to the recent financial market disruption, and is consulting widely and actively on a considered and proportionate set of reforms to strengthen the resilience of the banking system[8] while maintaining competitiveness. **Budget 2008 extends collaboration with the establishment of an industry-led working group to examine proposals to improve the supply of mortgage funding** (see Chapter 5). These actions build on the introduction of a new legislative framework for UK covered bonds.

3.22 The financial services sector will benefit significantly from the reduction in the CT rate to 28 per cent from April 2008. Following extensive discussion with industry stakeholders, **Budget 2008 introduces a series of new measures to improve the taxation of asset management, enable the expansion of securitisation transactions in the UK** (see Box 3.2) **and**

[5] Detailed updates on the VAT and related companies reviews were provided to stakeholders in December 2007 and can be found at: http://www.hm-treasury.gov.uk/pbr_csr/documents/pbr_csr07_tax.cfm. HMRC is publishing alongside Budget 2008 *Simplifying anti-avoidance legislation: a progress report on anti-avoidance simplification*. All three updates highlight areas of future work to be progressed post-Budget 2008.

[6] Further details of this review and how to participate are available at: http://www.hm-treasury.gov.uk/budget/budget_08/bud_bud08_index.cfm

[7] *Delivering a new relationship with business: Progress on HMRC's plans to improve the SME customer experience*, HMRC, March 2008.

[8] *Financial stability and depositor protection: Strengthening the framework*, HM Treasury, January 2008.

promote the expansion of the market in Islamic finance. The Government would like to take a similarly collaborative approach when considering other areas of financial services taxation. Where evidence-based, targeted changes can be identified that will increase competitiveness without impeding broader objectives, the Government will take action.

Islamic finance

3.23 In order to promote the City of London as a centre for global Islamic finance and put in place a level-playing field between conventional and alternative financing instruments, **Budget 2008 announces:**

- **the Government's aim to legislate, following consultation, in Finance Bill 2009 to provide relief from stamp duty land tax (SDLT) for alternative finance investment bonds;**
- **amendments to legislation to classify alternative finance investment bonds as loan capital for stamp duty and stamp duty reserve tax (SDRT);**
- **adjustments to legislation to allow existing CT and income tax rules on alternative finance arrangements to be amended by regulation;** and
- **work with the Financial Services Authority and stakeholders to clarify the regulatory treatment of sukuk.**

3.24 The Government will continue to examine the feasibility of a sovereign sukuk issue. It will also, in Finance Bill 2008, take legal powers to facilitate any future sovereign issuance, and provide a full response to the recently closed public consultation on sukuk issuance in the summer of 2008.

Box 3.2: Enhancing the competitiveness of UK financial services

Recent steps to support competitiveness include:

- **agreement on a joint funding package for Crossrail;**
- **working with the financial sector to create an International Centre for Financial Regulation in London;**
- **actively supporting work to expand and develop carbon markets, and to promote the role of London as a key centre of expertise in carbon trading (see Box 6.1);**
- **a better regulation package for the asset management sector that will save it up to £290 million per year;**
- **consulting on a Legislative Reform Order to modernise the governance arrangements of the Lloyd's insurance market, complementing Lloyd's own reforms and helping it continue to compete in the global insurance market; and**
- **strengthening economic and financial dialogue with China and India, providing a strong focus on financial markets and related opportunities for UK-based firms.**

Budget 2008 announces improvements to asset management taxation:

- **following extensive consultation, launching a new tax regime for Property Authorised Investment Funds on 6 April 2008;**
- **working further with industry on options for reform of SDRT Schedule 19;**
- **engaging with industry to consider a direct tax exemption for Authorised Investment Funds, taxing the investor as if they held the underlying assets directly;**
- **removing tax barriers impacting the development of offshore funds in Finance Bill 2008;**
- **introducing new tax rules to facilitate the development of the proposed regulatory regime for Funds of Alternative Investment Funds;**
- **announcing that the Government is minded to simplify the tax rules for the qualified investor scheme by replacing the substantial holding rule; and**
- **considering proposals to adapt the tax rules for Investment Trust Companies to enable tax-efficient investment in a wider range of asset classes.**

On securitisation, Budget 2008 also announces:

- **the introduction later this year of regulations enabling expansion of securitisation transactions into real estate.**

The Government is taking steps towards modernising insurance taxation by:

- **continuing the consultation on the taxation of general insurance reserves; and**
- **announcing further discussions with industry on the use of general insurance losses and on the possible extension of the tax rules applying to equalisation reserves to the Lloyd's market.**

Simplification measures on life insurance, insurance premium tax for overseas insurers and on securitisation, which will also enhance the competitiveness of UK financial services, are in Box 3.5.

INVESTING IN WORKFORCE AND SKILLS

3.25 Budget 2008 announces measures which, building on a decade of investment and reform, help deliver a skilled workforce and a flexible labour market complemented by world-class science and innovation.

Science and Innovation

3.26 The Sainsbury Review concluded that the UK is well placed to benefit from the opportunities of globalisation, but that further action is needed to secure the UK's comparative advantage in high-value, knowledge-intensive sectors. The review recognised that measures such as research and development expenditure do not capture the UK's significant strengths in non-scientific innovative activity.

Implementing Sainsbury

3.27 Good progress is being made in the implementation the Sainsbury Review recommendations. The Technology Strategy Board (TSB) is delivering on its leadership role and will shortly publish its strategy, including joint initiatives with the Regional Development Agencies and Research Councils and programmes to support innovation across a wider range of sectors. The Department for Innovation, Universities and Skills (DIUS) will pilot a reformed Small Business Research Initiative (SBRI) with the Ministry of Defence, Department of Health and other selected partners, prior to wider roll-out in 2009. DIUS and the Department for Children, Schools and Families (DCSF) are delivering a new campaign on Science, Technology, Engineering and Mathematics (STEM) skills, including a new £6 million communications campaign, working towards better careers guidance for pupils, and planning for a National Science Competition from 2008-09.

Project Enthuse

3.28 The Wellcome Trust has created Project Enthuse, which will provide a comprehensive funding and support package to enable all secondary schools to develop the skills of their science teachers at the National Science Learning Centre. The Government will invest £10 million over five years to support the scheme, levering up to £20 million investment from business and the Wellcome Trust.

3.29 Alongside Budget 2008, the Government is publishing *Innovation nation* (see Box 3.3), which sets out a vision for supporting innovation across all sectors of the economy.

3.30 Some businesses and Higher Education Institutions (HEI) are uncertain about whether knowedge transfer activity has charitable status and how this impacts on its CT treatment HMRC will continue to work with the sectors and regulators to provide greater certainty. The Government will also continue to support links between HEIs and business and promote knowledge transfer.

Box 3.3: *Innovation nation*

Commitments include:

- **development of an independent Innovation Index to capture a wider range of innovation, to be piloted in 2009, with a fuller system in place in 2010;**
- **working with the TSB and its partners to double the number of Knowledge Transfer Partnerships, and to pilot a new Further Education (FE) Specialisation and Innovation Fund to support knowledge transfer between FE and business;**
- **improving the innovative capability of the public sector, including a new Public Sector Innovation Laboratory and Whitehall Innovation Hub;**
- **further action on Intellectual Property (IP), building on the Gowers Review,[a] including dedicated IP management training for all Business Link and UKTI advisers; and**
- **publication of the first Annual Innovation Review for the UK in the autumn.**

[a] *Gowers Review of intellectual property*, HM Treasury, December 2006.

A flexible labour market and strong skills base

3.31 The flexibility of the UK's labour market has increased to historically high levels since the 1990s.[9] This allows firms to adjust smoothly to changing circumstances, helps maintain high levels of employment and is vital for a resilient economy. Net migration has helped to fill skill gaps and accounted for an estimated 15-20 per cent of average economic growth in the UK between 2001 and 2006.[10]

Implementing Leitch

3.32 In its plans for implementing the Leitch Review's[11] recommendations, the Government set out the ambition to achieve a world-class skills profile for the UK by 2020. Over 1.8 million people have improved their functional literacy and numeracy skills since 2001, over 100,000 people complete apprenticeships in England now compared to 40,000 in 2001-02, and more than 72,000 employers and 160,000 employees have benefited from Train to Gain. The 2007 Comprehensive Spending Review set out an increase in resources for adult training, from £3 billion in 2007-08 to £3.6 billion in 2010-11, to enable almost 2.8 million adults to gain higher-level skills (see Chapter 4 for further details on welfare and skills).

Train to Gain

3.33 As a key part of the skills reforms, the Government will expand and improve Train to Gain, with Government funding rising to over £1 billion by 2010-11. If employer demand exceeds the amount of skills support on offer within the resources already committed to Train to Gain, the Government will reassess the position, exploring how such demand can be met. Through Train to Gain employers have a choice over their training provider. Providers can only access Train to Gain funding if they deliver training that meets employers' needs.

Skills Accounts

3.34 The principles of customer choice will also underpin Skills Accounts, which will give learners purchasing power through 'virtual vouchers'. **Skills Accounts will be rolled out nationally from 2010 and will mirror the operation of Train to Gain, with the learner's choice directing the flow of funding to the wide range of accredited, high quality providers not just Further Education (FE) colleges.** This funding will be re-balanced between providers throughout the year to respond to the actual choice of learners.

3.35 Through Skills Accounts the Government will ensure that every adult can access investment in their skills. To expand this investment, **Budget 2008 announces £60 million of additional funding for adult skills,** focused on Level 3, which will support increased opportunity and progression. This will provide new opportunities for people to realise their talents, offer adults a second chance to retrain, and will be used to test new ways of delivering training. It will also enable leading employers to take on more adult apprentices.

3.36 **To help inform learners' choices a new advancement and careers service for adults in England will be trialled over the next two years and be fully operational from 2010-11. DIUS will set out the framework for the development of this service shortly.**

Improving quality

3.37 FE success rates have improved significantly from 59 per cent in 2000-01 to 77 per cent in 2005-06. Evidence[12] shows that, in the current inspection cycle, over 90 per cent of inspected FE colleges have been graded satisfactory or better. **For 2008-09 the minimum performance standards for providers has been raised, and the intention is to continue to raise it each year.**

[9] *Developing an index of labour market adaptability for the UK*, BERR Employment relations research series, No.85, November 2007.

[10] *The Economic and Fiscal Impact of Immigration,* Home Office, October 2007.

[11] *World Class Skills: Implementing the Leitch Review of Skills in England,* Department for Innovation, Universities and Skills, July 2007.

[12] Office for standards in education, children's services and skills.

Skills Academies

3.38 **The Government is developing a programme of National Skills Academies to drive employer-led excellence in the delivery of skills training by sector. There will be twelve in place by the end of 2008**.

Employer qualifications

3.39 DIUS are working with employers to end the outdated distinction between company training and national qualifications. Three major employers are now recognised to award their own qualifications. Around thirty more have had their training recognised and DIUS will expand the scheme further over the next year.

INVESTING IN INFRASTRUCTURE

Crossrail

3.40 The Eddington Review[13] made clear the importance of transport infrastructure for the UK's economic performance. The 2007 Comprehensive Spending Review set out the Government's plans to increase capital investment in transport from £6.7 billion in 2007-08 to £8.1 billion in 2010-11 including provision for Crossrail. This will provide a direct link between London's main economic centres of the West End, the City and Canary Wharf and connect these directly with Heathrow Airport and the Thames Gateway. Crossrail is projected to generate economic benefits of more than double its cost and to create up to 30,000 jobs.

Heathrow

3.41 Improving the passenger experience at the UK's major airports, particularly Heathrow, is critical to UK competitiveness. **To reduce delays for travellers at Heathrow, Budget 2008 announces new measures with airport operators to improve average and maximum waiting times at immigration. This will be accompanied by greater use of automated biometric technology and fast-track routes through immigration.**

Road pricing and active traffic management

3.42 Costs of congestion are forecast to more than double by 2025. Budget 2008 reaffirms the commitment to exploring national road pricing to tackle congestion and emissions. **It announces an invitation to the private sector to run a number of projects based on charging by time of day, distance travelled and route chosen. The Government will make available sufficient funding to ensure that these projects help answer the crucial questions on feasibility, cost effectiveness, privacy and the impact of real financial incentives on driver behaviour.** Budget 2008 also confirms additional funding to help local authorities develop proposals for charging schemes, which will be taken forward consistent with consideration of a national scheme.

3.43 **For motorways, the Government will set out the scope for introducing hard shoulder running by Pre-Budget Report 2008, and for locking in the benefits of extra capacity, such as lanes reserved for car-sharers or those willing to pay a toll.**

Supporting the road haulage industry

3.44 The Haulage Industry Task Group found that when hauliers break the law, for example on overloading or drivers' hours, they gain an unfair competitive advantage. Budget 2007 announced significant increases to the resources devoted to enforcement activity. Alongside this the Government conducted the Freight Data Feasibility Study to look at options for creating a database of foreign hauliers, including a vignette scheme. The conclusions, to be published next week, find that the options produce limited safety, congestion and environmental benefits. **The Government will therefore not take forward a vignette at this time but will instead focus on improving the UK's enforcement system. To support this and understand better the movement of foreign vehicles within the UK, the Government will refresh the 2003 Foreign Vehicle Data Survey**.

[13] *Transport's role in sustaining the UK's productivity and competitiveness*, HM Treasury, December 2006.

STRENGTHENING COMPETITION AND MARKET FRAMEWORKS

3.45 The Government recognises the importance of strong market frameworks for businesses. Measures on the environment set out in Chapter 6 develop the frameworks to give businesses incentives to reduce carbon emissions and bring forward investment in a wide range of low-carbon technologies.

Business support simplification

3.46 The advice, financial assistance and other support provided through the Government's business support schemes enable many businesses to start up and grow. To improve the effectiveness of these schemes the Government is reducing their number from over 3,000 to no more than 100 by 2010. The launch of all new products will be completed by March 2009, to enable closure or notice of closure of all obsolete schemes by the start of 2010. **Budget 2008 announces the merger into Business Link, with the associated resources, of all information, diagnosis and brokerage services associated with: all Regional Development Agency (RDA) support by March 2009, UK Trade and Investment (UKTI) support by June 2009, Protecting the Natural Environment support by April 2010, and Resource Efficiency support by October 2009.**[14]

Competition in utilities

3.47 An effective competition regime makes a key contribution to market frameworks. The Government has implemented significant reforms to ensure that the UK has a world-class competition regime. To achieve further progress it announced in February 2008 an independent review of competition and innovation in the water sector. This will explore options to increase the efficiency of water use and deliver benefits to both businesses and households through increased competition and innovation.

3.48 The Government takes seriously the need to tackle fuel poverty to ensure that vulnerable households can afford to heat their homes adequately (see Chapter 4). In the medium to longer-term low energy prices are determined by competitive energy markets. The Government will therefore continue to press for the liberalisation of EU energy markets and welcomes Ofgem's investigation into the markets in electricity and gas for households and small businesses.

Commercial use of public information

3.49 The Office of Fair Trading's (OFT) market study into the commercial use of public information[15] highlighted important issues around access to public sector information for commercial or other re-use. The Government commissioned Cambridge University to analyse the pricing of this information. This analysis is published alongside Budget 2008. **The Government will look closely at public sector information held by trading funds to distinguish more clearly what is required by Government for public tasks and ensure that this information is made available as widely as possible for use in downstream markets.** In the lead up to the next Spending Review the Government will ensure that information collected for public purposes is priced so that the need for access is balanced with ensuring that customers pay a fair contribution to the cost of collecting this information in the long term. These issues will be considered in conjunction with the assessment of trading funds (see Chapter 5).

Improved procurement for SMEs

3.50 The Government wants to see SMEs compete more effectively for public sector contracts, since this is likely to provide greater choice and better value for money, as well as encouraging innovation and enterprise. ***Enterprise: Unlocking the UK's talent*** **announces free trial periods for all suppliers newly registering with Supply2Gov. It also announces that firms**

[14] Further details of launch timetable are set out on http://www.berr.gov.uk/bbf/simplifying-business-support/page45200.html

[15] *The commercial use of public information (CUPI)*, OFT, December 2006.

supplying services to Government will be able to sell public sector invoices to debt specialists, which will be particularly advantageous to SMEs in managing their cash flow.

3.51 **In addition, the Government will set up an advisory committee, chaired by Anne Glover (Chief Executive of Amadeus Capital Partners Limited).** This will provide advice for the 2008 Pre-Budget Report on necessary Government action to reduce the barriers to SMEs competing for public sector contracts, within the scope of EU law and the policy objective of value for money, and advise on the practicality of setting a goal for SMEs to win 30 per cent of all public sector business in the next five years. The Science and Innovation White Paper published alongside Budget 2008 includes reforms of the SBRI which provides for a proportion of Government departments' research and development budgets to be spent with SME suppliers. (For more detail on how improved public procurement can also help achieve some of the Government's social and environmental objectives see Chapter 4 and Chapter 6 respectively.)

Box 3.4: The Lisbon Strategy for Growth and Jobs

The EU plays a significant role in promoting productivity growth and securing prosperity for the UK's citizens and businesses. The Spring 2008 European Council will launch the next cycle of the Lisbon Strategy for Growth and Jobs – the EU's structural reform agenda designed to raise the rate of growth and employment to underpin social cohesion and environmental sustainability. The measures set out in Budget 2008 are fully consistent with the Lisbon Strategy's objectives. The priorities at EU level include moving ahead with the proposals for liberalisation of the telecoms and energy sectors, implementing the Services Directive, delivering EU targets for reducing administrative burdens and assessing the EU's skills needs. The Strategy is approaching its 2010 deadline and the EU must therefore start to prepare a comprehensive economic reform strategy for post-2010, which is robust to new trends and continues to ensure sustainable growth with opportunity for all.

3.52 The Varney Review of taxation in Northern Ireland[16] concluded that there is no clear case for changing corporation taxation in Northern Ireland. Sir David's second review, which is expected to report soon, is seeking to identify ways of improving Northern Ireland's competitive position and increasing the size of the private sector. In England, *The Review of sub-national economic development and regeneration*[17] set out a package of institutional reforms of regional, sub-regional and local governance and decision-making to enable every spatial area to improve its competitiveness and fulfil its economic potential. The Department for Business Enterprise and Regulatory Reform (BERR) and the Department for Communities and Local Government (CLG) will consult on implementing these reforms shortly.

IMPROVING PUBLIC SECTOR PRODUCTIVITY

3.53 The public sector represents a significant proportion of the economy. Chapter 5 sets out progress on delivering the Government's vision of improved public sector efficiency and effectiveness. Public sector productivity is not only about reducing cost but also about delivering world-class public services that match people's expectations. This section outlines measures to ensure that, where Government delivers infrastructure and services in partnership with business, it obtains high quality outcomes and value for money.

Fairer public service markets

3.54 Where public services are delivered by a combination of public, private and voluntary sector providers, fair competition means that services are provided by whichever can offer the best value for money – with high quality and innovative services for citizens that are responsive

[16] *Review of tax policy in Northern Ireland*, HM Treasury, December 2007.
[17] HM Treasury, BERR and CLG, July 2007.

to their needs. BERR has commissioned a review of the emerging public services industry to identify opportunities to support its competitiveness, led by Dr DeAnne Julius. It will report in summer 2008.

3.55 Building on this, HM Treasury, together with other Government Departments, will study a number of key public service markets where the Government is committed to mixed provision. This work will consider opportunities for fair competition to deliver better quality public services and improve value for money.

Infrastructure procurement

3.56 *Infrastructure Procurement: delivering long-term value*, published alongside Budget 2008, sets out the Government's next steps to improve its procurement of significant assets, infrastructure and long-term service provision. It recognises the evolving needs of the public sector and explores new approaches to complex procurement, building on the experience of the Private Finance Initiative. It outlines a framework that will secure value for money while ensuring effective scrutiny and continuing to improve the commercial skills of procurers.

Box 3.5: Delivering tax simplification

To enhance UK productivity and competitiveness, Budget 2008 announces more than 20 tax simplification measures benefiting sectors across the UK economy:

Business

- from April 2008, allowing businesses to write-off unrelieved expenditure when certain capital allowances pools reach a de minimis of £1,000. This removes the need for over 500,000 businesses to track small pools over several years to receive comparatively small amounts of relief;
- as outlined earlier in Chapter 3, consulting on simplifying the rules and processes that govern the Enterprise Investment Scheme;
- from 1 July 2008, increasing voluntary disclosure limits for indirect tax returns to the greater of £10,000 or 1 per cent of turnover, up to a maximum of £50,000, removing the need for business to report up to 8000 errors each year;
- from 1 June 2008, simplifying legislation on taxing otherwise VAT-exempt supplies of land and property;
- introducing an online system from 1 January 2010, which will facilitate the recovery of overseas VAT by UK business;
- working with EU partners, aiming to reduce the Intrastat burden on business by lowering the coverage requirement to 95 per cent, which would remove the need for around a quarter of Intrastat declarants to complete returns on their imports of EU goods;
- modernising Pay As You Earn processes to simplify arrangements for all working students and reduce burdens on their employers. HMRC published a consultation document on 20 February 2008;
- as outlined earlier in Chapter 3, simplifying the North Sea fiscal regime;
- removing the requirement for energy suppliers to identify their energy bills as accounting documents for the climate change levy, reducing administrative burdens; and
- removing the requirement for new heavy goods vehicles and buses with an appropriate manufacturers' certificate of conformity to undergo a physical examination before being issued with a reduced pollution certificate.

Savings and Assets

- from April 2009, reducing administrative burdens by making it voluntary for Child Trust Fund (CTF) providers to receive the CTF voucher in order to open an account;
- from April 2008, introducing a package of measures to simplify the administration of ISAs and the Tax Deduction Scheme for Interest, including consolidating regulations, and reducing requirements for information returns and records retention;
- consulting this summer on simplifying and clarifying the tax treatment of dividends paid by Real Estate Investment Trusts (REITs) into Share Incentive Plans (SIPs);
- from today, abolishing the stamp duty I§land tax (SDLT) lease duty rule for all residential transactions, and for non-residential transactions, increasing the threshold from £600 to £1,000; and

- from today, abolishing the requirement to complete an SDLT 60 certificate verifying that no SDLT return is required for most property transactions below £40,000, leading to a reduction in the need to submit about 270,000 returns per year.

Financial Sector

- removing the requirement for overseas insurers to appoint a jointly and severally liable tax representative in the UK for insurance premium tax;
- responding to representations from the securitisation industry, removing certain stamp duty and stamp duty reserve tax barriers to securitisation transactions; and
- following consultation, simplifying and clarifying aspects of the life insurance taxation system through a package of measures on funding rules, the tax treatment of structural assets, rules on foreign currency assets, and the facilitation of transfers of business between friendly societies.

As set out earlier in Chapter 3, Budget 2008 announces simplification of the tax rules for offshore funds and that the Government is minded to simplify a tax rule for the qualified investor scheme.

Charities

- following consultation, introducing a package of measures to make the Gift Aid system easier to use, including simplifying record-keeping and auditing processes (for further detail on the consultation see Chapter 5); and
- consulting with charities on anti-avoidance legislation relating to substantial donors to simplify the system for charities and prevent innocent transactions from being caught.

Modernising tax administration

- consulting later this year on how to harmonise and simplify the rules about interest on tax paid late and on repayments of tax overpaid, and
- following consultation and in the context of wider tribunal reform, announcing streamlined and more consistent processes across taxes for reviewing decisions and handling appeals before they come before a tribunal.

4 FAIRNESS AND OPPORTUNITY FOR ALL

The Government is committed to employment opportunity for all. As well as ensuring that individuals can take advantage of the opportunities of an increasingly globalised world, it is also crucial to the ambition of eradicating child poverty and promoting saving. The Government's approach to delivering on this commitment is twofold: integrating the tax and welfare system, so that work always pays; and providing everyone with the support they need to find, retain and progress in work. The Government is also committed to providing better incentives for saving, including for old age. This complements the action the Government is taking to enhance financial security for today's pensioners.

The Government is committed to a modern and fair tax system that ensures everyone pays their fair share of tax to support public services and meet the fiscal rules.

This Budget sets out the next steps the Government is taking to support these aims, including:

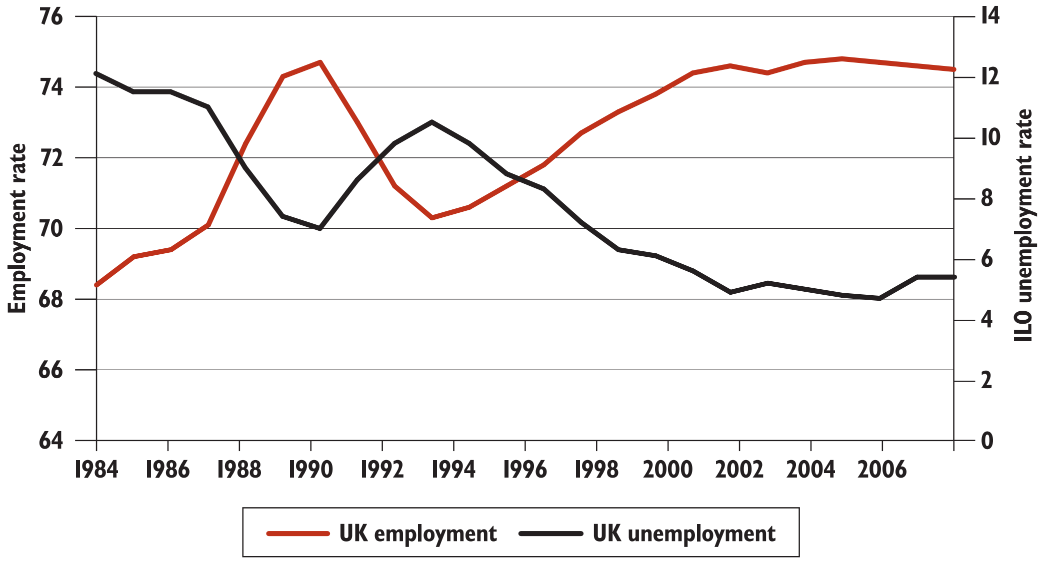
- **further financial support for children,** which will lift up to 250,000 children out of poverty;
- **Work Capability Assessments for all existing Incapacity Benefit claimants**, focusing on what people can do in work;
- **further action, with the energy companies and Ofgem, to help vulnerable groups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

EMPLOYMENT OPPORTUNITY FOR ALL

Labour market performance

4.1 Since 1997, the number of people in employment in the UK has increased by almost 3 million to more than 29 million, while the number of unemployed people has fallen by around 400,000. As Chart 4.1 shows, the working age employment rate is now 74.7 per cent and the unemployment rate is 5.2 per cent. In January 2008, the Jobseeker's Allowance (JSA) claimant count fell to below 800,000 – the lowest figure since June 1975 and half the level in 1997. *The UK economy: analysis of long-term performance and strategic challenges* shows how greater flexibility and increased stability have contributed to this. The UK now has a higher proportion of people in work than the US, France, Germany, Italy or the average of the EU.

Chart 4.1: UK employment and unemployment rates



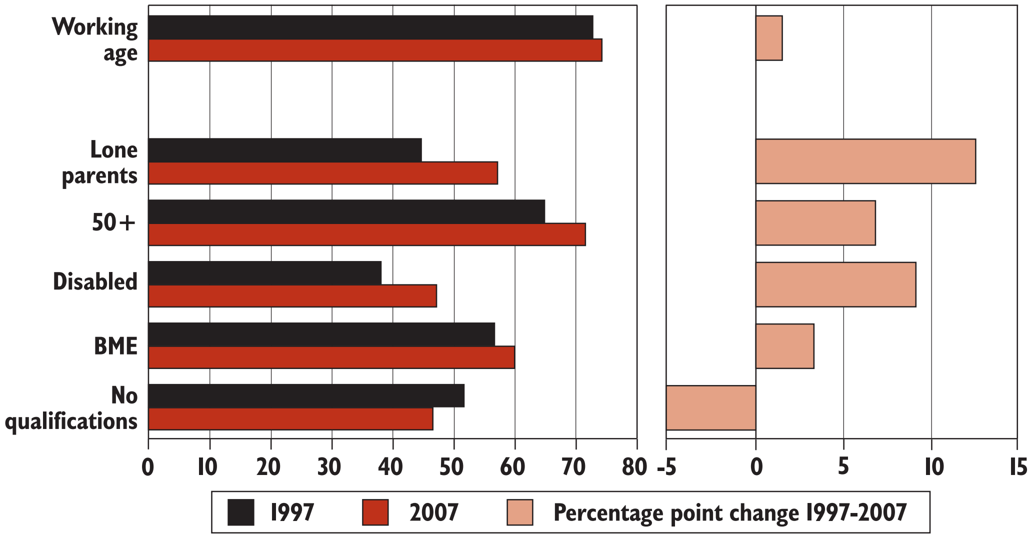
Source: Labour Force Survey, ONS

Active labour market policies

4.2 The improvements in employment have been of particular benefit to groups traditionally disadvantaged in the labour market, as Chart 4.2 illustrates. Compared with 1997, there are 335,000 more lone parents in work, 1.4 million more working age people over 50 in work and 885,000[1] more people with a health condition or disability in work. However, while the total number of people without qualifications is decreasing, the employment rate among this group has fallen and the employment rates of all the disadvantaged groups remain below the national average. Moving towards the Government's long-term aspiration of an employment rate equivalent to 80 per cent of the working age population will require more people in these groups to move into sustained employment.

[1] Change is since 1998 for figures for people with a health condition or disability, as the figures for 1997 are not comparable due to changes in definitions.

Chart 4.2: Employment rates of disadvantaged groups 1997 and 2007



Notes: 1997 disabled people value is from 1998, as data is available from spring 1998 only.
Minority ethnic group values are not directly comparable due to classification changes in 2001.
Data is from the spring quarter of the year shown.

Source: Labour Force Survey.

Principles of welfare reform

4.3 Building on the successful active labour market policies of the past decade, the Government's approach to welfare reform is based on five key principles:

- rights and responsibilities underpinning the welfare reform agenda;
- a personalised and responsive approach to meet individual needs;
- retention and progression, with employment support focused not just on job entry but also on helping people remain and progress in work;
- working in partnership to make the best use of expertise across the public, private and third sectors; and
- devolution and local empowerment, recognising the important role regions, cities and localities should play in strategy and delivery.

4.4 A successful labour market is dependent on a benefit system that supports these aims. The Government will be bringing forward radical reforms to the benefit system, to improve opportunities and incentives to work, to support those who cannot work, to make progress towards the child poverty targets, and to maintain sound public finances.

Reform of incapacity benefits

4.5 As many as 90 per cent of people expect to return to work when they start a claim for Incapacity Benefit (IB). Nearly half of working age disabled people are already in employment and for most IB claimants a move back into employment is possible and beneficial with appropriate support. **From late 2008, an integrated and simplified Employment and Support Allowance (ESA) will replace the current system of incapacity benefits for new claimants,** which will have a clearer balance of rights and responsibilities. It will be accompanied by a new Work Capability Assessment, which will focus on what a person can do in work, not what they cannot do. To ensure this increased work focus benefits current as well as future claimants, **from April 2010 all incapacity benefits claimants who started their claim before October 2008 will be required to take the Work Capability Assessment.** The introduction of ESA will also be supported by the national rollout of the successful Pathways to Work programme in 2008, delivered primarily by the private and third sectors. People with the most severe health conditions and disabilities will not be required to participate in Pathways to Work, although they will still be able to take up the support programme, should they wish.

4.6 The way the Government contracts with specialist providers to support existing IB customers is key to achieving results. *Ready for Work: full employment in our generation*, published in December 2007, outlined a welfare system aimed at supporting the most disadvantaged claimants into work. It set out the Government's intention to pilot a new approach where providers who are successful in moving people off benefits and into sustained employment are rewarded with increased funds to invest in further activity. **The Government will explore using a new funding mechanism to reward private and voluntary sector specialist providers for investing in helping long-term incapacity benefits claimants to return to work.**

Flexible New Deal

4.7 *Ready for Work* also announced that the **Flexible New Deal will be introduced for JSA claimants from October 2009,** replacing the current New Deals for the unemployed with more personalised, flexible support. All JSA claimants who fail to find work after 12 months of Jobcentre Plus support will be referred to an external provider for further specialist help.

Conditionality for lone parents

4.8 With comprehensive childcare and employment support in place, it is now reasonable that lone parents engage actively with the labour market. Following consultation, *Ready for Work* also announced that, from October 2008, **lone parents whose youngest child is aged 12 or over will lose eligibility to Income Support solely on the grounds of being a lone parent.** They will move onto JSA, where they will be expected to actively seek work, or onto another benefit if appropriate for their circumstances. To help lone parents moving into work, **there will be an additional package of in-work support from April 2008, including national roll-out of In Work Credit and the In Work Emergency Fund, and support from Personal Advisers for the first six months in work.**

Personalised integrated skills and employment support

4.9 Chapter 3 highlighted the importance of skills in preparing individuals to adapt to an increasingly flexible labour market. To tackle the rising unemployment rate for unskilled individuals, Jobcentre Plus and the Learning and Skills Council will work together on longer-term support, retention and advancement – delivering a seamless, personalised service that enables low-skilled benefit claimants to access the training they need to find, retain and progress in work.

Making work pay

4.10 The Government is committed to making work pay by improving incentives to participate and progress in the labour market. Through the Working Tax Credit (WTC) and the National Minimum Wage (NMW), the Government has boosted in-work incomes, thereby improving work incentives and tackling poverty among working people.

The Working Tax Credit

4.11 The WTC is a form of financial support designed to top up in-work income for the low-waged, thereby improving incentives to work. ***Working Tax Credit and labour supply: Treasury Economic Working Paper No.3* is published alongside Budget 2008.** It examines the impact of WTC on the labour supply of those without children through two different analytical approaches and shows that the policy has been effective in encouraging people into work.

The National Minimum Wage

4.12 The NMW ensures a fair minimum rate of pay, while retaining flexibility for employers. On 5 March 2008, the Low Pay Commission (LPC) presented its 2008 report to Government, making several recommendations, including on the new NMW rate. The Government's response included agreement to the new rates recommended by the LPC. These will come into effect from October 2008. **The adult rate of the NMW will increase to £5.73, the development rate for 18-21 year olds will increase to £4.77, and the youth rate for 16-17 year olds will increase to £3.53.**

Box 4.1: The tax credits system

The tax credits system is now working well, after some well-documented problems in the first year of operation. However the Government continues to look for opportunities to improve the experiences of the 6 million families benefiting from tax credits.

The 2005 Pre-Budget Report announced a package of improvements to the tax credits system. These were designed to provide more certainty around tax credit awards, while maintaining the flexibility to respond to falls in income and changes in circumstances. This has significantly improved the way in which the system operates, and the reforms are expected to reduce overpayments by around a third. In May 2008, HMRC will publish information on the 2006-07 finalised annual awards, which should therefore include a substantial fall in end-year adjustments leading to an overpayment.

Building on these reforms, and learning from the experiences of Australia and New Zealand, HMRC is improving its understanding of the needs and circumstances of the different people receiving tax credits. This is delivering real improvements. For example, when a household breaks up, HMRC now helps customers to make claims by telephone to ensure their payments continue.

HMRC has revised the Code of Practice used to decide whether to write-off an overpayment, in order to make decision-making more objective.

HMRC will also:

- **proactively contact vulnerable customers, during the 2008 renewals window, and offer them additional support to renew their claims. Where customers fail to renew in time and are still eligible, they will be helped to get back into payment quicker;**
- **roll out new services in November and December 2008 to make claiming tax credits easier and quicker. HMRC will also help customers keep their claims up to date to avoid overpayments, by proactively seeking information and making better use of the information already held;**
- **work with Children's Centres to pilot different ways and different locations for providing advice and services;**
- **by the end of 2008, introduce new ID authentication services to help reduce tax credits error and fraud**; and
- **support the introduction of these services with improved communications products**, to make sure that tax credit customers have the information they need, when they need it.

The Government is determined to build on these improvements and will be bringing forward further proposals by summer 2008.

Tackling the unemployment trap

4.13 The unemployment trap occurs when those without work find the difference between in-work and out-of-work incomes too small to provide an incentive to enter the labour market. Table 4.1 shows that, since the introduction of the NMW in April 1999, the Government has increased the minimum income that people can expect when moving into work, thereby reducing the unemployment trap.

Table 4.1: Weekly minimum income guarantees (MIGs)

	April 1999	October 2008	Percentage increase in real terms[2]
Family[1] with one child, full-time work	£182	£292	24%
Family[1] with one child, part-time work	£136	£229	30%
Single person, 25 or over, full-time work	£113	£189	30%
Couple, no children, 25 or over, full-time work	£117	£223	48%
Single disabled person in full-time work	£139	£235	31%
Single disabled person in part-time work	£109	£172	22%

Assumes the prevailing rate of NMW and that the family is eligible for Family Credit/Disability Working Allowance and Working Tax Credit/Child Tax Credit. Full-time work is assumed to be 35 hours. Part-time work is assumed to be 16 hours.
[1]Applies to lone parent families and couples with children alike.
[2]RPI growth is taken from HM Treasury's economic forecasts.

Reform of Housing Benefit

4.14 Over 4 million low-income tenants receive help with the cost of their rent through Housing Benefit (HB). The Government has made administrative and structural improvements in recent years, which has helped local authorities halve the time taken to process claims since 2002. It is also continuing to test process improvements, for example through the "In and Out of Work" pilots currently being tested in six local authority areas. And **the Local Housing Allowance (LHA), which replaces the current support for private sector tenancies with a flat rate allowance based on family size and area, is being introduced nationally from April 2008.** Despite HB being available both in and out of work, it is still seen by some as a disincentive to work. Expenditure is also rising, even though the number of people claiming is forecast to remain static. As the LHA is introduced, **the Government will therefore undertake a comprehensive review of the working age HB system,** to look at its effectiveness, particularly in promoting work incentives, efficiency and fairness, and to ensure that it represents value for money for the taxpayer.

The poverty trap

4.15 The poverty trap occurs when those in work have limited incentives to move up the earnings ladder because it may leave them little better off. Marginal deduction rates (MDRs) measure the extent of the poverty trap by showing how much of each additional pound of gross earnings is lost through higher taxes and withdrawn benefits or tax credits. Table 4.2 shows the progress that has been made in reducing the number of families facing very high MDRs since before Budget 1998. The increase in the number of households facing MDRs of between 60 and 70 per cent is primarily due to the introduction of tax credits, which has extended financial support so that far more families benefit, including low-income working people without children.

Table 4.2: The effect of the Government's reforms on high marginal deduction rates

Marginal deduction rate[1]	Before Budget 1998	2008-09 system of tax and benefits
Over 100 per cent	5,000	0
Over 90 per cent	130,000	30,000
Over 80 per cent	300,000	150,000
Over 70 per cent	740,000	200,000
Over 60 per cent	760,000	1,875,000

[1] Marginal deduction rates are for working heads of non-pensioner families in receipt of income-related benefits or tax credits where at least one person works 16 hours or more a week, and the head of the family is not receiving pensioner or disability premia.

Note: Figures are cumulative. Before Budget 1998 figures based on 1997-98 estimates of caseload and take-up rates; estimates for the 2008-09 system of tax and benefits are based on tax credits caseloads in April 2007, and earlier data for housing and council tax benefits.

GIVING EVERYONE THE BEST START IN LIFE

Tackling child poverty

4.16 The number of children in poverty rose sharply in the 1980s and 1990s and in 1998-99 some 3.4 million children were in relative low-income poverty: the UK had the highest child poverty rate in Europe. In light of this, the Government set itself ambitious targets to eradicate child poverty by 2020 and halve it by 2010. Considerable progress has already been made: some 600,000 children have been lifted out of relative poverty since 1998-99 and absolute poverty has more than halved from 3.4 million to 1.6 million. Had the Government done nothing other than simply uprate the tax and benefit system, there would likely have been around 1.7 million more children in poverty than there are today.

4.17 Budget 2008 sets out the next steps, including measures to make significant further progress towards the target of halving child poverty by 2010:

- **increasing the first child rate of Child Benefit to £20 a week from April 2009,** reinforcing the Government's commitment to Child Benefit as the foundation of financial support for all families;
- **increasing the child element of the Child Tax Credit by £50 a year above indexation from April 2009** to further help low to middle income families; and
- **disregarding Child Benefit in calculating income for Housing and Council Tax Benefit from October 2009,** improving work incentives for many of the lowest paid families and boosting their incomes. A working family with one child on the lowest incomes will gain up to £17 a week from this change.

4.18 Together these changes will lift up to a further 250,000 children out of poverty. Including the reforms announced in Budget 2007 and the 2007 Pre-Budget Report and Comprehensive Spending Review, measures announced in the last year will lift a total of over 500,000 children out of poverty.

4.19 To eradicate child poverty by 2020 requires a renewed drive on child poverty for the next decade. This needs to draw on new ideas and approaches to ensure sustainable progress is made, improving children's life chances for the longer term. *Ending child poverty: everybody's business*, published alongside the Budget, sets out the new approach the Government will pilot and further areas of work that will help develop the strategy for 2020. These new pilots will look at new approaches to increasing parental employment and raising incomes, to tackling deprivation in communities and to improving poor children's life chances. **The Government is therefore investing an additional £10 million in 2008-09, £35 million in 2009-10 and £80 million in 2010-11 across the UK to prepare for the next decade.**

4.20 The Government cannot achieve these objectives alone. Ending child poverty requires a sustained national, regional and local effort involving devolved administrations, across all agencies, service providers and professionals and including communities and business. Families need to be active participants in this process. *Ending child poverty: everybody's business* sets out the beginnings of a contract out of poverty: a pledge that all parts of society will do their bit to tackle this blight on children, communities and future prosperity. The Government is looking to families to make a commitment to improve their situations where they can and to take advantage of the opportunities on offer, for example by taking a job.

4.21 While good progress has been made nationally, child poverty in London has fallen by less than elsewhere in the UK. In recognition of this, **the Government is asking delivery agencies in London to identify better ways of working together to tackle child poverty and increase parental employment in the capital.** Stephen Timms, the Minister of State for Employment and Welfare Reform, will lead this work jointly with Beverley Hughes, the Minister for State for Children, Young People and Families. This will take forward specific recommendations from the London Child Poverty Commission's final report and support the strategic work of the London Skills and Employment Board.

A FAIR AND INCLUSIVE SOCIETY

Promoting saving, financial capability and inclusion

4.22 The Government seeks to support saving and asset ownership for all – from childhood, through working life and into retirement. The key challenges are to: equip people with the capability to make savings decisions; promote access to good savings opportunities; and make incentives to save more effective.

Saving Gateway

4.23 The Saving Gateway was first proposed in 2001 to explore matching (a government contribution for each pound saved) as an incentive to save for those on lower incomes. Two pilots have taken place confirming the success of matching as a saving incentive and the financial inclusion benefits of the scheme. As set out in Box 4.2, **the Government announces that the Saving Gateway will be introduced nationally with the first accounts available to savers in 2010.**

Box 4.2: The Saving Gateway

The Saving Gateway is a cash saving scheme for those on lower incomes. Following the success of the pilots in promoting saving and financial inclusion, **the Saving Gateway will be introduced nationally, with the first accounts available to savers in 2010.** Individuals in receipt of the following benefits and tax credits will be entitled to open an account: Working Tax Credits; Child Tax Credits paid at the maximum rate; Income Support; Jobseeker's Allowance; Incapacity Benefit; Employment and Support Allowance and Severe Disablement Allowance.

Accounts will be offered by financial institutions such as banks and building societies and will run for two years. At the end of the accounts, the Government will match (a contribution for each pound saved) money which people save into their Saving Gateway accounts. Third sector organisations such as credit unions, social housing providers and the Citizens Advice Bureau have expressed interest in providing information and support on the scheme. **A consultation document, *The Saving Gateway: operating a national scheme*, is published alongside Budget 2008.**

Child Trust Fund

4.24 The Child Trust Fund (CTF) was introduced in 2005 and will ensure that, in future, all young people have a financial asset at age 18. All newborn children receive a government contribution of £250 (£500 for children in lower income families), to be invested in a long-term savings or investment account. Government contributions will also be made to all children at age 7, and looked-after children will receive additional payments. Following consultation, and as outlined in Chapter 3, **the Government announces that, from April 2009, the requirement for providers to receive the CTF voucher from parents before opening an account will become voluntary rather than mandatory.** This will reduce administrative burdens and is designed to increase the number of accounts opened by parents.

Individual Savings Accounts

4.25 Individual Savings Accounts (ISAs) have been successful in developing and extending the saving habit and ensuring a fairer distribution of tax relief. As announced in Budget 2007, **from April 2008 ISAs will be simpler and more flexible.** The annual ISA allowance will rise to £7,200, up to £3,600 of which can be saved in cash with one provider. The remainder can be invested in stocks and shares with either the same or another provider. Savers will also be able to transfer money saved in cash ISAs into stocks and shares ISAs, and all Personal Equity Plans will automatically become stocks and shares ISAs.

Financial capability

4.26 Many consumers are not confident in making decisions about their money. The Government launched an independent review, led by Otto Thoresen, to develop a national approach to providing independent and preventative guidance on financial matters, tailored to an individual's specific needs. The final report, published on 3 March 2008, sets out a blueprint for a new service providing "Money Guidance". **The Government welcomed the review's final report and has announced that it will implement the central recommendation to launch a £12 million Money Guidance "pathfinder" scheme, in partnership with the Financial Services Authority.** The Government will provide further detail in its financial capability action plan later in the spring.

Financial inclusion

4.27 Financial inclusion is about ensuring everyone has the opportunity to access the financial services products needed to participate fully in modern-day society and the economy. On 6 December 2007, the Government set out its plans for the £130 million Financial Inclusion Fund over the next spending period. **The Government will announce new terms of reference for the Financial Inclusion Taskforce in 2008-11 and appoint new members to the Financial Inclusion Taskforce shortly.**

Supporting people in later life

4.28 The Government is committed to tackling pensioner poverty, promoting greater well-being in later life, encouraging and rewarding saving, and enabling people to meet their income aspirations in retirement.

Support for pensioners

4.29 Pensioners are now no more likely to be in poverty than the population as a whole. Since 1997, the Government has increased support for pensioners in line with the principle of progressive universalism – support for all with more for those who need it most. Over £11 billion more is being spent on pensioners in 2008-09 compared with 1997 policies, with half the extra spending going to the poorest third of pensioners. These policies have contributed to a three quarters fall in the number of pensioners living in absolute poverty since 1997 to 0.8 million, and the number in relative poverty has fallen by over one-third to 1.8 million. To benefit pensioners, the Government has:

- guaranteed that increases in the basic State Pension will be in line with the Retail Price Index or 2.5 per cent (whichever is higher);
- introduced Winter Fuel Payments and committed to pay them at their current rates (£200 for households with someone over 60, £300 if over 80) for the lifetime of this Parliament. Alongside the Winter Fuel Payments, **Budget 2008 announces an additional one-off payment of £100 to over-80s households and £50 to over-60s households in 2008-09;**
- introduced free television licences for the over 75s, free eye tests and local bus travel for the over 60s. Budget 2006 announced **free off-peak bus travel in England for the over 60s and disabled from April 2008;** and
- increased the age-related allowances to support pensioners who pay tax. **In April 2008, the age-related personal allowances will rise by £1,180 above indexation,** so that by April 2009 only 41 per cent of pensioners aged 65 or over will pay income tax.

Pension Credit

4.30 Pension Credit was introduced in 2003 to provide security in retirement through a minimum guaranteed income (worth £124 per week in 2008-09), while rewarding households who have made provision for their retirement. In December 2007, a package of measures was announced to simplify the claims process of income-related benefits for pensioners, including greater automation of HB and Council Tax Benefit applications for those eligible for Pension Credit, benefiting around 50,000 pensioners by 2010.

Encouraging retirement saving

4.31 The Government is committed to encouraging individuals to save for their retirement. The state pension reforms already legislated for, including the restoration of the earnings link to the basic State Pension, will provide a simpler and more generous state pension. **The Government recently announced it would further simplify the complex system of accruals for the State Second Pension for those reaching State Pension Age from 2020.** These changes will support the reforms to private pension saving in the Pensions Bill.

Incentives to save

4.32 The reforms will mean that the large majority can expect to benefit in their retirement from having saved. The Department for Work and Pensions is developing an information strategy to ensure that those auto-enrolled have the information they need, should they wish to consider whether to opt-out, and has recently set up a work programme to build a shared understanding around incentives to save in the context of pension reforms.

Pensions tax simplification

4.33 The Government provides generous tax reliefs to encourage and support pension saving, estimated to be worth £17.5 billion in 2007-08. In return, individuals are required to secure an income in retirement. As an exception, the Government allows individuals with "trivial" pension funds – that may not be economic for individuals or providers to turn into a pension – to be taken as a lump sum. **Following consultation, the Government announces changes to ease the administration of making certain trivial commutation payments and to help tackle the issue of small stranded pension pots.**

Helping vulnerable households heat their homes

4.34 The Government's Fuel Poverty Progress Report published in December 2007 outlines measures already in place to help tackle fuel poverty, including increasing energy efficiency. The Government believes further action is now needed to help vulnerable groups deal with rising energy prices. The Government welcomes the steps the energy companies have already taken to help vulnerable customers cope with higher prices. There is common agreement on the need to do more. Energy companies currently spend around £50 million a year on social tariffs; the Government would like to see that figure rising over the period ahead to at least £150 million a year. **Acting with the companies and Ofgem, the Government will draw up a plan for voluntary and statutory action to achieve that. To underpin this as necessary, the Government will legislate to require companies to make a fair contribution.**

4.35 Customers using prepayment meters typically pay around £55 more on their energy bill compared to standard credit, and £144 compared to direct debit. These differentials have increased since the Energy White Paper. It is not clear whether these simply reflect extra costs to the energy companies nor whether pre-payment customers are being given enugh information on the availability of other tariffs. The Government believes that the time is now right to tackle this issue and is looking to Ofgem and the suppliers to bring forward proposals for treating prepayment customers more fairly. However, if sufficient progress is not made by next winter, the Secretary of State for Business, Enterprise and Regulatory Reform is prepared to use his statutory powers with a view to reducing the differential between prepayment and other forms of payment.

Promoting equality and fairness for all

Equalities

4.36 The Government remains committed to reducing inequality in Britain. It believes that people should be treated equally and have the opportunity to progress in life irrespective of age, gender, race, disability, sexual orientation or religion/belief. To help make this vision a reality for Britain, the Government will publish its first Equality Strategy in the spring. This will focus on key areas such as education, employment, health and the criminal justice system. It will describe how the Government will measure the barriers to progress experienced by different groups in fulfilling their aspirations and potential. The Government has also committed to introducing a new Equality Bill by the end of this Parliament. This will bring together, modernise and strengthen the existing legislation prohibiting discrimination and promoting equality in Great Britain. Moreover, around a third of public spending goes on purchasing goods and services. **The Government will shortly publish a practical guide to demonstrate how social issues can be addressed in public procurement.**

A MODERN AND FAIR TAX SYSTEM

Modernising the tax system

4.37 A modern and fair tax system encourages work and saving, responds to business developments and globalisation, supports the provision of world-class public services and ensures that everyone makes a fair contribution.

Income tax and NICs

4.38 As announced at Budget 2007, **the Government will simplify the personal tax system by removing the 10 pence starting rate and cutting the basic rate of income tax from 22 pence to 20 pence from April 2008.** The Government will maintain the existing 10 pence rate for savings income. **There are no changes to the main rates for taxing dividends.** The 10 pence savings rate and the 20 pence basic rate bands will be raised in line with inflation.

4.39 The 2007 Pre-Budget Report confirmed that **the upper earnings and profits limits for national insurance will rise by £100 a week in April 2008, and from April 2009 they will be aligned with the increased level at which taxpayers begin to pay the 40 pence rate of income tax.** By 2009, the UK's tax and national insurance system will have the lowest basic rate of tax for over 75 years, and one of the simplest personal tax structures of any developed country.

4.40 To improve the present separate systems for collecting Class 2 and 4 national insurance contributions (NICs) from the self-employed, **the Government is publishing a consultation document, *Improving the collection of National Insurance Contributions from the self-employed*, alongside Budget 2008.**

Capital gains tax

4.41 A major reform of the capital gains tax (CGT) regime will deliver a system that is more sustainable and straightforward for taxpayers, while remaining internationally competitive. Reform will replace layers of complex legislation built up over many decades with an easy-to-understand personal allowance, a single headline rate of tax and a focused tax relief for entrepreneurs. This remains in line with the Government's objectives to support business and enterprise and to keep the tax system as simple and as fair as possible.

4.42 As announced at the 2007 Pre-Budget Report, **for disposals on or after 6 April 2008, CGT will be set at 18 per cent.** In addition, as announced on 24 January 2008, **a new entrepreneurs' relief will also be available on the disposal of a trading business or shares in a trading company,** provided the seller is an officer or employee of the company and has a minimum 5 per cent stake in the business. This will reduce the effective tax rate to 10 per cent for up to the first £1 million of gains made over a lifetime. Budget 2008 confirms that **the tax-free annual exempt amount for 2008-09 will rise to £9,600,** ensuring that individuals with gains below this amount in this year are not brought into tax. The Government will continue to monitor the CGT regime for any signs of avoidance or abuse and will not hesitate to act should such activity come to light. The Government does not see the need for any change to the taxation of life insurance bonds as a result of CGT reform.

Box 4.3: Residence and domicile consultation

The package of changes to the rules on residence and domicile announced in the 2007 Pre-Budget Report was intended to strike the right balance between fairness and competitiveness. The special remittance basis rules, which help to attract international talent and investment, are important to UK competitiveness, but can only be sustainable in the longer term if they are fair. It is right that people who decide to make their home in this country should pay their fair share of tax.

Having consulted on these proposals, **the Government intends to implement the following changes from April 2008:**

- **the special remittance basis of taxation will continue for non-domiciled UK residents;**
- **adults using the remittance basis of tax, who have been resident in the UK for longer than 7 out of the past 10 tax years, will be subject to an annual tax charge of £30,000 a year as regards the foreign income and gains they leave outside the UK, unless their unremitted foreign income and gains are less than £2,000 a year.** This means that adults who continue to benefit from the special remittance basis rules after 7 years in this country will make an additional contribution through the charge;
- **people using the remittance basis of taxation will no longer be entitled to personal allowances, unless they have unremitted foreign income and gains of less than £2,000 a year**. This means that people in this group will have a choice between tax free allowances (on the same basis as other UK taxpayers) or enjoying the special remittance basis rules which keep the foreign income and gains that they leave abroad outside the UK tax system;
- **the residence rules will be changed so that any day when a person spends midnight in the UK counts towards establishing UK residence**. This means that residents cannot opt out of paying their fair contribution by saying they are not resident in the UK; and
- **loopholes and anomalies in the remittance basis rules will be removed,** to ensure that the remittance basis works as originally intended and can no longer be used as a vehicle for avoiding UK tax. Income and gains of offshore trusts will be taxed only when they are remitted to the UK, even if these relate to UK assets.

The Government is grateful to all those who took part in the consultation and has addressed their concerns in finalising the changes, including about art.

The Government has decided that there is no case for considering further changes to increase the contribution of non-domiciles. Therefore the changes announced above mark the end of the residence and domicile review and offer a package of reforms that will both protect UK competitiveness and deliver greater fairness. They will not be revisited for the rest of this Parliament or the next.

Dividend tax credit

4.43 Budget 2007 announced a simplification of the tax system for UK individuals with foreign shares. From April 2008, the non-payable dividend tax credit will be extended to dividends from non-UK resident companies, provided the investor owns less than a 10 per cent shareholding. **Budget 2008 announces that, from April 2009, the non-payable dividend tax credit will be further extended to investors with a 10 per cent or greater shareholding in a non-UK resident company,** unless the source country does not levy a tax on corporate profits similar to corporation tax.

Gambling industry

4.44 Budget 2008 announces changes to gambling duties:

- **from 4pm on 14 March 2008, all rates of amusement machine licence duty (AMLD) will increase in line with inflation;** and
- **gaming duty bands will increase in line with inflation for accounting periods starting on or after 1 April 2008.**

4.45 The Government will continue to consider the case for moving to a Gross Profits Tax for the lottery and will announce its plans at Pre-Budget Report 2008.

Alcohol

4.46 As incomes have risen, alcohol has become increasingly more affordable. **A 6 per cent increase in all alcohol duty rates will come into effect on 17 March 2008.** This will add 4 pence to the price of a pint of beer, 55 pence to the price of a bottle of spirits and 14 pence to the price of a bottle of wine. In order to ensure that alcohol duties keep pace with rising incomes, **alcohol duty rates will increase by 2 per cent above the rate of inflation in future years.**

Tobacco

4.47 Maintaining high levels of tax on tobacco helps to reduce overall tobacco consumption. Therefore **Budget 2008 announces that, from 6pm on 12 March 2008, tobacco duties will increase in line with inflation,** adding 11 pence to the price of a packet of cigarettes.

VAT on smoking cessation products

4.48 The rate of VAT on smoking cessation products was reduced to 5 per cent on 1 July 2007. Since then retail prices of these items have dropped while sales have increased. To further support the Government's objective to reduce smoking prevalence, **this reduced rate will be continued beyond its original expiry date of 30 June 2008.**

Tobacco smuggling

4.49 To reinforce its efforts to prevent the supply of cheap illicit tobacco, **the Government announces that the UK Border Agency will develop a comprehensive strategy to exert further downward pressure on the volume of tobacco smuggling, with the intention that the agency will publish the strategy by the time of the 2008 Pre-Budget Report.**

Tax regime for trusts

4.50 Finance Act 2006 brought certain trusts into the mainstream inheritance tax regime for discretionary trusts, with a two-year transitional period for trusts set up before 22 March 2006. Following representations, **Finance Bill 2008 will clarify the position where a transitional serial interest is created for the same beneficiary within the transitional period.** This will ensure that the legislation delivers the original policy intention. In addition, in order to allow time for trustees to take account of this, **the transitional period will be extended by six months to 5 October 2008.**

VAT exemption for investment management

4.51 Following a ruling by the European Court of Justice, **the Government will extend the current VAT exemption for investment management to all collective investment funds available for direct investment by the general public, from 1 October 2008.**

Sale of lessors legislation

4.52 There are some circumstances where the sale of lessors legislation may not be working as expected and commercially driven transactions may be adversely affected. **The Government will consider this issue and make an announcement as soon as possible.**

Transfer to or from trading stock

4.53 **The Government will legislate existing law and practice for a transfer to or from trading stock which is not made in the course of trade.** In computing the profits of the trade, the transfer is treated as made at market value.

VAT: staff hire concession

4.54 **The staff hire concession, which currently allows employment businesses to charge VAT solely on the margin on their supplies, will be withdrawn by HMRC with effect from 1 April 2009.**

Further modernisation

4.55 As set out in Chapter A, the Government is making further changes to the tax system in the areas of:

- small and medium-size enterprise research and development tax credits and vaccines research relief, to obtain state aid approval;
- satisfying tax repayment claims where the tax was originally in the form of funding bonds; and
- pension schemes.

Modernising tax administration

4.56 A modern and efficient tax administration benefits the Government, taxpayers and businesses. New measures will further modernise HMRC, improve compliance and make it as easy as possible for those who want to pay the right amount of tax.

Taxpayers' charter

4.57 The Government is committed to ensuring that the tax system is useable and accessible for all taxpayers. A taxpayers' charter could play an important role in that relationship, setting out both rights and responsibilities in a single accessible document. The Government announced the start of work to develop a charter on 10 January 2008. **HMRC will launch a consultation with interested parties and directly with members of the public on the development of a taxpayers' charter.**

Review of HMRC powers, deterrents and safeguards

4.58 HMRC's review of powers, deterrents and safeguards is designed to provide greater consistency across taxes, a modern framework of law and practice for HMRC and strong safeguards for taxpayers. It aims to improve HMRC's effectiveness and reduce costs for compliant taxpayers by supporting those who seek to comply, while coming down harder on those who seek to avoid their responsibilities. Budget 2008 announces:

- **further modernisation and alignment of penalties, by extending a common approach to incorrect tax returns to all taxes and duties. A single framework of penalties for failing to notify a new taxable activity will also be introduced;**
- **a modernised approach to compliance checks and assessing errors across income tax, CGT, corporation tax, PAYE, VAT and NICs,** to provide better clarity and consistency and to allow flexible approaches that respond to the taxpayer's circumstances; and
- **changes to make it easier for taxpayers to pay what they owe on time and to support HMRC in effectively tackling those who pay late.** These involve accepting payment by credit card, setting off repayments of one tax against the debts of another, and aligning and modernising HMRC's civil debt enforcement powers.

Future consultations

4.59 The Government will continue to seek ways of improving tax administration, including modernising powers and taxpayer safeguards. **Budget 2008 announces future consultations in 2008 on:**

- **modernising and aligning penalties for late filing of tax returns and late payment of tax;** and
- **harmonising and simplifying the rules on interest on tax paid late and on repayments of tax overpaid.**

Tribunal reform **4.60** Following consultation, **the Government announces a streamlined and more consistent process across taxes for reviewing decisions and handling appeals before they come before a tribunal.** This will complement wider tribunal reform.

Amendments to HMRC powers **4.61** In addition to the above, the Government announces further amendments:

- **legislating to allow HMRC to waive interest and surcharges for those affected by the floods in summer 2007 and any future designated national disaster;**
- **providing powers to legislate, by Treasury Order, existing HMRC concessions in secondary legislation.** These powers are designed to provide an efficient way to legislate and so preserve, where appropriate, tax treatment currently allowed by existing concessions; and
- **clarifying powers under the Customs and Excise Management Act 1979 concerning the opening of containers and baggage for customs examination.**

Protecting tax revenues

4.62 Protecting tax revenues against fraud and artificial avoidance schemes is essential if the tax system is to support the Government's objectives. The vast majority of taxpayers seek to contribute their fair share towards funding public services. However the minority who do not put pressure on the public finances and impose costs on others, that undermine fairness and economic performance. The Government will also continue to defend the tax system robustly against legal challenges under EU law.

Strategy to protect tax revenues **4.63** The Government is committed to supporting those who want to comply and to deterring and challenging those who attempt to pay less than their fair share. The comprehensive action it has taken has already reduced underpayments of tax, as well as reducing costs for compliant tax payers. ***Protecting Tax Revenues*, published by HMRC alongside the Budget, sets out the progress made so far and how HMRC is responding to new challenges by further strengthening its strategy.**

Disclosure regime **4.64** The disclosure regime, introduced at Budget 2004, allows the Government to respond to avoidance swiftly and in a targeted fashion. Following announcements at the 2007 Pre-Budget Report and subsequent consultations, **the Government will legislate in Finance Bill 2008 to improve the existing system of identifying users of disclosed tax avoidance schemes, and will legislate later in 2008 to extend the stamp duty land tax (SDLT) disclosure rules to residential property worth £1 million or above. A formal response to this aspect of the consultation will be published in due course,** including the timetable for consulting on and introducing secondary legislation.

Tackling avoidance **4.65** The Government announces measures to address a number of avoidance schemes, many of which have been identified through the disclosure regime:

- **ending of the use of artificial arrangements by individuals to create trading losses to offset against other income through sideways loss relief;**
- **closure of a number of highly artificial avoidance schemes involving partnerships and trusts that seek to avoid a charge under the controlled foreign companies rules;**
- **measures to counter attempts to sell, and accelerate the availability of, capital allowances on plant or machinery;**

- **clarification that the application of the related party rules in the corporate intangible assets regime is unaffected by any insolvency arrangements in which any company or partnership may be involved;**

- **clarification of legislation relating to employment-related shares and securities,** to ensure rules to prevent double taxation are not exploited to reduce the amount of tax and national insurance paid on employment income;

- **confirmation that a company's relief on its pension contributions in a given year are limited to the actual contributions it has made in that year;**

- **clarification of SDLT anti-avoidance provisions introduced in Finance Act 2008,** to tackle SDLT avoidance which exploited legislation intended to help the transfer of property between different partners within an investment partnership; and

- **measures to counter two schemes designed to avoid payment of SDLT.** The first scheme misuses provisions intended to help financial institutions using alternative finance schemes. The second scheme misuses provisions to allow group relief from SDLT.

4.66 The Government is taking further action to close avoidance schemes identified since the 2007 Pre-Budget Report, by legislating:

- **to counter avoidance involving head leases and sub-leases of plant or machinery and the granting of leases for premium and similar arrangements,** as announced on 13 December 2007;

- **to prevent individuals obtaining tax relief for manufactured payments made as part of arrangements that intend to avoid tax,** as announced on 31 January 2008; and

- **to disallow the expenses of managing an investment business as a deduction against a company's ring-fence oil and gas profits.**

Modernising approaches to anti-avoidance

4.67 The Government is committed to modernising approaches to anti-avoidance where appropriate. The Government announces that it will:

- **continue to consult on a principles-based approach to financial products avoidance, with the intention of legislating in Finance Bill 2009. In the meantime, the Government will introduce targeted legislation in Finance Bill 2008 to counter known avoidance schemes involving both disguised interest and the transfer of income streams;** and

- **repeal outdated and complex anti-avoidance provisions and scrutinise the extent to which certain legislation might be repealed or redrafted in simpler ways,** as part of the anti-avoidance simplification review.

Double taxation treaties

4.68 **The Government announces, with retrospective effect from 12 March 2008, clarification of indefinitely retrospective legislation introduced in 1987 to counter double taxation treaty avoidance schemes,** so that the legislation applies as intended and is effective. This will ensure that, notwithstanding the wording of any double taxation treaty, UK residents pay UK tax on their profits from foreign partnerships. **Budget 2008 announces there will also be a further measure to prevent future tax avoidance through the misuse of double taxation treaties by UK residents.**

Income shifting

4.69 The Government firmly believes it is unfair that some individuals can arrange their affairs to gain a tax advantage by shifting part of their income to another person who is subject to a lower rate of tax. **The Government considered the responses received to the recent consultation and believes that a further period of consultation will ensure that the legislation in this area provides clarity and certainty for businesses and their advisers. The Government now intends to introduce legislation through Finance Bill 2009 and will not enact legislation effective from 6 April 2008.**

Travel expenses for temporary workers

4.70 The Government is concerned at the growing use of structures, such as "umbrella companies" or overarching contracts of employment with employment businesses, to obtain tax relief for travel expenses that would not be available to other workers. It will monitor the use of these structures and, if necessary, consider action in the future.

VED refunds

4.71 **Budget 2008 announces that vehicle excise duty (VED) refunds will be restricted to the registered keeper of a vehicle and applicable only when a vehicle has: been stolen, destroyed, sold or otherwise disposed of; become eligible for a nil licence; been declared as statutorily off-the-road; or been permanently exported.** This will help ensure that motorists cannot avoid paying a pre-announced rate of VED.

VAT repayment claims

4.72 **The Government will provide a transitional period to 1 April 2009, during which businesses can make VAT repayment claims for rights that accrued before the introduction of the three-year cap in 1996 and 1997. HMRC's powers of assessment will also be amended to ensure that assessments may be made to recover any amounts paid during the transitional period, which are subsequently found to have been incorrectly paid.**

5 STRONGER COMMUNITIES AND EFFECTIVE PUBLIC SERVICES

The Government's aim is to deliver world-class public services through sustained investment matched by reform, supporting strong and sustainable communities and a better quality of life. The Government is supporting schools and wider children's services to raise attainment for all pupils, is bringing forward a package of measures to help respond to short-term and long-term housing challenges and is supporting the third sector with a package of measures to enhance Gift Aid. The Budget announces:

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

5.1 Over the last ten years investment coupled with reform has generated real improvements in public services. This chapter sets out how the Government will build on these improvements already made in delivering efficient and effective public services. This chapter also sets out steps to increase housing supply and support home ownership, at the same time as responding to the increased uncertainty of current short-term market conditions. Finally this chapter sets out new investment to improve results in schools and new support for the third sector.

DELIVERING EFFICIENT AND EFFECTIVE PUBLIC SERVICES

Investment in priorities

5.2 In June 1997 the Government launched the first Comprehensive Spending Review (CSR), to focus resources on priority areas such as health, education and transport. Building on the platform of stability provided by the Government's fiscal framework, the 1998 CSR and subsequent Spending Reviews have delivered sustained increases in spending for public services, so that since 1997:

- spending on the National Health Service (NHS) has almost doubled in real terms;
- total spending on education is nearly 60 per cent higher in real terms and as a proportion of GDP has risen from 4.5 to 5.4 per cent in 2007-08, and is set to rise to 5.6 per cent by 2010-11;
- public expenditure on transport is 90 per cent higher in real terms;
- spending on public order and safety has increased by over 50 per cent in real terms; and
- grant to local government will have increased by 45 per cent in real terms by 2010-11.

Improvements in services

5.3 Matching this growth in spending with ambitious reforms the Government has been able to achieve major improvements across frontline services. For example:

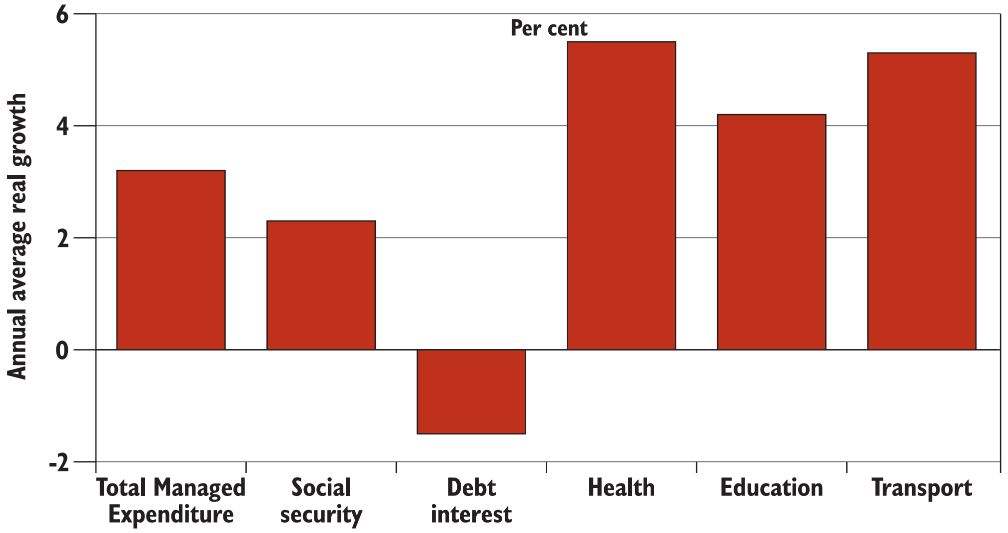
- investment in the NHS has helped reduce those experiencing inpatient waiting times of over 6 months from 284,000 in 1997 to virtually zero in 2007-08;
- in education, over 60 per cent of 15 year-olds in 2006-07 achieve five or more good GCSEs or equivalent, up from 45 per cent in 1997;
- nearly 650,000 registered childcare places have been created since 1997;
- overall crime rates in England and Wales fell by 32 per cent and total violent crime fell by 31 per cent between 1997 and 2006-07;[1] and
- the transport system continues to improve with over 100 road schemes completed and more rail journeys being made than at anytime since the 1960s.

5.4 This step-change in resources and outcomes has been made possible by:

- a fiscal framework that ensures sound public finances and protects investment;
- stable and sustainable economic growth with low unemployment and debt interest, releasing resources for priorities;
- clear outcome-based Public Service Agreements (PSAs) that set out what will be achieved with increased resources;
- ambitious efficiency savings, with over £20 billion of savings delivered in SR04 and £30 billion planned over CSR07 period; and
- asset disposals and spectrum auctions which have raised £82 billion to reduce debt and fund improvements in UK infrastructure since 1997.

[1] *Crime in England and Wales 2006-07*, Home Office, July 2007.

Chart 5.1: Releasing resources for priorities – annual average real growth rates, 1997-98 to 2010-11



Source: HM Treasury.

CSR spending plans

5.5 The 2007 CSR announced spending plans and ambitious savings for the three years to 2010-11, continuing sustained real increases in public spending and focusing resources on frontline public services. Public sector net investment will reach 2¼ per cent of GDP over CSR07 period and total public spending will grow at 2.2 per cent per year in real terms funding:

- continued sustained investment in the NHS, with an average real increase in resources of 4 per cent per year;
- further sustained increases in resources for education, science, transport, local government, housing, child poverty, security and international development; and
- major capital projects such as the 2012 Olympic Games and Paralympic Games and Crossrail.

5.6 By 2011 the Government will have delivered the longest sustained real increase in public spending since 1945. The Budget re-affirms the Government's commitment to continued real terms growth in spending and to further improved value for money across the whole of the public sector, releasing resources to frontline services. The Budget's fiscal forecast assumes total spending growing at a sustainable and prudent rate of 1.9 per cent year in real terms over 2011-12 and 2012-13 with public sector net investment remaining at 2¼ per cent of GDP.

Efficiency, value for money and delivery

Public Service Agreements

5.7 Clear priorities, strong accountability and effective performance management are fundamental to ensuring that increased resources result in higher standards across public services. From April 2008, the Government will work with delivery partners and across departmental boundaries to deliver the Government's priority outcomes for the CSR07 period – set out in 30 new Public Service Agreements (PSAs) announced at the 2007 CSR. The new performance management framework creates the conditions for more innovative and responsive public services, excellent outcomes for all, and greater value for money.

Gershon Efficiency Programme

5.8 As part of the 2004 Spending Review the Government set stretching efficiency targets for departments and the wider public sector. The Government can announce that departments and local authorities have now reported delivery of over £23 billion efficiency savings – including over £8 billion from procurement and £1 billion from the back office – and over 77,600 net workforce reductions, as well as over 12,600 reallocations to the front line. In addition, departments continue to make strong progress towards the 2010 Lyons relocation target, with over 15,700 posts relocated.[2]

5.9 These figures are not yet all finalised but indicate continued strong delivery of the Government's efficiency ambitions, with headline efficiency and workforce reduction figures already in excess of the Government's own targets.

Value for money in the CSR

5.10 This strong focus on efficiency and value for money will continue as the Government prepares to deliver an additional £30 billion of net, cash-releasing savings over the CSR07 period. Departments have already set out their value for money targets and how and where they will make these savings in published Vfm Delivery Agreements. To build in extra scrutiny the National Audit Office will review departmental value for money savings during the CSR07 period.

Value for money post-CSR

5.11 In order to build on the success of the Gershon Review and the 2007 CSR, the Government will begin work now to inform the value for money framework in the post-CSR period, and will set out its framework at Budget 2009 (see Box 5.1).

[2]For further details see *2004 Spending Review: efficiency progress to December 2007*, HM Treasury, March 2008

Box 5.1: Driving further value for money across government

The Government will match investment in public services with reform and a constant effort to improve value for money. The Government's approach in the current spending period has been to implement the recommendations made by Sir Peter Gershon to inform the 2004 Spending Review. In the most comprehensive and wide-ranging efficiency programme ever attempted, departments have now reported savings of over £23 billion for the SR04 period. The Government will build on this success and strengthen its approach in the CSR07 period. All departments have now published plans which will deliver another £30 billion of savings by 2010-11.

In order to maintain the pace of reform and prepare the ground for the post-CSR period, the Government will:

- **Achieve significant further operational savings in the post-CSR period, building on the 5 per cent real annual reductions in administration budgets across all departments, which will reduce the running costs of central government to a record low as a percentage of public spending, and the £30 billion of savings to be delivered during the CSR07 period. The Government intends to maintain a firm discipline on back-office costs and administration, and to ensure that efforts to drive efficiency in the public services keep pace with developments in the private sector. The Government will announce more detailed plans for taking this forward before the summer, including how the Government will incorporate knowledge and expertise from the private sector in its analysis. The Government will set out at Budget 2009 what level of savings will be delivered.**
- **Alongside this, the Budget launches the Public Value Programme. Major improvements in value for money depend not only on a firm discipline on back-office costs, but also on a continual effort to find smarter ways of doing business and in taking wider policy decisions. The Programme will therefore look at all major areas of public spending to identify where there is scope to improve value for money and value for money incentives. Initial areas already identified for investigation include road-building, commissioning in the health sector, regeneration spending, value for money incentives in public sector budgeting frameworks, and the way in which major public sector IT projects are run and accounted for.**

Both of these areas of work will inform the Government's framework for value for money in the post-CSR spending period, which will be set out in Budget 2009.

Value for money in benefit spending

5.12 Alongside the continuing focus on public service efficiency set out above, the Government will explore ways of improving the working age benefit system to increase work incentives and deliver value for money for the taxpayer. Chapter 4 sets out the Government's ambitious agenda of welfare reform, including the announcement in the Budget of the extension of the Work Capability Assessment to all Incapacity Benefit claimants and a review of Housing Benefit.

Public sector pay

5.13 Since 1997 the public sector has recruited 36,000 more teachers, 79,000 more nurses and 36,000 more doctors. The competitiveness of the overall public sector reward package, which includes valuable pension benefits, is demonstrated by healthy levels of recruitment and retention, with record levels of front line staff. To ensure this continues, the Government will seek to maintain the necessary levels of recruitment and retention to support service delivery while continuing to ensure affordability, value for money and consistency with the achievement of the Government's inflation target of 2 per cent. The Government will seek to agree multi-year pay awards during the CSR07 period, where appropriate, as a means of locking in economic stability and providing greater certainty for departments and public sector staff, facilitating long-term strategic decision making.

Asset management and sales

5.14 The Government is committed to managing the stock of public assets to deliver optimal results for society and the economy. Following the 2007 CSR, departments are publishing asset management strategies setting out how they will deliver best value from their assets. To support the introduction of asset management strategies the **Treasury and Shareholder Executive will undertake an assessment of the governance, business plans and future development strategies of each of the trading funds and a selection of public corporations** (excluding those already subject to central government review).

5.15 An important part of asset management is the identification of opportunities to release assets that are surplus to Government's requirements or, where public policy goals can be maintained, assets that can be better managed in, or are otherwise value for money to sell to, the private sector. The Government is on track to deliver its target to dispose of £30 billion of surplus fixed assets between 2004-05 and 2010-11, with sales of £18.4 billion already delivered. Progress has also been made on financial asset sales, including Westinghouse and British Energy shares totalling £6 billion, the appointment of financial advisers to execute the sale of student loans in 2008-09 and the announcement by the Department for Culture Media and Sport on 5 March of its intention to appoint financial advisers on the sale of the Tote.

Spectrum management

5.16 As broadcast media and mobile technologies continue to grow in importance and diversity, efficient use of the electromagnetic spectrum to deliver the services that society demands remains an important issue for both the public and private sectors. In line with the Government's Forward Look on public sector spectrum, the Ministry of Defence will by May 2008 publish an implementation plan setting out its plans for the release of spectrum to the market. Other departments are adopting similar processes. To ensure best use of spectrum by the private sector, Ofcom has also confirmed that in contrast to some previous spectrum releases which were available for specific uses only (notably mobile telephone services) the spectrum released by digital switchover will be available for all technologies. The Government fully supports this decision.

FOCUSING RESOURCES ON PRIORITIES

Investing in Health

5.17 The NHS will celebrate its 60th birthday in 2008-09 with a budget of £96 billion, almost double in real terms its budget of a decade ago. This represents the largest sustained funding increase in NHS history. It has delivered 79,000 more nurses and 35,000 more doctors. It has enabled 149 new hospitals to open, or to be on their way to opening. Ten years ago half of the NHS estate was built before the NHS itself was established; this is now down to a fifth.

5.18 Investment combined with reform has delivered major improvements. In 1997 people were having to wait up to two years for a heart operation. In today's NHS, the number of heart operations has more than doubled and virtually no-one waits over three months. Long waits for inpatient treatment, commonplace in 1997, are now very rare. Over 280,000 people were waiting more than six months for an operation in 1997; in January 2008 this was down to under 100 people and the average wait is now under six weeks. By 2004 improvements in public health, along with better treatment for cancer and heart disease, had helped to increase life expectancy by 2.1 years for men and 1.4 years for women.

Sustained investment in education

5.19 Improving the life-chances of children and young people and enhancing services and support for families has been a priority for increased investment over the last decade with sustained increases in expenditure on education and wider children's services, with education spending in England rising by an average of 2.8 per cent per year in real terms between 2007-08 and 2010-11. Sustained investment, matched with reform, has focused on raising standards for all, with greater support for the most disadvantaged. This has resulted in almost all three and four year-olds benefiting from free early-years education and a significant increase in the number of young people continuing in education or training post-16.

5.20 The Government's *Children's Plan*,[3] published in December 2007, sets out a comprehensive strategy – in partnership with parents, children themselves, schools and wider children's services – for ensuring that every child is healthy, happy, safe and supported to achieve their potential.

Supporting and challenging under-attaining schools

5.21 The Government has made substantial progress since 1997 in raising school standards – with the number of schools where less than 30 per cent of pupils attain 5 A* to C at GCSE, including English and maths, falling from 1,610 in 1997 to 638 today.

5.22 However, this is still too many schools below this minimum benchmark of performance. While some schools below the 30 per cent level are already improving, with dedicated leaders and staff working to raise standards in challenging circumstances, others are failing to make the necessary progress.

5.23 Budget 2008 therefore announces that the Department for Children, Schools and Families will take forward **a £200 million package over the next three years, to raise the level of support and challenge for under-attaining schools, bringing forward by a year to 2011 the Government's ambition that there should be no schools with fewer than 30 per cent of pupils attaining 5 A* to C at GCSE, including English and maths.** By 2011, the Government will expect all schools to have achieved the benchmark or to be subject to formal intervention.

5.24 The new package will support rolling out the successful London Challenge model across the country; empowering more of the best head teachers to help turn around low attaining schools; creating new trusts and federations based on successful schools; and, in areas of greatest need, driving forward a faster expansion of the Academies programme. DCSF will publish a detailed strategy for delivering the Government's floor target ambition in summer 2008.

[3] *The Children's Plan: building brighter futures*, Department for Children, Schools and Families, December 2007.

Home security

5.25 The Criminal Justice System and security have also been a vital priority for the Government. Since 1997 spending on public order and safety has increased by over 50 per cent in real terms, whilst crime has fallen by about a third. In responding to global insecurity, the Government has more than doubled counter-terrorism spending compared with pre-September 2001 levels, and this is set to rise further from £2½ billion in 2007-08 to over £3½ billion by 2010-11.

5.26 The Government has made further ambitious commitments: to achieve full roll-out of neighbourhood policing by 1 April 2008, and give everyone access to one of the 3,600 neighbourhood policing teams across England and Wales. In parallel we will increase prison capacity by up to 15,000 places by 2014, adding to the 20,000 delivered since 1997. A Points Based Migration System will deliver comprehensive immigration reform ensuring that Britain continues to reap the economic benefits of migration, which contributes around 15 to 20 per cent of trend growth. Both the Home Office and Ministry of Justice are being resourced to meet these commitments. By 2010-11 Home Office spending will be £10.3 billion, whilst the Ministry of Justice's will rise to £9.9 billion.

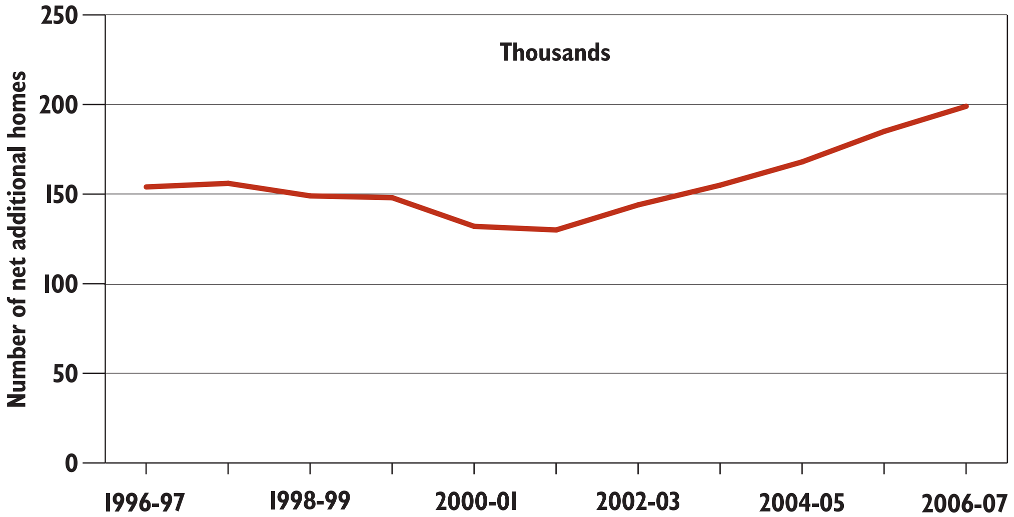
Defence and military operations

5.27 The CSR07 period will see the Ministry of Defence budget rise to £36.9 billion by 2010-11 representing 1.5 per cent average annual real growth over the three years to 2010-11. Taken together with the last three Spending Reviews, in 2000, 2002 and 2004, this represents a decade of sustained real growth in planned defence expenditure – making it the longest period of steadily increasing planned defence spending since the end of the Cold War. At the same time and in order to support UK troops on the front line, the additional costs of military operations will continue to be funded on top of the defence budget and provision was made in the CSR Reserve for this purpose. This includes provision for Urgent Operational Requirements such as additional protected mobility vehicles.

DELIVERING DECENT AND AFFORDABLE HOUSING FOR ALL

5.28 The Government's aim is to increase housing supply and affordability and ensure everyone has access to a decent home at a price they can afford in communities where they want to live and work. Sustained economic growth and stability has helped over 1.8 million households across the UK into home ownership over the last decade, and in 2006-07 housing supply grew by around 199,000 net additional homes, the highest level since the 1980s, and up from 154,000 in 1996-97 (See Chart 5.2).

Chart 5.2: Net additional homes in England per annum 1996-97 to 2006-07



Source: Local Authority returns to Communities and Local Government and Regional Assemblies.

Tackling short-term market conditions

Short-term market conditions

5.29 The UK housing market is currently slowing, with annual house price inflation having declined from above 10 per cent in August 2007 to around 2½ per cent in February 2008. This slowdown is related to the tightening in credit conditions for secured lending, which has been affected by the ongoing disruption in global financial markets. This is having an effect on housing finance, and the Government is working with mortgage lenders and investors to find solutions to ensure the stability of mortgage finance supply.

5.30 Mortgage arrears and repossessions have meanwhile risen from their historic lows in 2004. The Government has put in place statutory regulation, through the Financial Services Authority (FSA), to help ensure that lenders lend responsibly and borrowers are able to make informed choices. The FSA is currently reviewing its mortgage regime and will publish its findings which will include the treatment of borrowers in arrears, in 2008. The Government also provides targeted support for those experiencing difficulties through the provision of debt advice and Support for Mortgage Interest (SMI), delivered through Income Support, income-based Jobseekers Allowance and Pension Credit.

5.31 The Government welcomes the Council of Mortgage Lenders' recent statement, which sets out the steps the industry is taking to help support borrowers facing repossession. These measures include working with debt advisers, pro-actively identifying at-risk borrowers and only repossessing as a last resort.

5.32 Some stakeholders have expressed concerns in light of the recent growth of the sale and rentback market. This market offers some homeowners the option of selling properties at discounted rates in exchange for tenancy arrangements. **The Office of Fair Trading will lead a study of the market this year, focusing on consumers' experience of these arrangements, and consider options where appropriate to strengthen consumer protections. The study will draw on contributions from the FSA.**

Improving provision of finance in the mortgage market

Housing Finance Review

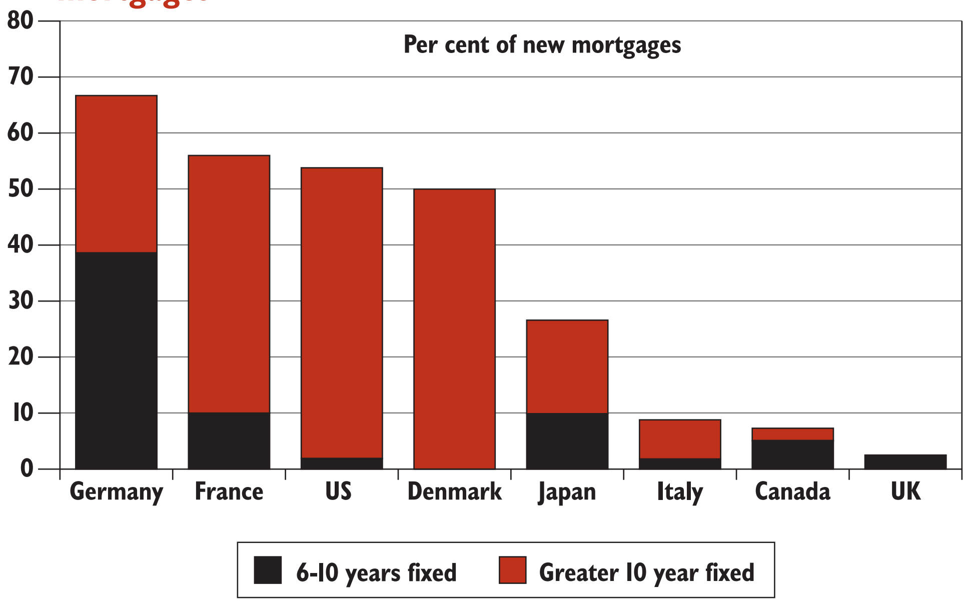
5.33 A well-functioning housing finance system is important to many aspects of people's lives and to the functioning of the wider economy. A stable and efficient supply of affordable housing finance is a central part of achieving long-term housing affordability goals. At the same time, however, housing finance can entail significant risks for consumers, and managing those risks efficiently is important for borrowers, lenders and the wider financial sector.

5.34 The UK mortgage market has many strengths. It is very competitive, with hundreds of lenders operating in the market including a wide variety of domestic and international banks, building societies and specialist lenders, supported by one of the largest intermediary markets in Europe. There are challenges, however, for the UK housing finance system and to address these the Chancellor announced in July 2007 that HM Treasury would undertake a review of housing finance (see Box 5.2).

5.35 One key challenge for the UK market lies in the secondary funding markets for UK mortgage lenders. Secondary market funding refers to the process of originating mortgages, packaging and reselling these assets to investors, releasing capital for the lender to fund other mortgages. UK lenders access secondary funding markets mainly by issuing two types of financial product to investors: covered bonds and Residential Mortgage Backed Securities. In 2006, almost one third of all UK mortgages were funded through secondary markets. The recent disruption in financial markets has led to a sharp contraction in liquidity in the markets for securitised finance, which have effectively closed to new issuance. This has led to higher costs for lenders, with significant implications for UK mortgage borrowers.

5.36 Another key challenge identified for the UK housing finance market is that, unlike in many other countries, there is very little mortgage debt with the interest rate fixed for more that a few years (see Chart 5.3). Long-term fixed-rate mortgages, if these offer flexibility to repay early, can bring benefits to many borrowers by offering protection against interest-rate risk. These mortgages may also contribute to wider macroeconomic stability by decreasing the risk of defaults should interest rates rise.

Chart 5.3: International comparison of long-term fixed-rate mortgages



Source: European Mortgage Federation, CML/BankSearch, Merrill Lynch. HM Treasury calculations, Statistics Canada.

Notes: 2007 data for Canada; 2006 data for UK and US; 2005 data, Japan, Denmark and Germany; 2004 data for France and Italy. Includes adjustable-rate mortages (ARMs) where the initial rate is fixed for a defined period. For the UK data does not split between 6-10 year fixed rate mortgages. Therefore the assumption has been made that UK 10+ year fixed is negligible given that it is known that less than 1 per cent of the stock of UK mortages are 10 year fixed-rates.

Box 5.2: Housing Finance Review

Given its centrality to housing affordability, the financial sector and the wider economy, the Chancellor announced in July 2007 that the Treasury would undertake a review of housing finance. The Review document is published alongside the Budget and sets out analysis and proposals on two key challenges:

- the recent disruption in global financial markets which raises issues about liquidity and transparency in the mortgage-backed securities markets; and
- the low availability of affordable and flexible fixed-rate mortgage products which may help borrowers manage better the risks associated with housing finance.

Improving secondary market funding

Well-functioning secondary funding markets are critical for an efficient mortgage market. Last year approximately one third of all mortgages were financed through secondary market funding. Access to these markets is now effectively closed due to the ongoing disruption in financial markets. To help lenders access robust and liquid secondary market funding, the Government has already introduced a UK legislative framework for covered bonds, which entered into force on 6 March 2008.

Furthermore, **the Government is establishing a Working Group to take forward market-led initiatives to help improve the mortgage-backed securities market.** The Working Group will include the mortgage industry, the investment industry and also HM Treasury, the Bank of England and the FSA. The Working Group will report initially to the Chancellor in summer 2008 and present proposals at the time of the 2008 Pre-Budget Report.

Removing barriers to long-term fixed rate mortgages

The UK mortgage market is unusual in having a low proportion of long-term fixed-rate mortgages compared with other countries. There is evidence, however, that at least some people may want, and would benefit from, this type of mortgage. Lenders in the UK, however, have limited means to manage the risk of these mortgages and need to include early repayment charges to cover their costs. Many other countries by contrast have a high proportion of fixed rate mortgages, and in some countries such as Denmark and the USA, these mortgages do not have early repayment charges.

The **Government is also inviting views on options for a UK legislative framework to deliver more affordable long-term fixed-rate mortgages** and the lessons to be learned from international markets and institutions. The Government will work with a range of stakeholders and experts and will provide an update at the 2008 Pre-Budget Report in the light of their findings and stakeholder responses.

Housing supply

5.37 The Housing Green Paper and 2007 CSR set out the Government's strategy for increasing housing supply, including a target of delivering over 240,000 net additional homes per year by 2016, and a total of 3 million new homes by 2020. This was underpinned by increases in spending on housing from £8.8 billion in 2007-08 to £10 billion in 2010-11 and reforms to streamline the planning system, bring more land forward for development and coordinate infrastructure delivery better.

Planning

5.38 Effective planning systems are essential to ensuring that development is delivered in a strategic and sustainable manner. As part of the implementation of the *Review of sub-national economic development and regeneration,*[4] the Government will shortly consult on

[4] *Review of sub-national economic development and regeneration*, HM Treasury, Department for Business Enterprise and Regultory Reform and Communities and Local Government, July 2007.

bringing together the Regional Economic Strategy (RES) and Regional Spatial Strategy (RSS) into a single strategy setting out housing plans alongside wider economic, social and environmental objectives. The Housing Green Paper announced the Government's intention to conduct RSS mini-reviews to ensure each strategy sets ambitious plans consistent with the Government's national targets.

Releasing land for development

5.39 More land is needed for housing if the Government is to achieve its objectives. As set out in the planning policy statement on housing, local authorities are required to identify a rolling five-year supply of developable land as part of a longer term 15 year strategy to deliver the homes needed in their areas. The Government has also committed to achieving the delivery of 200,000 new homes on surplus public sector land by 2016, and **the Budget announces that the Government has firmly identified sites on central government surplus land with potential for 70,000 new homes.** Communities and Local Government will announce further details shortly. Work will continue to identify further sites and to streamline processes to speed up the release of surplus land for housing by central government, applying new higher standards on quality, sustainability and affordable housing, including on the recently released sites in Dover, Chichester and Warrington. The Government is also developing a new approach to the use of surplus land owned by local government, with a more active role for local authorities in housing development.

Vacant, derelict and contaminated

5.40 The Government is introducing measures to reform the tax incentives for developing brownfield land to make them more environmentally sustainable. The landfill tax exemption for waste from contaminated land will be phased out by 1 April 2012. **The Government will recycle the additional revenue to extend land remediation relief to expenditure on derelict land and to the removal of Japanese knotweed by treatment** from 1 April 2009. The Government will consult on draft legislation in the summer. Following the commitment in Budget 2007 and the 2007 Pre-Budget Report, the **Government has considered the merits of extending business rates to include derelict and vacant previously developed land, but has decided not to pursue such an extension at this time.**

Community Infrastructure Levy

5.41 Communities and Local Government (CLG) is progressing plans for the Community Infrastructure Levy (CIL) announced in the 2007 Pre-Budget Report. Local councils in England and Wales will be empowered to apply a CIL to new developments and spend the income on the infrastructure needed to support the growth of their areas, including housing growth.

5.42 CLG recently published an explanation of how it is envisaged CIL will operate. Legislation is progressing through Parliament as part of the Planning Bill, and subject to Parliament's decisions, CLG aims to formally consult on the draft Regulations in autumn 2008, with a view to finalising them in spring 2009. **CLG will make further announcements on CIL before the summer.**

VAT on renovation of poor quality property

5.43 In the 2007 Pre-Budget Report, the Government announced a reduction in VAT on the costs associated with refurbishment or renovation of properties that have been empty for more than two years. In further support of its housing objectives, **the Government will now explore the case for additional targeted and cost-effective VAT measures** for the refurbishment or renovation of other dwellings that are of too poor quality to rent or sell.

Making houses more affordable

More affordable housing

5.44 While the Government's long-term strategy is to build more homes to improve housing supply and affordability, it also wants to provide help now for more young people and families to buy their own homes. As part of the 2007 CSR, the Government set a target of 70,000 more affordable homes a year by 2010-11, including direct assistance to homebuyers through its shared equity and shared ownership programmes, which will help 25,000 households a year to enter home ownership. To deliver this, the Housing Corporation is undertaking a £8.4 billion investment programme over the next three years, the largest investment programme in its history, and recently announced the first £3.3 billion of allocations.

5.45 Budget 2007 announced the launch of a shared equity competition, which invited bids for a shared equity product to be delivered in partnership with Government from April 2008. The aim is to encourage innovation and develop products that offer improved affordability and value for money. **Two winning schemes – Co-operative Bank/Places for People group and Chase, a housing association consortium – have been selected from the many proposals put forward, and will be made available to eligible households from 1 April 2008. The new products offer equity loans of up to 50 per cent of the property purchase price, reducing the conventional mortgage required. These loans are larger than those previously available and will help bring home ownership within the reach of many more households.**

Shared ownership

5.46 From today changes to Stamp Duty Land Tax (SDLT) rules mean that shared-ownership buyers **will generally only pay SDLT on the final 20 per cent of the property,** unless they elect to pay SDLT upfront.

Greener homes

Greener Homes

5.47 It is important to ensure the delivery of the Government's housing supply and home ownership objectives are consistent with the Government's climate change and wider environmental objectives. It is therefore the Government's ambition that all new homes are zero carbon from 2016. Further details are set out in Chapter 6.

SUPPORTING THE THIRD SECTOR

5.48 The third sector makes a vital contribution to building stronger communities and delivering a better quality of life to the people it serves. Over the next ten years the Government wants to put the third sector at the heart of work to build active and connected communities. The Third Sector Review[5], published in July 2007, recognised the importance of supporting third sector organisations through sustainable finance if they are to continue to grow and achieve their aims. The Minister for the Third Sector will report to Parliament annually on commitments made in the Review from October this year, though early indications are that good progress is already being made.

Supporting giving

5.49 The Government directly supports charities through a number of methods, one of which is the wide package of tax incentives worth over £3 billion to donors and charities each year. Gift Aid accounted for around £1 billion of this package in 2006-07. However, the Government believes there is even greater scope for charities to claim additional funds through Gift Aid. Budget 2007 announced a consultation with the charitable sector on measures to increase take-up of the relief.

Gift Aid package

5.50 Throughout the consultation charities were strongly supportive of the Gift Aid system, recognising the benefits of this successful tax relief. Having listened to over 500 views from

[5] *The future note of the third sector in social and economic regeneration: final report*, HM Treasury and Cabinet Office, July 2007.

across the third sector, the Government is today announcing a wide-ranging package of measures, including **major reform to the auditing process; a comprehensive programme for bringing additional smaller charities into Gift Aid; redesign of guidance; outreach to 5,000 new charities through the launch of targeted marketing tools**; and a number of other administrative changes (as set out in Chapter 2 of *Consultation on Gift Aid: the Governments response*[6], published alongside the Budget). The Government also recognises the need to minimise administrative burdens for the sector while ensuring predictable income streams for charities. **Although the basic rate of tax will be 20 per cent the Budget announces that Gift Aid will continue to be paid at a transitional rate of 22 per cent for three years**, with no increase in administrative burdens in claiming Gift Aid for charities. The consultation raised issues around the Gift Aid system and ways to alter the mechanics of the system to make it easier for some donors to give. These are complex issues that require a better understanding of donor behaviour and a full assessment of the risks that could arise if alterations were to be made to a currently successful system. **The Government will continue to work with donors and charities to develop understanding of donor behaviour and use that to inform further thinking about Gift Aid.**

5.51 The Government will also continue to work with the sector on other ways to support charitable giving, including through payroll giving.

Simplifying the tax system for charities

5.52 As part of the Government's objective to simplify the tax system, the Budget announces a number of measures that will further reduce the administrative burdens placed on charities, including **consulting on legislation affecting substantial donors**. Further detail on the simplification package can be found in Chapter 4.

[6] Consultation on Gift Aid: the Government's response, HM Treasury, March 2008.

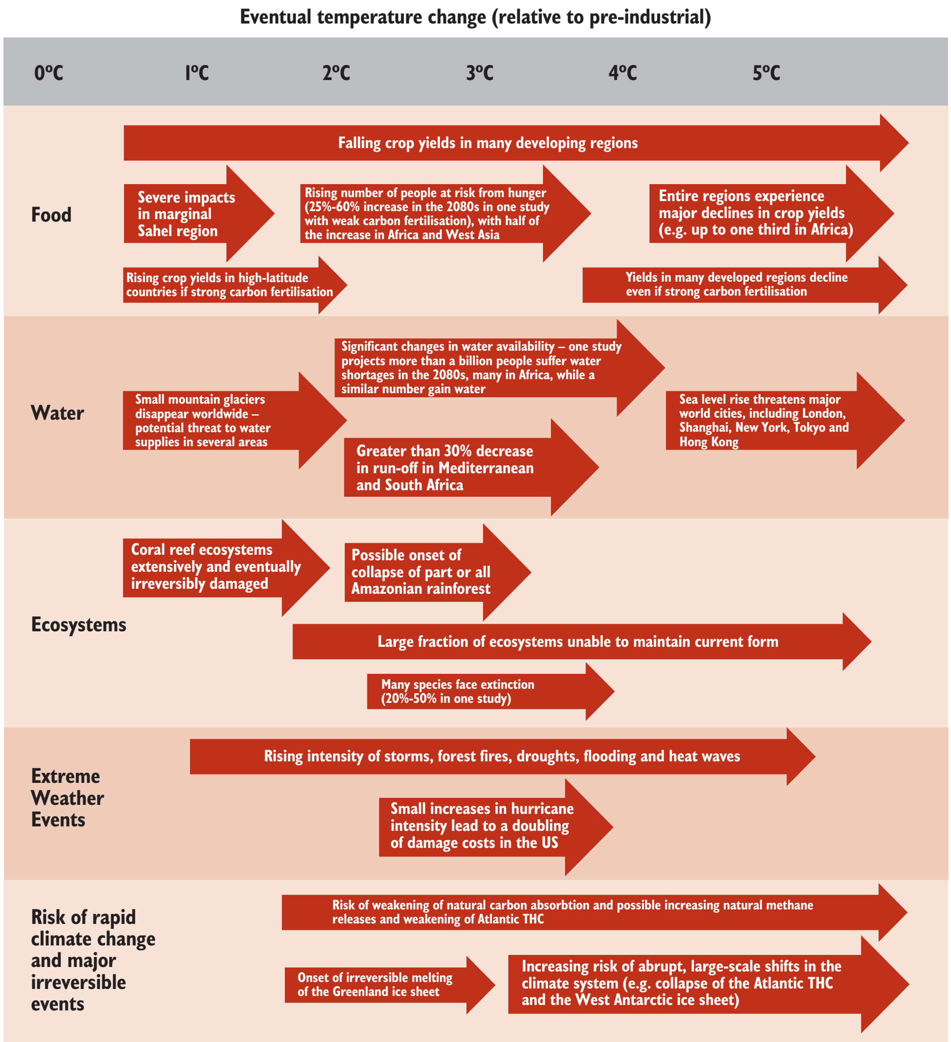
6 An environmentally sustainable world

Tackling climate change is the most serious and pressing global environmental challenge the world faces. Budget 2008 sets out new policies to reduce emissions across all major sectors of the economy and ensure the UK continues to lead the climate change agenda internationally. The Government is also acting to protect the UK's natural enviroment. Budget 2008 announces:

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

6.1 Tackling climate change is the most serious and pressing global environmental challenge the world faces. Concentrations of carbon dioxide and other greenhouse gases have increased markedly as a result of human activities, and the impacts can now be readily observed in increases in the world's air and ocean temperatures, widespread melting of snow and ice and rising sea levels.[1] Without a major global effort to reduce emissions of greenhouse gases, temperatures could rise by 5-6°C by the end of the century (see Chart 6.1). A change in the global climate on this scale would have major and irreversible consequences, including physical changes likely to lead to large-scale movements of population, serious impacts on the ability to meet basic human needs for food, water and security (particularly in the developing world), and the loss of unique and valuable habitats and species.

Chart 6.1: Projected impacts of climate change[2]



6.2 The Stern Review[2] concluded that the costs of reducing emissions to levels that avoid the worst risks of climate change are significant but manageable, whereas delay will be costly and dangerous. This conclusion has stood up to vigorous international scrutiny and debate since the report was published.

6.3 The Government has adopted the framework for climate change policy recommended by the Stern Review, based around three key elements:

- pricing carbon through trading, tax or regulation – ensuring that emissions reductions are delivered in the most cost-effective way;

[1] Technical Summary in *Climate Change 2007: The Physical Science Basis. Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change* [Solomon, S., D. Qin, M. Manning, Z. Chen, M. Marquis, K. B. Avery, M. Tignor and H. L. Miller (eds.)]. Cambridge University Press, 2007.
[2] *The Economics of Climate Change: The Stern Review*, Cambridge University Press, 2007.

- encouraging innovation in low-carbon technologies; and
- removing barriers to action, including policies to encourage long-term behavioural change.

6.4 The Budget sets out new policies to reduce emissions across all major sectors of the economy and ensure the UK continues to develop its international leadership of the climate change agenda.

BUILDING A GLOBAL DEAL

6.5 Climate change is an international issue that requires coordinated international action. The momentum, both for practical action and for reaching a global deal, is building in countries around the world. The UK is playing a leading role taking this forward in the EU, at the UN, through the G7 and bilaterally.

6.6 In the EU, the UK was instrumental in the agreement of ambitious EU objectives on climate change and energy. These include the development of emissions trading and carbon markets as a tool for tackling climate change cost-effectively.

Box 6.1 UK leadership on EU and international action

The European Commission has recently published its proposals including:

- ambitious plans to develop Phase III of the EU Emissions Trading Scheme (from 2012 to 2020). **Defra will consult on the implications of the Commission's proposals;**
- a target of 20 per cent for greenhouse gas emissions reductions from the EU by 2020, which would increase to 30 per cent as part of an international deal;
- a target of 20 per cent of energy in the EU to be sourced from renewables by 2020; and
- an enabling regulatory framework for carbon capture and storage and its inclusion in the EU Emissions Trading Scheme.

The Government will continue to work with other Member States ahead of their EU presidencies to ensure that climate change and energy remain at the top of the EU agenda.

The Government is **actively supporting work to expand and develop carbon markets,** and promote the role of London as a key centre of expertise in carbon trading. The UK has worked closely with US states and other countries, and will be extending its engagement as more commit to action. The Carbon Markets Experts Group (which met for the first time in February) will discuss at its next meeting how linking international schemes would create a more liquid global carbon market.

6.7 At a global level, many of the major emerging economies are already taking steps to tackle the growth in their emissions. For example, China has begun to implement ambitious national goals on energy efficiency and renewable energy, and the Indian Government announced in its budget last month that it would take steps to improve energy efficiency, switch to lower carbon fuels, and develop platforms for emissions trading.

Bali conference

6.8 A strong international framework will enable countries to go further, setting out a level of ambition that is proportionate to the scale and urgency of the threat, particularly the threat to the world's most vulnerable countries and communities. G8 leaders agreed at Heiligendamm last year to set a global long-term goal for emissions reductions, and EU leaders have stated that this goal should be to reduce global emissions by no less than 50 per cent by

2050. In Bali last December, the UN launched a two-year process to negotiate the framework for climate change policy beyond 2012, including emissions reduction, technology, and adaptation.

Climate change and development

6.9 Development is an integral part of global efforts to tackle climate change. Global emissions cannot be reduced without helping developing countries move to a lower carbon growth path. And without action to tackle climate change, efforts to promote economic development and poverty reduction will be undermined. The Goverment's support to developing countries to tackle climate change sits within its broader commitment to tackle global poverty and achieve the internationally agreed Millennium Development Goals, supported by increases in DfID's 2007 CSR budget of 11 per cent in real terms.

6.10 In Bali, finance ministries agreed on the need to scale up finance to developing countries to help them tackle climate change through clean technologies, adaptation and avoiding deforestation. Carbon markets will play a major part in delivering that finance, and there will also be a greater role for the International Financial Institutions (IFIs), especially World Bank funds.

Environmental Transformation Fund

6.11 The UK has been working with the G7, including Japan, the US and other partners, on the creation of a strategic multilateral investment framework to help developing countries tackle climate change. **The UK will use its £800 million international Environmental Transformation Fund (ETF) with international partners to invest in clean technologies, help developing countries adapt to the impacts of climate change and act on deforestation.** One example of this work is the pledge made in Budget 2007, with £50 million of UK support for the Congo Basin Forest fund to save rainforests. This project aims to demonstrate the real environmental and poverty reduction results that well-targeted international finance can deliver.

Working in partnership with others

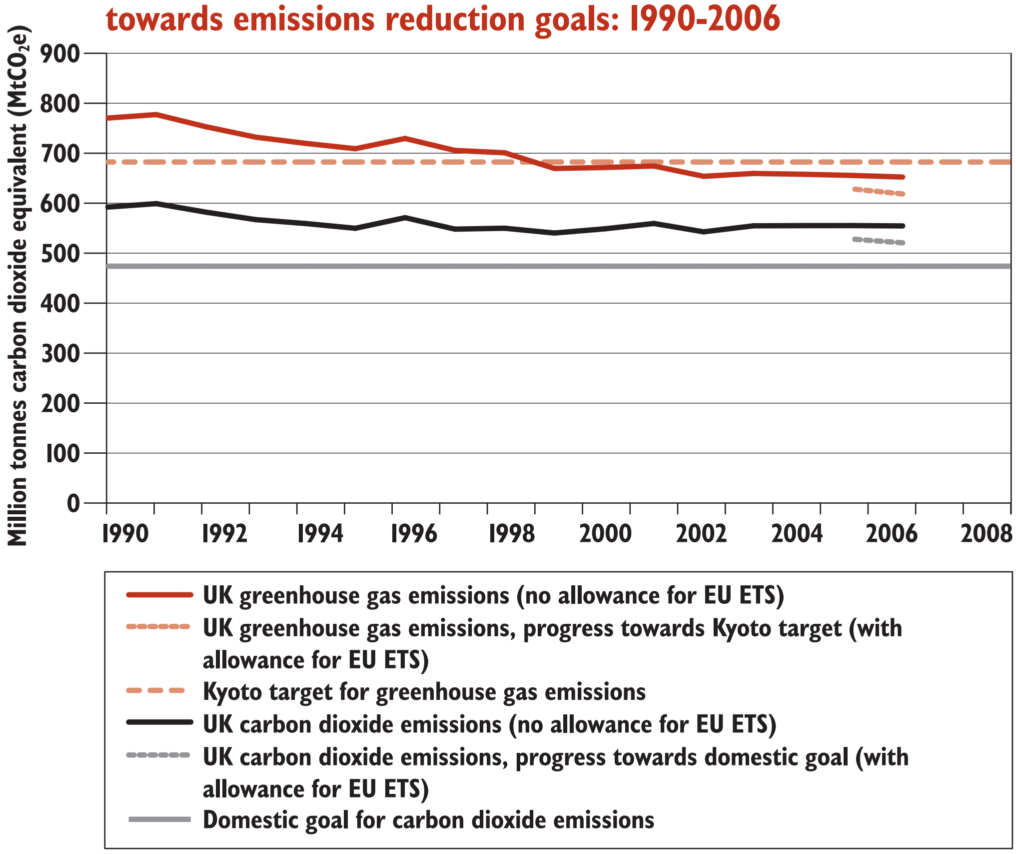
6.12 The UK has been supporting other countries and regions that wish to develop an economic analysis of climate change similar to the Stern Review. **The Government will work with the state of California to collaborate on investment in new energy technologies and to build links between emissions trading schemes.**

BUILDING A LOW-CARBON BRITAIN

6.13 However, international action on its own is not enough. The UK must show leadership domestically in order to help achieve progress in the negotiations and to reduce the UK's carbon footprint and meet the UK's commitments.

6.14 The Government has put in place a comprehensive set of measures to reduce greenhouse gas emissions and enhance the security and sustainability of the UK energy system. Since 1990, the Kyoto baseline year, UK greenhouse gas emissions have fallen by 19 per cent, including reductions through the EU Emissions Trading Scheme (see Chart 6.2).

Chart 6.2: UK greenhouse gas emissions and progress towards emissions reduction goals: 1990-2006



Source: AEA Energy & Environment and Defra.

The Climate Change Bill

6.15 The Government believes that the scale of the challenge ahead means that it is right to go further. That is why the UK is putting in place new legislation that creates a radical statutory framework to make further deep cuts in emissions. The Climate Change Bill will commit the Government to living within fixed and binding five-year carbon budgets, based on the advice of the independent Committee on Climate Change. It is the first legislation of its kind in the world, establishing a system that will offer a credible, predictable and flexible path for British businesses and consumers to play their part in reducing the UK's carbon footprint.

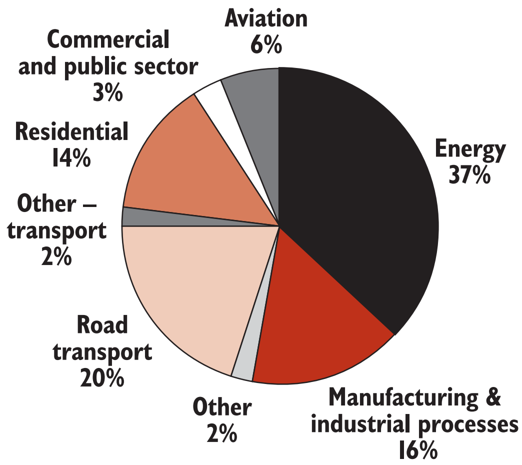
6.16 Carbon budgets will provide a strong, clear focus for government decision-making on climate change policy and will set out for industry and individuals a pathway for the next 15 years. This will provide a clear signal for the investment and innovation needed to move towards a low-carbon economy without compromising the Government's objectives for economic growth. **Recognising the important economic and fiscal implications of the decisions required, the Government announces its intention to set out the carbon budgets and its plans to meet them alongside Budget 2009.**

Long-term targets

6.17 The UK currently has a long-term goal of reducing emissions of carbon dioxide by 60 per cent by 2050. The Prime Minister has asked the Committee on Climate Change to review whether this target should be raised, up to 80 per cent. The Government recognises the developing science of climate change, the risks associated with failing to achieve significant emissions reductions and the particular responsibilities placed on developed countries to achieve reductions. It also recognises that these cuts need to be achieved in the context of an international deal that requires action by all and a framework within which to act.

6.18 Meeting the UK's long-term targets will require working towards effectively decarbonising both power generation and transport in the UK. Carbon must be priced into investment decisions, further investment must be made in low-carbon technologies and policies must be put in place to change behaviour. Emissions need to be reduced in all sectors so as to equip them for the challenges of the future. Chart 6.3 shows the proportion of the UK's carbon dioxide emissions from each sector. This Budget takes action in all of the major sectors.

Chart 6.3: UK carbon dioxide emissions by sector (2005)



REDUCING EMISSIONS FROM THE TRANSPORT SECTOR

6.19 Transport is the second largest source of carbon dioxide emissions in the UK with around 28 per cent of UK carbon dioxide emissions. Due in part to sustained economic growth, emissions from transport are projected to continue growing until 2015. The Government's objective is to transform the transport sector to meet the demands of business and personal travel while reducing carbon emissions.

The King Review

6.20 Budget 2007 announced that Professor Julia King would lead a review to examine the vehicle and fuel technologies that, over the next 25 years, could help to decarbonise road transport, especially cars. In her report, Professor King makes recommendations in four key areas where she believes action must be taken if the UK is to move towards decarbonising road transport:

- reducing vehicle emissions;
- changing consumer behaviours;
- encouraging cleaner fuels; and
- research and development.

6.21 **The Government welcomes the final report of the review, published alongside this Budget. A detailed Government response to the review will be published in the summer.** This Budget sets out the action Government is taking forward under the four key areas of the review.

Box 6.2: Budget 2008 and the King Review

Budget 2008 measures include:

- **significant reform of vehicle excise duty to incentivise motorists to purchase fuel efficient vehicles;**
- **improving the information available for consumers;**
- **a £40 million research, development and demonstration programme for low-carbon vehicles, jointly funded by the Technology Strategy Board, the Engineering and Physical Sciences Research Council and the Department for Transport;**
- **encouraging the development and use of the cleanest and most sustainable biofuels by switching support to the Renewable Transport Fuel Obligation and by pushing for a sustainable EU biofuel policy;**
- **establishing international collaboration with the Indian Government to develop low cost, low-carbon vehicles; and**
- **pushing for a longer-term EU target for vehicle manufacturers to reduce average carbon dioxide from new cars to 100g carbon dioxide per km in 2020.**

Cleaner and more efficient vehicles

6.22 The King Review has found that there are existing technologies that can be used to save carbon dioxide now, and opportunities to develop new technologies that can deliver the vehicles that will be needed in a low-carbon world. The Budget announces measures to incentivise both short and long-term action.

Carbon dioxide from cars

6.23 The European Union has established voluntary agreements with car manufacturers to reduce average carbon dioxide emissions from new cars to 140g per km by 2008-09. It is becoming clear that this target will not be met. The European Commission therefore published a proposal last year to set car manufacturers a mandatory target to reduce average new car carbon dioxide emissions to 130g per km by 2012. **The Government will ask the EU to set a longer-term target to reduce the average new car carbon dioxide emissions to 100g per km by 2020.**

Consumer behaviour

6.24 The Government is committed to ensuring that motorists have the clearest information to inform their purchasing choices. The 'Act on CO_2' campaign in its first year has helped to provide motorists with this information. To take this further, the King Review recommends:

- the introduction of colour-coded car tax discs;
- the strengthening of advertising regulation to provide clearer information on vehicles;
- redesigning and making compulsory the current new car fuel economy label; and
- considering whether dashboard technology can encourage smarter driving.

6.25 **The Government announces today that the Department for Transport will actively explore these ideas in collaboration with external stakeholders through the Low Carbon Vehicle Partnership.**

Vehicle excise duty

6.26 Fiscal measures also have an important role to play and can highlight the environmental impacts of different vehicles at the point people purchase them.

6.27 Analysis from the King Review suggests that there is a wide range of environmental performance within a particular group of cars (such as family saloons or hatchbacks). Drivers could reduce carbon dioxide emissions and fuel bills by up to 25 per cent by choosing the most efficient vehicle in its group. The review also concluded that over the long-term the technology exists to reduce the average carbon dioxide emission of new cars to 100g per km by 2020.

6.28 In order to support this target, and strengthen the environmental incentive to develop and purchase fuel-efficient cars, **Budget 2008 announces reform of the vehicle excise duty (VED) structure. From 2009, VED will be restructured with new bands, based on carbon dioxide so that people gain financially by choosing the car with the best environmental performance in a given group. The financial difference between the most and least polluting cars will increase, so that making a small change in car emissions has a greater financial impact. From 2010, there will be a new higher first-year rate based on carbon dioxide emissions, to influence purchasing choices. Specific changes include:**

- **six new VED bands from 2009-10 – including a new top band (band M) for the most polluting cars that emit more than 255g CO_2 per km;**
- **reducing the standard rate of VED, in 2009-10, for all new and existing cars that emit 150g of CO_2 per km or less, and increasing the standard rate of VED on the most polluting cars to £425;**
- **from 2010-11, extending the zero rate of VED, during the first year of ownership, to all new cars that emit 130g CO_2 per km or less – the EU proposed target for average new car emissions in 2012;**
- **holding the first-year rate for all new cars that emit between 131 and 160g CO_2 per km equal to the standard rate in 2010-11;**
- **introducing for the most polluting cars a first-year rate of £950 in 2010-11; and**
- **providing a £15 or £20 discount for alternatively fuelled cars in 2009-10, and £10 in 2010-11; and aligning the alternative fuel and standard rates of VED in 2011.**

6.29 As a result of these reforms, the majority of motorists will be better or no worse off in 2009. Chapter A provides further details of the new VED structure.

Box 6.3 Taxation of business travel

Company car tax was reformed in 2002 and is now based on carbon emissions, encouraging the take up of more fuel-efficient cars in company fleets. **Budget 2008 announces that the Government will further promote more environmentally-efficient business travel and the take up of cleaner cars through:**

- **replacing the existing capital allowance treatment for business cars with an emissions-based approach. Cars will be placed in one of two capital allowance pools according to their CO_2 emissions, with cars whose emissions are above 160g per km receiving a lower allowance. 100 per cent first-year allowances will continue to be available for cars with CO_2 emissions not exceeding 110g per km;**
- **increasing company car tax rates on all but the cleanest cars emitting less than 135g CO_2 per km in 2010-11;**
- **enhancing the incentives to drive fewer miles through changes to the fuel benefit charge from April 2009;**
- **offering a lower VED rate for diesel vans that comply with EU air-quality emission standards; and**
- **maintaining tax-free mileage allowances (AMAPs) rates and thresholds at current levels. The Government will take decisions on whether to align the tax/National Insurance Contribution treatment of AMAPs in light of the outcome of the HMRC consultation on collecting tax on benefits in kind and expense payments: *Including benefits in kind and expense payments in the payroll – a fresh approach.***

Further detail on these measures can be found in Chapter A.

Fuel duty **6.30** It is the Government's policy that fuel duty rates should rise each year at least in line with inflation as the UK seeks to reduce polluting emissions and fund public services. **Budget 2008 therefore confirms that main road fuel duty rates will rise by 1.84 pence per litre on 1 April 2009, and announces that rates will then also increase by 0.5 pence per litre above indexation on 1 April 2010**. By 2010-11, main fuel duty rates will remain at least 11 per cent lower in real terms than they were in 1999. Consistent with the Government's overall stance of ensuring stability for the long-term, while maintaining responsiveness to short-term conditions, **Budget 2008 also announces that the planned fuel duty increase of 2 pence per litre in April 2008 will now take place on 1 October 2008. The Government can also confirm that rebated oils duty increases will also be deferred until 1 October 2008, when they will rise in proportion to main road fuel duties. These rates will also rise by the same proportion as main road fuel duties in the subsequent two years**.

Public transport **6.31** Public transport has an important role to play in reducing emissions. Public support for buses has risen to £2.5 billion this year, with further funding to allow free off-peak nationwide travel for pensioners and the disabled from April 2008. The Secretary of State for Transport will shortly publish a consultation document on the reform of bus subsidy, with proposals targeted at delivering carbon dioxide savings to support climate change goals and modernising bus services, through incentives for new technology.

Encouraging cleaner fuels

Biofuels **6.32** The King Review highlights that in the longer term, biofuels have the potential to make a significant contribution towards reducing emissions in the transport sector. Biofuels are produced from a wide range of sources, including maize, rapeseed and sugar cane. In principle, biofuels can reduce greenhouse gas emissions compared to the use of fossil fuels. However, factors including land use changes, fertiliser inputs, processing methods and transport can significantly reduce the greenhouse gas emission savings available (see Table 6.1 which shows the carbon dioxide reduction of different sources of biofuels compared to gasoline).

Table 6.1: Carbon dioxide reduction of different sources of biofuels[1]

Biofuels	Bioethanol				Biodiesel
Feedstock	Cereals, corn	Sugar beets	Sugar cane	Ligno-cellulosic	Vegetable oils
CO2 reduction compared to gasoline/diesel (per cent)	15–25	50–60	90	70	40–60

[1] The possible ranges of greenhouse gas savings could be wider than implied by the IEA's work due to emissions related to fertilizer use and potential land use change from growing demand for biofuels. For example:

- nitrogen fertiliser releases nitrous oxide, a greenhouse gas 210 times more potent than carbon dioxide, both during its production and when applied to crops;
- land use change, for example releasing carbon stocks from soil as previously uncropped land is ploughed, is also a key source of carbon emissions from biofuel feedstock cultivation; and
- there are also emissions associated with processing feedstocks into fuels, which vary according to the processing requirements and the energy source (e.g. coal power station versus renewable energy).

Source: IEA

6.33 The Government believes that it is important that policy supports sustainable biofuels. The Secretary of State for Transport announced that Ed Gallagher, chairman of the Renewable Fuels Agency, would lead a study of the wider economic and environmental impacts, including the impacts on food prices, of different forms of biofuel production. **Tomorrow the Secretary of State for Transport will publish the terms of reference of the review.**

6.34 The Government announced in the Pre-Budget Report 2005 that it would introduce the Renewable Transport Fuel Obligation (RTFO) from 2008. The existing duty differential for biofuels has limited scope to recognise different biofuels, whereas the newer RTFO will provide a sharper environmental focus through its sustainability criteria. **To encourage the development of the cleanest, most sustainable biofuels the duty differential for biofuels will cease in 2010. The RTFO buy out price will be set at 30 pence per litre, providing a better incentive for biofuels.**

6.35 The European Commission has proposed that at least 10 per cent of all fuel must be sourced from biofuels by 2020. **Today the Chancellor and the Secretaries of State for BERR, DfID, Defra and DfT have written to the European Commission to outline the principles on which the UK believes EU biofuel policy must be based. These are that:**

- **reducing greenhouse gas emissions must be at the heart of EU policy;**
- **targets must be set at the appropriate level, taking into account the indirect impacts of biofuels, and must be revised if they cannot be met in a sustainable or cost-effective manner;**
- **robust sustainability standards must be in place;**
- **EU policy must ensure a level playing field between domestic and international producers – in particular unfair EU biofuel import tariffs should be abolished; and**
- **in line with the UK's position on vehicle efficiency standards, the EU must get the balance right between encouraging biofuels and decarbonising cars.**

Research and development

6.36 The King Review concluded that the UK could reduce car carbon dioxide by using existing technologies, and also by pioneering new technologies to develop the vehicles of the future. **The Budget announces a £40 million research, development and demonstration programme, which will focus on low-carbon vehicle concepts and the acceleration of their commercialisation.**

6.37 The review recommends that a new research, development and demonstration programme be established between the UK and India to support a consortium of companies and universities to develop a 'low-cost, low-emission' car. **The UK Government accepts this and has today written to the Indian Government seeking their support for a collaborative programme.**

Aviation

Air passenger duty

6.38 Aviation accounts for 6.3 per cent of the UK's carbon dioxide emissions. This is projected to rise to as much as 21 per cent by 2050. The Government is committed to enabling the aviation industry to expand in an environmentally sustainable way, ensuring that it pays the external costs that its activities impose on society at large, as well as contributing fairly to public services. For this reason, at Pre-Budget Report 2007, the Government announced that air passenger duty would be replaced by a duty payable per plane, rather than per passenger, from 1 November 2009. This will send better environmental signals and ensure that aviation duty better reflects environmental costs. The Government began a consultation[3] on the design of the new duty in January and welcomes responses by 24 April. **In order to strengthen the environmental signal through taxation, this Budget announces that the Government will increase forecast tax revenues from the new per plane duty by 10 per cent in the second full year of operation.**

Aviation in EU ETS

6.39 The UK Government is confident that agreement will be reached on the inclusion of aviation in the EU Emissions Trading Scheme by 2012, which will help to ensure that right across Europe the aviation sector plays its part in delivering real carbon reductions.

REDUCING EMISSIONS FROM THE ENERGY SUPPLY SECTOR

6.40 Energy supply is the UK's single biggest contributor to carbon dioxide emissions. The Stern Review estimated that the global power sector will need to be at least 60 per cent decarbonised by 2050 to meet the climate goals and that much deeper reductions would be required by developed countries.

Energy policy framework

Energy White Paper

6.41 The Government's climate change and energy policy objectives go hand in hand. The Energy White Paper, published in May 2007, sets out the Government's framework for energy policy to reduce energy-related emissions, ensure that supplies of energy are secure in a changing world, improve energy efficiency, and tackle fuel poverty so that the most vulnerable in society are able to pay their bills in a world of higher energy prices.

6.42 The Government's strategy is based on the principle that independently regulated, competitive energy markets are the most cost-effective and efficient way of delivering the objectives for the energy sector. The role of Government is to set the framework and remove barriers for investors to enable a wide range of technologies to be deployed by the private sector.

[3] *Aviation duty: a consultation*, HM Treasury and HM Revenue and Customs, 31 January 2007

Renewables

6.43 The UK is committed to tripling the contribution made by renewable electricity by 2015. The European Commission has now brought forward an EU-wide target for 20 per cent of energy production to come from renewable sources by 2020, and the Government will consider a wide range of measures to enable the UK to play its part. **In the summer, the Government will launch a full consultation on what more the UK should do to increase renewable energy use and meet its share of the EU target. The Government will also consult on the most appropriate support mechanism for microgeneration at individual and community level, including the option of a feed-in tariff. The Government will also consider how to address barriers such as planning and grid access.**

Carbon pricing

EU ETS

6.44 Carbon pricing through the EU Emissions Trading Scheme (EU ETS) ensures that energy generators face the cost of their emissions and helps to reduce emissions in the business and energy supply sectors in an effective and least-cost way.

6.45 In the initial phases of the EU ETS, most allowances have been distributed for free. This gives participants a period of transition and recognises that many of their investment decisions were taken before trading was introduced.

6.46 In the longer term, the free distribution of allowances can reduce the incentives for firms to reduce emissions because they do not face the full financial cost of carbon emissions. Auctioning of allowances is the most efficient way to avoid this. The UK is one of the Member States going furthest on auctioning in Phase II, within the limits set by the EU Directive. The UK continues to urge the European Commission to put in place a flexible framework that allows Member States to go further on auctioning in future phases. **Budget 2008 announces that in Phase III the UK will auction 100 per cent of allowances to the large electricity producers' sector.**

Technology policy

6.47 The UK wants the EU to agree a more ambitious emissions trading scheme to serve as the basis for an effective global carbon market. A market price for carbon will help to encourage a change in investment patterns towards a low-carbon energy sector. However the Stern Review was clear that carbon pricing alone will not be sufficient to reduce emissions on the scale and pace required. The risks around climate change and the newness of many of the technologies mean that there is a case for government intervention to support investment earlier in innovation.

Energy Technologies Institute

6.48 The Energy Technologies Institute (ETI), announced in Budget 2006, has now been legally established. A 50:50 partnership between Government and industry, its current membership of BP, Caterpillar, EDF Energy, E.ON UK, Rolls-Royce and Shell aims to raise up to £1.1 billion over ten years for transformational research and development in low-carbon energy technologies. To make the most of the potential that exists in the UK's natural resources, **Budget 2008 announces that the first projects supported will be on offshore wind (a £40 million fund joint with the Carbon Trust) and marine, wave and tidal (up to £20 million).**

Environmental Transformation Fund

6.49 The domestic Environmental Transformation Fund (ETF) allocates over £400 million to ensure that technologies that are in the later stage of development can be brought to market and demonstrated. It is the Government's intention that the ETF is a genuinely transformational fund that works closely with the ETI, research councils and other funding bodies, as well as internationally, to coordinate support across the technology chain. **In the summer, the Government will publish a low-carbon technology strategy, which will detail how the**

coordination of existing and new schemes can maximise the UK's efforts in developing the right technologies to tackle global climate change.

Box 6.4 The domestic Environmental Transformation Fund: allocations

- **Carbon Trust technology programmes (over £90 million) – including offshore wind (joint with ETI), 3rd generation solar photovoltaic, sustainable bioenergy and low cost fuel cells;**
- **energy efficiency demonstration and deployment (over £45 million) – including trials and loans for energy saving in the public sector, small businesses and households; and**
- **renewable energy and low-carbon technologies (at least £200m) – including offshore wind, marine, bioenergy, anaerobic digestion, microgeneration, carbon abatement technologies, hydrogen and fuel cells – including CCS.**

Carbon capture and storage

6.50 The Stern Review highlighted carbon capture and storage (CCS) as a key technology for tackling global carbon emissions. CCS has the potential to reduce carbon emissions from fossil fuel power stations by 90 per cent.

6.51 The UK is taking a lead in demonstrating the technologies at a commercial scale, by launching a competition to design and build the world's first post-combustion coal CCS power station. Bidders will submit responses to pre-qualification criteria by the end of this month – the first step in the process of having an operational CCS power station by 2014. This project creates opportunities for UK industry in constructing and maintaining the plant, designing the capture technology and building transport infrastructure and injection into the carbon store. **Alongside the UK competition, BERR will shortly announce a new call for expressions of interest under the Environmental Transformation Fund to support the development of component parts of CCS.**

6.52 The Government is also developing the regulatory framework for CCS in the UK. The Energy Bill will enable carbon to be captured in the UK and stored in the North Sea. **The Government will shortly be launching a consultation on CCS regulations as well as what it would mean for a new coal-fired power station to be 'capture ready', (i.e. to be in a position to retrofit CCS technology once it is proven at a commercial scale), and whether all new fossil fuel power stations should demonstrate that they are capture ready.**

REDUCING EMISSIONS FROM THE BUSINESS AND PUBLIC SECTOR

6.53 Industry, business and the public sector contribute 19 per cent of the UK's carbon dioxide emissions. Measures in the energy supply sector will help to decarbonise the energy inputs in this sector, but reducing energy demand is also important. Many businesses are already taking action to improve their energy efficiency.

Climate change levy and climate change agreements

6.54 The climate change levy (CCL) is the centre of the Government's policy approach. It was introduced in 2001 to encourage businesses to reduce their energy demand. Climate change agreements (CCAs) provide businesses, in over 50 energy-intensive sectors, with an 80 per cent discount from the levy in return for improving energy efficiency and/or reducing emissions. Independent analysis by Cambridge Econometrics estimates that by 2010 the levy will have reduced energy demand in the commercial and public sector by around 15 per cent a year delivering savings of around 12.8 $MtCO_2$ a year. By 2010, it is estimated that CCAs will deliver savings of around 7 $MtCO_2$ a year. As announced at Pre-Budget Report 2007, the Government intends to extend the CCA scheme until 2017, subject to state aid approval.

6.55 Budget 2007 announced that CCL rates will increase in line with inflation from 1 April 2008 to maintain the levy's environmental impact. **Budget 2008 announces that CCL rates will also be raised in line with inflation from 1 April 2009.**

Energy services

6.56 Energy Service Companies (ESCOs) promote energy efficiency by providing information, finance and installation of energy-saving measures through long-term energy service contracts. By linking their income to energy savings achieved, these contracts save both emissions and costs.

6.57 To help develop the energy services market and support businesses, **Budget 2008 announces that the Government will:**

- **develop voluntary agreements with all energy suppliers to promote the market for energy services.** Suppliers will be expected to develop, trial and promote innovative service packages, commit to better data sharing and monitor their impact;
- **work with businesses to promote knowledge of energy services.** As a first step, the Chancellor will host a summit, bringing together energy service providers and energy suppliers with business groups to promote the market and consider ways to encourage uptake;
- **require energy suppliers to provide smart meters for medium and large businesses within the next five years** to improve information on energy consumption and help support the energy services market; and
- **lead by example in developing the energy services market.** Government procurements should capture the benefits of energy services in the public sector.

Zero carbon buildings

6.58 In the 2006 Pre-Budget Report the Government announced its ambition for all new homes to be zero carbon by 2016. This Budget sets out further measures to help delivery of the zero carbon home ambition (paragraph 6.73). The Government has been working with the UK Green Building Council to develop plans to reduce emissions from new non-domestic buildings down to zero.

6.59 **It is the Government's ambition that all new non-domestic buildings be zero carbon from 2019. The Government will consult this year on the timeline for this ambition and its feasibility, and review progress in 2013.** Achieving this goal will establish Britain amongst the world leaders in the field and make a significant contribution toward mitigating climate change by saving approximately 75 $MtCO_2$ in the next thirty years.

6.60 The Government is taking action to reduce the carbon dioxide impact of public sector buildings. It is already the Government's ambition that all new schools are zero carbon from 2016, and a taskforce is being set up to advise on how to achieve zero carbon schools, whether the timescale is realistic, and how to reduce carbon emissions in the intervening period. **Today the Government announces an ambition for all new public sector buildings to be zero carbon from 2018.** There are key barriers that will have to be overcome in the coming months and years to deliver this, and there may be areas where achieving zero carbon presents particular challenges. **The Government will therefore establish a taskforce to advise on the timeline, how to reduce carbon emissions in the intervening period, and the particular challenges faced in some sectors such as hospitals, prisons and defence establishments.**

6.61 The Government is also putting in place policies to help reduce the carbon dioxide impact of the existing building stock. Many existing buildings that business and the public sector occupy were not designed with energy efficiency in mind. The 2007 Pre-Budget Report announced that microgeneration investments would not be subjected to ad hoc reassessments of business rates liability; **Budget 2008 confirms that this will be implemented from 1 October 2008. The Government will also consider the merits of the further use of fiscal instruments to promote energy efficiency in non-domestic buildings.**

Sustainable public sector procurement

6.62 In order to drive up standards in sustainable procurement for public sector buyers, **the Government is publishing a new policy framework for procurement including practical guidance on how procurers can take the environment into account; will set up a new Centre for Expertise in Sustainable Procurement; and will shortly set out plans to make the Government's use of IT more sustainable.**

REDUCING EMISSIONS FROM THE HOUSEHOLDS SECTOR

6.63 Households account for around a quarter of the UK's energy consumption and 14 per cent of carbon dioxide emissions. Households are also the sector where some of the most cost-effective opportunities for emissions reductions exist: individuals can take action within their own homes that both reduces their impact on the environment and reduces their energy bills. Budget 2008 aims to support and encourage individuals to take action themselves now and in the short-term; and to set standards for new homes that will support zero carbon lifestyles in future.

Products

6.64 Individuals can reduce emissions by the choices they make when using electrical equipment or buying products. Reducing the energy consumed by appliances on standby, and improving the energy efficiency of the products used in homes and offices provides one of the most cost-effective ways to meet the Government's climate change and energy goals.

6.65 In 2007, the Government announced that major retailers, with the support of manufacturers and energy companies, have agreed the ambition to phase out inefficient incandescent light bulbs by 2011, as well as looking at other possible voluntary agreements. The Government is consulting on standards and targets for other products.

Reducing emissions from homes

6.66 Much of the UK's existing housing stock is not designed to be energy-efficient. People can play a major part in reducing emissions by taking simple steps to improve insulation in their homes, making homes more affordable to heat and reducing wasted energy. Budget 2008 highlights existing schemes to help people lower their carbon footprint and save money, and announces new measures to encourage further action.

6.67 One of the key schemes that supports householders in making their homes more energy efficient is the Carbon Emissions Reduction Target (CERT). This scheme obliges energy suppliers to install energy efficiency measures like loft and cavity wall insulation in homes, with estimated spending of £2.8 billion.

Box 6.5 – The Carbon Emissions Reduction Target (CERT)

The Carbon Emissions Reduction Target (CERT) is the latest phase of the successful Energy Efficiency Commitment programme – a scheme that obliges energy suppliers to install energy efficiency measures and promote reductions in carbon emissions for households. CERT will deliver a step change in emissions reductions, delivering carbon dioxide savings of 154 $MtCO_2$ over 40 years (the projected lifetime of the measures). The scheme will not only help reduce emissions but will lower energy bills. CERT obliges energy suppliers to direct at least 40 per cent of carbon dioxide savings to a priority group of people on low incomes and the over 70s. It is estimated that £1.5 billion of efficiency measures might be spent on the priority group. Energy suppliers can lose their licences if they do not meet the targets. The most likely mix of measures, based on information from energy suppliers, industry representatives and experts, will include the following major installations (over the next three years):

- **cavity wall insulation in 1.2 million homes in the priority groups, and 2.9 million homes in total. By the end of CERT approximately half of fillable homes should have been insulated;**
- **loft insulation installed in 1.1 million homes in the priority group and 2.7 million homes in total;**
- **31 million energy-efficient light bulbs provided to priority groups and 110 million such light bulbs in total; and**
- **fuel switching (mainly from electric to gas central heating) in 90,000 homes in priority groups and in 160,000 homes in total.**

6.68 The Green Homes Service, announced by the Prime Minister in November 2007, will be launched on 1 April. The service will help people improve the energy efficiency of their homes, choose lower emissions transport, reduce waste and conserve water. It will direct people to the practical steps they can take, and to the full range of support available, including help through CERT. **Budget 2008 announces the allocation of £26 million to the Green Homes Service in 2008-09**, helping over two million people in its first year. **Budget 2008 also announces that, in order to support effective delivery and to harness the enthusiasm and expertise of community groups and other interested parties, the Government will convene a Green Homes Forum in the autumn.**

6.69 The Government is supporting a collaborative research programme in Materials for Energy, including better insulation for solid walls, with the successful projects to be announced next month. **The Government is also interested in exploring what more can be done to raise awareness amongst the public of the ways and benefits of improving domestic energy efficiency, and to find ways to make solid wall homes more efficient.**

Green electricity

6.70 Consumers can help to reduce emissions now by switching tariffs to green electricity. The Government is keen to ensure that there is clear information for customers on the environmental impacts of different sources of green electricity. **Ofgem will be publishing a set of guidelines in the summer that will give customers greater confidence on the environmental benefits of their tariff.**

Microgeneration

6.71 Microgeneration technologies, such as solar heating and small wind turbines, which can be used at household and community level, have the potential to make an increasingly important contribution over the next few years, to both improved energy security and lower carbon emissions. The Government will continue to work with Ofgem to make it easier for people to comply with relevant regulations.

6.72 On 11 March Ofgem published a report into the microgeneration market in which they noted that there are barriers to consumers obtaining the best rewards from microgeneration. In particular, there is currently no way to compare the prices offered by different companies for selling electricity back to the grid. **The Government will be working with the Energy Saving Trust, Ofgem and energy suppliers to provide this information impartially to consumers.**

Zero carbon homes

6.73 For the longer-term, the Government has outlined its ambition that from 2016 all new homes would be zero carbon. In Pre-Budget Report 2006 the Government announced a time-limited Stamp Duty Land Tax exemption for new zero-carbon homes from 1 October 2007. **This Budget includes further action to meet the Government's 2016 zero-carbon homes ambition:**

- for the homebuyer, the **Government will extend the Stamp Duty Land Tax exemption to new flats, retrospectively from 1 October 2007,** and will make changes to provide for Government departments to charge a fee when assessing whether a dwelling meets the zero-carbon standard;
- to give the construction industry the certainty it requires to prepare for delivering the ambition, **the Government will set out the definition for a zero-carbon home for the purposes of the 2016 ambition by the end of 2008, following a consultation in summer;**
- to drive progress against the ambition the **Government will provide pump-prime funding for a new 2016 delivery unit that will launch this year to guide, monitor and coordinate the zero-carbon programme; and**
- to ensure opportunities to reduce carbon emissions from new housing between now and 2016 are taken up **all new homes built on central government land released through the surplus public sector land programme from April 2008 will reach a minimum of Level 3 of the Code for Sustainable Homes.**

PROTECTING THE UK'S COUNTRYSIDE AND NATURAL RESOURCES

6.74 The Government recognises the importance of protecting and enhancing the natural environment so that domestic growth is more environmentally sustainable.

6.75 It is important to reduce the UK's vulnerability to the impacts of climate change that are already occurring and to prepare for more significant changes to come. As part of new duties introduced under the Climate Change Bill, the Government will produce a strategic risk assessment on the impacts of climate change, looking more than 50 years ahead, and will develop a comprehensive programme to respond to these risks.

Landfill tax

6.76 Landfill tax increases the price of waste sent to landfill, encouraging more sustainable ways of managing waste. The tax – working with other measures – has been successful with overall quantities of waste recorded at landfill sites registered for the tax falling by around 26 per cent. The UK is on track to meet its 2010 targets under the Landfill Directive.

6.77 As announced in Budget 2007, from 1 April 2008 and until at least 2010-11, the standard rate of landfill tax will increase by £8 per tonne each year. In Budget 2007, the Government also announced that the lower rate, applying to inactive waste, will also increase from £2 to £2.50 per tonne from 1 April 2008. The Government expects the standard rate to continue to increase beyond 2010-11. **However, the Government announces today that the lower rate will be frozen at £2.50 per tonne in 2009-10.**

6.78 As set out in Chapter 5, the Government is introducing measures to reform the tax incentives for brownfield sites. As part of this, the Government will remove the exemption from landfill tax for waste arising from the clearance of contaminated land. The revenue derived from removing this exemption will be used to extend land remediation relief. The exemption will be phased out by 1 April 2012.

Landfill communities fund

6.79 The landfill communities fund redresses some of the environmental costs of landfill by improving the environment near landfill sites. Since its introduction in 1996, over £800 million has been spent through the scheme, with over 22,000 projects funded. **The Government today announces that the value of the fund will be increased by £5 million to £70 million for 2008-09. It will also be amending the regulations to reduce the administrative burden on environmental bodies by relaxing their reporting requirements. The Government will also transfer the authority to revoke the enrolment of environmental bodies from the fund's regulator to HMRC.**

Single-use carrier bags

6.80 The Government has already called on retailers to take voluntary action to encourage the shift away from single-use carrier bags. Given the damage that single-use bags inflict on the environment, the Government is committed to taking strong action. **Budget 2008 announces that the Climate Change Bill will legislate so that, if there is not sufficient progress on a voluntary basis by the end of the year, the Government can exercise powers early next year to impose a charge on these bags.**

6.81 **The Government will consult in the meantime on the operation of the charge and how to ensure that any money raised goes to environmental charities. The Government will ensure that donations made by retailers to charitable causes out of any money raised will attract tax relief in the normal way.**

Enhanced capital allowances for waste

6.82 As announced in Budget 2007 the Government has reviewed the classes of equipment that can qualify for enhanced capital allowances (ECAs) for good quality combined heat and power (CHP) to ensure that the scheme includes all necessary equipment for CHP facilities to use solid refuse fuel. This work is now complete and the qualifying criteria will be revised accordingly and incorporated in new lists, which will be published later in 2008.

Aggregates levy

6.83 The aggregates levy was introduced in 2002 to ensure that the external costs associated with the exploitation of aggregates are reflected in the price of aggregate, and to encourage the use of recycled aggregate. There is strong evidence that the levy is achieving its environmental objectives – between 2001 and 2005, sales of virgin aggregate in Great Britain reduced by around 18 million tonnes, with an estimated increase in the use of recycled aggregate in England of nearly 6 million tonnes.

6.84 In Budget 2007, the Government announced that the levy will increase from £1.60 per tonne to £1.95 per tonne from 1 April 2008, reflecting inflation since the introduction of the levy. **The Government announces today that the levy will increase from £1.95 per tonne to £2.00 per tonne from 1 April 2009, to maintain its environmental impact.**

Table 6.2: The environmental impacts of Budget measures

Budget measure	Environmental impacts
Climate change and air quality	
Climate change levy package	The climate change levy is estimated to deliver annual emissions savings of over 12.8 million tonnes of carbon dioxide by 2010[1]. Climate change agreements are estimated to deliver annual emissions savings of around 7 million tonnes of carbon dioxide by 2010.
Carbon capture and storage	Carbon capture and storage demonstration is expected to deliver savings of around 0.7 $MtCO_2$ per year by 2020.
Fuel duty	Fuel duty increases announced for 2008 to 2010 are expected to result in carbon savings of around 0.5 $MtCO_2$ a year by 2010-11.
Support for biofuels	The RTFO is expected to save between 2.6-3 $MtCO_2$ in 2010-11[2].
Abolition of biofuels duty differential	Expected to deliver annual emissions savings of 0.3 $MtCO_2$ in 2012-13.
Rebated fuels	Maintaining the relative differential with main road fuels will deliver small CO_2 and local air pollution benefits through increased use of less polluting fuels and less use of rebated fuels, which are more polluting.
Vehicle excise duty (VED)	The environmental signals provided by VED will help deliver reductions in CO_2 emissions. The numbers of vehicles in the lowest CO_2 emission graduated VED bands are forecast to grow significantly in the longer term in part due to VED reform.
VED incentives for Euro V/VI vans	Encouraging the early take-up of cleaner emissions Euro V diesel vans is expected to deliver accelerated air quality benefits, resulting from lower nitrous oxide and particulate matter emissions of Euro V compliant diesel vans compared to Euro IV equivalents.
Company car tax (CCT)	CO_2 emissions savings of the 2005 reformed CCT system are estimated to be significant, and are forecast to rise to between 1.5 and 3.3 $MtCO_2$ per year in the long run[3].
Company car fuel benefit charge (FBC)	The number of company car drivers getting free fuel for private use has fallen by around 600,000 since 1997, partly as a result of changes to the company car tax system in April 2002 and changes to the fuel benefit rules in April 2003, helping to reduce levels of CO_2 emissions, local air pollutants and congestion[4]. Increasing the FBC in line with the changes in the retail prices index in 2008-09 will deliver a small additional reduction in CO_2 emissions.
Introduction of aviation duty and increase in revenue in 2011-12	CO_2 emissions savings from the increase in aviation taxation are estimated to be approximately 0.75 $MtCO_2$ in 2011-12. In addition, there will be further environmental savings caused by a reduction in other negative environmental impacts, including air quality and noise emissions.
Package to encourage energy service companies	Smart Metering, and benefits from other policies, expected to deliver 0.5 $MtCO_2$ a year by 2020[5].
Zero carbon homes	Small reductions in emissions.
Non-domestic buildings	Ambition for all new non-domestic buildings to be zero carbon from 2019. Estimated to save 75 $MtCO_2$ in the next thirty years.
Landlords Energy Saving Allowance (LESA)	Small reduction of carbon emissions.
Reduced rate of VAT on professionally-installed energy saving materials and microgeneration (from 17.5% to 5%)	Small reduction of carbon emissions.
Reduced rate of VAT on domestic fuel and power (from 8% to 5%)	Estimated to increase carbon emissions by 0.7 $MtCO_2$ by 2010[6].
Protecting the UK's countryside and natural resources	
Landfill tax	Between 1997-98 and 2006-07, the total quantity of waste disposed to landfill sites registered for landfill tax fell by 26 per cent, while the amount of active waste disposed to landfill fell by almost 19 per cent[7]. The landfill tax is expected to save up to 0.2 MtC a year by 2010.
ECAs for waste	Incentivising a market for solid refuel fuel, to encourage more sustainable alternatives to landfill.
Landfill communities fund	The landfill communities fund has provided over £800 million for projects since its introduction.
Aggregates levy and aggregates levy sustainability fund	An 8 per cent reduction in sales of aggregates in the UK between 2001 and 2005. An increase of nearly 6 million tonnes of recycled aggregates in England. Reductions in noise and vibration, dust and other emissions to air, visual intrusion, loss of amenity and damage to wildlife habitats.

ECAs for energy and water-efficient technologies	More sustainable water and energy use by business.
Reform of Land Remediation Relief and phasing out of landfill tax exemption for waste arising from the cleance of contaminated land.	Providing enhanced support for the clean up of contaminated and derelict land in a more environmentally sustainable manner

[1] Modelling the initial effects of the Climate Change Levy, Cambridge Econometrics, available at www.hmrc.gov.uk

[2] DfT.

[3] HMRC modelling.

[4] HMRC modelling.

[5] BERR (Energy billing and metering, Changing Consumer Behaviour: A Consultation on Policies Presented in the Energy White Paper (August 2007))

[6] HMRC modelling

[7] Data at www.uktradeinfo.com, in calendar years.

Financial Statement and Budget Report

A BUDGET POLICY DECISIONS

A.1 The Economic and Fiscal Strategy Report (EFSR) explains how the measures and other decisions announced in Budget 2008 build on those already introduced to advance the Government's long-term goals. This chapter of the Financial Statement and Budget Report (FSBR) brings together in summary form all the measures and decisions that affect the Budget arithmetic that have been announced since Budget 2007 and gives their estimated effect on government revenues and spending to 2010-11. The chapter also includes a summary of the changes to the main rates and allowances for the personal tax and benefit system, the business tax system, value added tax (VAT), environmental taxes, and other indirect taxes.

A.2 The appendices to this chapter provide additional information on Budget measures:

- Appendix A1 provides details of tax changes and other policy decisions which were announced in Budget 2007 or earlier, but which take effect from or after April 2008;
- Appendix A2 explains in detail how the effects of the Budget measures on government revenues are calculated; and
- Appendix A3 provides estimates of the costs to the Government of some of the main tax allowances and reliefs.

A.3 In the text of this chapter, the number or letter in brackets after each measure refers to the line in Tables A1 and A2 where its costs or yield are shown. The symbol '–' indicates that the proposal has no Exchequer effect until at least 2011-12. The symbol '*' indicates that the effect is negligible, amounting to less than £3 million a year.

BUDGET POLICY DECISIONS

A.4 Table A1 summarises the Budget 2008 measures that affect government revenues and spending. These include tax measures, national insurance contributions (NICs) measures, measures that affect Annually Managed Expenditure (AME), and additions to Departmental Expenditure Limits (DEL). Measures that are financed from existing DEL provisions are not included.

Table A.1: Budget 2008 policy decisions

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

Table A.1: Budget 2008 policy decisions (continued)

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

A.5 Table A2 summarises the impact on government revenues and spending of other measures introduced since Budget 2007, including those measures announced in the 2007 Pre-Budget Report and Comprehensive Spending Review.

Table A.2: Other measures announced since Budget 2007

			(+ve is an Exchequer yield)			£ million
			2008-09 indexed	2009-10 indexed	2010-11 indexed	2008-09 non-indexed
		Sustainable growth and prosperity				
a	†	Tax simplification: increase income tax self assessment payment on account threshold	0	–90	0	0
b		Removal of Enterprise Zone Allowances	0	–5	–25	0
c		Extending capital allowances for thermal insulation	0	–5	–10	0
		Fairness and opportunity for all				
d	†	Implementing the state second pension White Paper reforms	0	+320	+450	0
e	†	Modernisation of residence and domicile taxation	0	+700	+500	0
f	†	Indexation of the Working Tax Credit	0	0	0	–390
g	†	Indexation of the disabled child element and the severely disabled child element of the Child Tax Credit	0	0	0	–20
h	†	Increase child element of the Child Tax Credit by £25 in April 2008 and a further £25 in April 2010[1]	–150	–160	–310	–690
i	†	Indexation of income tax allowances	0	0	0	–1,410
j	†	Indexation of national insurance rates and limits	0	0	0	–1,000
k	†	Transferable inheritance tax allowances for married couples and civil partners	–1,000	–1,200	–1,300	–1,100
l	†	Capital gains tax reform	+250	+300	+500	+250
m		Increase in Savings Credit Threshold	+20	+20	+20	+20
		Protecting revenues				
n	†	Removal of national insurance contributions exemption	+200	+200	+200	+200
o	†	Tackling income shifting	0	+25	+260	0
p	†	Life insurance companies avoidance	+20	+30	+30	+20
q	†	Countering interest relief exploitation by individuals	+10	0	0	+10
r	†	Vehicle excise duty enforcement	+10	+20	+25	+10
		Protecting the environment				
s	†	Aviation duty[2]	–60	+110	+520	0
t	†	Non-car vehicle excise duty rates for 2008-09	–5	–5	–10	–5
u	†	Fuel benefit charge: revalorisation since 2003	+80	+70	+65	+80
v	†	Extending the exemption for oils used in electricity generation	–5	–5	–5	–5
w	†	Enhanced capital allowances for biofuel plants	+30	+20	+35	+30
		TOTAL POLICY DECISIONS	–600	+345	+945	–4,000

† *Announced in the 2007 Pre-Budget Report and Comprehensive Spending Review.*

[1] *Negative tax costs. AME spending consequences are included within the Comprehensive Spending Review settlement.*

[2] *Intention to replace air passenger duty by per plane duty from November 2009.*

PERSONAL TAX AND SPENDING MEASURES

Income Tax

Bands, rates and personal allowances

A.6 As announced in the 2007 Pre-Budget Report, all income tax personal allowances for the under 65s will rise in line with statutory indexation in 2008-09. (i)

A.7 The savings and basic rate limits are increased in line with statutory indexation. (23)

A.8 As announced in Budget 2004, the lifetime allowance for tax privileged pension schemes will be £1.65 million in 2008-09. The annual allowance will be £235,000 for 2008-09.

Table A.3: Bands of taxable income

2007-08	£ a year	2008-09	£ a year
Starting rate 10 per cent	0-2,230		
Basic[2,3] rate 22 per cent	2,231-34,600	Basic[1,3] rate 20 per cent	0-36,000
Higher[3] rate 40 per cent	over 34,600	Higher[3] rate 40 per cent	over 36,000

[1] *From 2008-09 the general rule is that all income above personal allowances is taxable at the main rates of tax: the basic rate and the higher rate. There is a 10p starting rate for savings income only. For 2008-09 the starting rate limit for savings will be £2,320. If an individual's non-savings taxable income exceeds the starting rate limit, then the 10p starting rate for savings will not be available for savings income.*

[2] *The rate of tax applicable to interest remains at 20 per cent for income between the starting and basic rate limits.*

[3] *The rates applicable to dividends are 10 per cent for dividend income up to the basic rate limit and 32.5 per cent above that.*

Table A.4: Income tax allowances

	2007-08	£ a year 2008-09	Increase
Personal allowance			
age under 65	5,225	5,435	210
age 65-74	7,550	9,030	1,480
age 75 and over	7,690	9,180	1,490
Married couple's allowance[1]			
aged less than 75 and born before 6th April 1935	6,285	6,535	250
aged 75 and over	6,365	6,625	260
minimum amount[2]	2,440	2,540	100
Income limit for age-related allowances	20,900	21,800	900
Blind person's allowance	1,730	1,800	70

[1] *Tax relief for these allowances is restricted to 10 per cent.*

[2] *This is also the maximum relief for maintenance payments where at least one of the parties is born before 6 April 1935.*

Effects on the Scottish Parliament's tax varying powers – statement regarding Section 76 of the Scotland Act 1998

A.9 A one penny change in the Scottish variable rate could be worth approximately plus or minus £380 million in 2008-09 and plus or minus £400 million in 2009-10. These figures do not include an estimate of the behavioural impacts of invoking the Scottish variable rate. In HM Treasury's view, an amendment to the Scottish Parliament's tax-varying powers is not required as a result of these changes.

National Insurance Contributions

A.10 As announced in the 2007 Pre-Budget Report, the national insurance contributions (NICs) thresholds, limits and flat rates will increase in line with statutory indexation for 2008-09, except the Upper Earnings and Upper Profit Limits (UEL/UPL), which will rise by £75 above indexation per week. There will be no changes to NICs rates for employers and employees, or to the rate of profit related NICs paid by the self-employed. (j)

Table A.5: Class 1 national insurance contribution rates 2008-09

Earnings[1] £ per week	Employee (primary) NICs rate[2] per cent	Employer (secondary) NICs rate[3] per cent
Below £90 (LEL)	0	0
£90 to £105 (PT/ST)	0[4]	0
£105 to £770 (UEL)	11	12.8
Above £770	1	12.8

[1] *The limits are defined as LEL – lower earnings limit; PT – primary threshhold, ST – secondary threshhold; and UEL – upper earnings limit*

[2] *The contracted-out rebate for primary contributions in 2008-09 is 1.6 per cent of earnings between the LEL and UEL for contracted-out salary-related schemes (COSRS) and contracted-out money purchase schemes (COMPS).*

[3] *The contracted-out rebate for secondary contributions is 3.7 per cent of earnings between the LEL and UEL for COSRS and 1.4 per cent for COMPS. For COMPS, an additional age-related rebate is paid direct to the scheme following the end of the tax year. For approved personal pensions, the employee and employer pay NICs at the standard, not contracted-out rate. An age and earnings related rebate is paid direct to the personal pension provider following the end of the tax year.*

[4] *No NICs are actually payable but a notional Class 1 NIC will be deemed to have been paid in respect of earnings between LEL and PT to protect benefit entitlement.*

Table A.6: Self-employed national insurance contribution rates 2008-09

Annual profits[1] £ per year	Self-employed NICs Class 2 £ per week	Class 4 per cent
Below £4,825 (SEE)	0[2]	0
£4,825 to £5,435 (LPL)	£2.30	0
£5,435 to £40,040 (UPL)		8
Above £40,040		1

[1] *The limits are defined as LPL – lower profits limit and UPL – upper profits limit.*

[2] *The self-employed may apply for exemption from paying Class 2 contributions if their earnings are less than, or expected to be less than, the level of the Small Earnings Exception (SEE).*

Tax credits, benefits and personal taxes

Tax credits

A.11 As announced in the 2007 Pre-Budget Report, all the elements of the Working Tax Credit, except for the childcare element, will rise in line with indexation from 6 April 2008 (f)

A.12 As announced in the 2007 Pre-Budget Report, the disabled child element and the severely disabled child element of the Child Tax Credit will increase in line with indexation. (g)

A.13 As announced in the 2007 Pre-Budget Report, from 6 April 2008, the child element of the Child Tax Credit will rise by £25 a year above earnings indexation. This is in addition to the Budget 2007 commitment to increase the child element by £150 from 6 April 2008. (h)

Child Poverty Financial Support

A.14 With effect from 6 April 2009, the first rate of child benefit will increase to £20 per week. (18)

A.15 New child poverty pilots will be introduced from April 2008. (19)

A.16 A Child Benefit disregard will be introduced for Housing Benefit and Council Tax Benefit from October 2009. (20)

A.17 With effect from 6 April 2009, the child element of the Child Tax Credit will be increased by £50 a year above indexation. (17)

Child Benefit **A.18** As announced in the 2007 Pre-Budget Report, from April 2008 Child Benefit will increase in line with indexation to £18.80 and £12.55 for first and later children respectively, and the rate of Guardians Allowance will increase to £13.45. (-)

Child Trust Fund **A.19** The requirement for Child Trust Fund (CTF) providers to receive a CTF voucher to open an account will be removed from 6 April 2009. (-)

A.20 In 2008-09, a one-off payment of £100 will be made to households containing someone aged over 80 and of £50 to households containing someone aged over 60. (21)

Table A.7: Working and Child Tax Credits rates and thresholds

	2008-09 £ a year
Working Tax Credit	
Basic element	1,800
Couples' and lone parent element	1,770
30 hour element	735
Disabled worker element	2,405
Severe disability element	1020
50+ Return to work payment (16-29 hours)	1,235
50+ Return to work payment (30+ hours)	1,840
Childcare element of the Working Tax Credit	
Maximum eligible cost for one child	£175 per week
Maximum eligible cost for two or more children	£300 per week
Per cent of eligible costs covered	*80%*
Child Tax Credit	
Family element	545
Family element, baby addition	545
Child element	2,085
Disabled child element	2,540
Severely disabled child element	1,020
Income thresholds and withdrawal rates	
First income threshold	6,420
First withdrawal rate (per cent)	*39%*
Second income threshold	50,000
Second withdrawal rate (per cent)	*6.67%*
First threshold for those entitled to Child Tax Credit only	15,575
Income disregard	25,000

Armed Forces Council Tax Relief **A.21** As announced on 25 September 2007, a measure will be introduced, with effect from 1 April 2008, to ensure that payments under the new Armed Forces Council Tax Relief scheme will be tax-exempt. (-)

Incapacity benefit **A.22** Starting in April 2010, the eligibility for incapacity benefits of all existing IB claimants will be reassessed using the new Employment Support Allowance Work Capability Assessment (22)

Savings credit **A.23** As announced in the Benefit Uprating Statement on 6 December 2007, from 6 April 2008 the maximum Savings Credit will rise to £19.71 for a single person and £26.13 for a couple. (m)

State Second Pension **A.24** As announced in the 2007 Pre-Budget Report, the introduction of the Upper Accruals Point for the State Second Pension will now take effect from 6 April 2009. (d)

Pensions tax simplification

A.25 As announced in the 2007 Pre-Budget Report, the taxation of pension schemes will be simplified further. A package of measures will cut the administrative burdens arising from the lifetime allowance and anti-avoidance rules, and will simplify protected rights to pre-April 2006 lump sums. (*)

A.26 A measure will be introduced, with effect from Royal Assent, to expand and clarify the scope and tax treatment of authorised payments from pension funds. (-)

A.27 Changes will be made to simplify the rules governing the commutation of trivial pension pots. (*)

Enterprise Management Incentives (EMIs)

A.28 With effect from 6 April 2008, the individual option grant limit for EMIs will be increased to £120,000. Measures will also be introduced, with effect from Royal Assent, to bring EMIs, in line with the EU state aids rules by providing that firms with more than 249 employees, and those involved in shipbuilding, and coal and steel production, will no longer be able to issue qualifying EMI options. (2)

EIS

A.29 Subject to state aids approval, the annual investor limit for an Enterprise Investment Scheme (EIS) investor to claim income tax relief will be increased to £500,000. This increase will apply to investments made from 6 April 2008. (3)

Dividend tax credit

A.30 From 6 April 2009, the non-payable dividend tax credit will be further extended to investors with a 10 per cent or greater shareholding in a non-UK resident company, unless the source country does not levy a tax on corporate profits similar to corporation tax. (5)

A.31 The definition of EEA member state with respect to entitlement to allowances and reliefs will be amended to encompass UK nationals. (-)

Individual Savings Accounts (ISAs)

A.32 As announced on 18 October 2007, savers who withdrew ISA funds from Northern Rock between 13 and 19 September 2007 will be allowed to return their funds to an ISA to restore their tax advantage. (-)

Residence and domicile taxation

A.33 As announced in the 2007 Pre-Budget Report, a package of changes to the rules on residence and domicile will take effect from 6 April 2008. It will introduce a new charge on remittance basis users, remove personal allowances from remittance basis users, close loopholes, correct anomalies in the remittance basis rules and change the rules on day counting for residence. (e)

A.34 From 6 April 2008, the rate of tax payable by remittance basis users in respect of foreign dividend income will be amended to 40 per cent from 32.5 per cent, correcting a Tax Law Rewrite oversight. (4)

A.35 As announced in the 2007 Pre-Budget Report, restrictions in the application of remittance-basis taxation to employment and investment income from the Irish Republic will be removed from 6 April 2008. (*)

Holiday homes owned abroad through companies

A.36 A retrospective exemption will be introduced to remove the tax charge that arises where individuals have private use of an overseas home bought through a company. (*)

Employer provided vans amending the fuel benefit rules

A.37 A measure will be introduced, with effect from Royal Assent, to ensure that the van fuel benefit legislation mirrors that for company cars. (-)

GLA severance pay **A.38** The tax treatment of payments under the new Greater London Authority (GLA) severance pay scheme will be brought into line with those under existing severance pay schemes for Westminster MPs and members of the Devolved Administrations. (-)

CHARITIES AND COMMUNITIES

Gift Aid **A.39** With effect from 6 April 2008, charities will be able to claim Gift Aid at a transitional rate, consistent with a basic rate of income tax of 22 per cent, for three years. (1)

Unclaimed Assets **A.40** A measure will be introduced, with effect from Royal Assent, to ensure that the Dormant Accounts and Unclaimed Assets Scheme does not increase tax or administrative burdens for either financial institutions or their customers. (-)

TAXES ON CHARGEABLE GAINS, INHERITANCE TAX, ASSETS AND PROPERTY

Capital gains tax reform **A.41** As announced in the 2007 Pre-Budget Report, for disposals on or after 6 April 2008 the capital gains tax rate will be set at 18 per cent. Alongside this change, both taper relief and indexation allowance will be withdrawn. As further announced on 24 January 2008, a new entrepreneurs' relief will be available in respect of certain disposals on or after 6 April 2008. This will reduce the effective tax rate to 10 per cent for up to the first £1 million of qualifying gains made over a lifetime. (l)

A.42 From 6 April 2008 the capital gains tax annual exempt amount will be increased in line with statutory indexation to £9,600. (-)

Inheritance tax **A.43** As announced in the 2007 Pre-Budget Report, with effect from 9 October 2007, if an individual's inheritance tax nil-rate band is not used up on their death, the unused proportion can be transferred to their surviving spouse or civil partner. The measure also applies to all widows, widowers and bereaved civil partners alive on 9 October 2007. (k)

A.44 A measure will be introduced, with effect from 22 March 2006, to ensure that the transitional provisions in the inheritance tax rules for trusts enacted in Finance Act 2006 apply as intended. In addition, provision will be made to extend the transitional period to end on 5 October 2008. (-)

A.45 As announced in the 2007 Pre-Budget Report, measures will be introduced to ensure that scheme pensions and lifetime annuities are used solely to provide an income in retirement and not as a means of diverting tax relieved savings into inheritance. The measures will take effect for surrenders made on or after 10 October 2007 and for increases in pension rights attributable to the death of a member from 6 April 2008. (-)

A.46 As announced in the 2007 Pre-Budget Report, a measure will be introduced, with effect from 6 April 2006, to restore protection from inheritance tax charges for savings in overseas pension schemes that are tax-recognised and regulated in their own country, or provide a pension income for life. (-)

SDLT relief for new zero-carbon homes **A.47** A measure will be introduced, with retrospective effect from 1 October 2007, to extend the Stamp Duty Land Tax (SDLT) relief for new zero-carbon homes to new flats. (-)

SDLT simplification **A.48** As announced in the 2007 Pre-Budget Report, a £40,000 notification threshold for SDLT will be introduced from 12 March 2008. SDLT transactions with lower values will no longer need to be notified to HMRC. From 12 March 2008, the SDLT lease duty rule threshold for commercial property will be increased from £600 to £1,000. (-)

A.49 From 12 March 2008, the SDLT lease duty rule will also no longer apply to residential property (10)

A.50 As announced in the 2007 Pre-Budget Report, a measure will be introduced to amend SDLT anti-avoidance provisions introduced in Finance Act 2007 to ensure that where there is a transfer of an interest in a property held within an investment partnership, there is no charge to SDLT. The amendment will apply retrospectively from 19 July 2007. (*)

Stamp Duty – administrative burden reduction

A.51 As announced in the 2007 Pre-Budget Report, and with effect from 13 March 2008, the requirement to stamp instruments transferring stock or marketable securities where the duty is only £5 will be removed. (*)

BUSINESS TAXES, TAXATION OF FINANCIAL SERVICES AND SPENDING MEASURES

A.52 The measures covered in paragraphs A.51 to A.56 apply to corporation tax from 1 April and to income tax from 6 April in the relevant year.

Enterprise Zone Allowance

A.53 As announced on 17 December 2007, Enterprise Zone Allowances will be withdrawn from April 2011 as a consequence of the withdrawal of Industrial Buildings Allowances (IBAs). (b)

Capital allowances

A.54 From April 2008 businesses with main or special rate capital allowances pools that fall to £1,000 or below will be able to write-off the remaining unrelieved expenditure. (13)

A.55 As announced on 7 December 2007, thermal insulation added to existing commercial buildings will be deemed to be plant and machinery and receive capital allowances at 10 per cent from April 2008. (c)

A.56 Expenditure on the replacement of integral features of a building, as defined by the new classification announced in Budget 2007, will be deemed to be capital for tax purposes and attract capital allowances rather than revenue deductions from April 2008. (-)

A.57 As announced in the 2007 Pre-Budget Report, the relief for alterations to buildings in response to a notice from a fire authority will be withdrawn for expenditure incurred from April 2008. (*)

R&D tax credits

A.58 A measure will be introduced in order to meet state aids requirements to prevent future claims for R&D tax credits or Vaccines Research Relief (VRR) from being made by companies in difficulties. It will also introduce a cap of 7.5 million euros on the future amount of aid that can be claimed and require large companies to make a declaration when making VRR claims confirming the incentive effect of the aid. (-)

Associated companies rules

A.59 A measure will be introduced, with effect from Royal Assent, to simplify the associated companies rules relating to the small companies rate of corporation tax. (12)

Tax-based venture capital schemes

A.60 A measure will be introduced, with effect from 6 April 2008, to add shipbuilding, and coal and steel production to the list of excluded activities for the Enterprise Investment Scheme, Venture Capital Trusts and the Corporate Venturing Scheme. (*)

North Sea oil taxation

A.61 A package of measures will be introduced to reform the North Sea Fiscal Regime. This will include changes to the treatment of corporation tax losses created by decommissioning and an extension of 100 per cent first-year capital allowances to long-life assets and mid-life decommissioning, both with effect from 12 March 2008, and reforms to Petroleum Revenue tax, with effect from 30 June 2008. (7)

Property Authorised Investment Funds **A.62** A new elective tax regime for Authorised Investment Funds investing in property will be launched, with effect from 6 April 2008. (*)

Offshore funds **A.63** A measure will be introduced to modernise the tax regime for investment into offshore funds. (*)

Funds of Alternative Investment Funds **A.64** A new elective tax regime for Authorised Investment Funds investing into certain offshore funds will be introduced to coincide with the commencement of the Financial Services Authority's proposed Funds of Alternative Investment Funds regime. (*)

Islamic Finance **A.65** A measure will be introduced, with effect from Royal Assent, to modify the stamp duty definition of loan capital for the purposes of alternative finance investment bonds. (-)

Securitisation **A.66** A measure will be introduced, with effect from Royal Assent, to amend legislation relating to securitisation companies to address anomalies in the rules on stamp duty. (*)

Unclaimed assets **A.67** As a result of the introduction of International Accounting Standards, a measure will be introduced, with effect from on or after 1 January 2008, to spread the repayment of tax to banks and buildings societies on dormant accounts. (6)

Funding bonds **A.68** With effect from 12 March 2008, new legislation will clarify that HMRC will satisfy tax reclaiment claims using funding bonds, where the tax to be repaid was originally paid to HMRC in the form of funding bonds. (-)

Insurance premium tax (IPT) **A.69** With effect from Royal Assent, the requirement for overseas insurers to appoint jointly and severally liable IPT representatives will be removed and the rules under which tax due from overseas insurers can be recovered from an insured party in the UK will be modernised. (*)

Life insurance simplification **A.70** A package of measures will be introduced, generally with effect for periods beginning on or after 1 January 2008, to simplify the tax treatment of contingent loans and financial reinsurance, clarify the tax treatment of structural assets, facilitate the transfers of business between friendly societies, amend the rules on foreign currency assets plus other minor clarifications, corrections and consequential changes. (*)

Commmunity Investment Tax Relief (CITR) **A.71** A measure will be introduced with retrospective effect, to ensure that where a bank invests in a Community Development Finance Institution (CDFI) under the CITR, any deposits that the CDFI makes with the bank in the course of its ordinary banking arrangements will not reduce the amount of tax relief available to the bank. (*)

VALUE ADDED TAX

VAT registration **A.72** From 1 April 2008, the VAT registration threshold will be increased from £64,000 to £67,000 and the deregistration threshold from £62,000 to £65,000. (14)

VAT option to tax **A.73** From 1 June 2008, revised legislation will be introduced to extend the cooling-off period to 6 months and relax the disapplication rules for commercial property sold for housing development. (15)

VAT on fund management **A.74** With effect from 1 October 2008, the VAT exemption for fund management will be extended to the management of listed closed-ended funds and certain overseas investment funds. (16)

Staff hire concession **A.75** The staff hire concession, which currently allows employment businesses to charge VAT solely on the margin on their supplies, will be withdrawn by HMRC with effect from 1 April 2009. (8)

Smoking cessation products **A.76** The reduced VAT rate of 5 per cent for smoking cessation products, introduced on 1 July 2007 as a time-limited incentive, will continue to have effect beyond 30 June 2008. (9)

Empty homes **A.77** As announced in the 2007 Pre Budget Report, on 1 January 2008 the rate of VAT applied to the renovation and alteration of homes that have been unoccupied for between two and three years was reduced to 5 per cent. (*)

ENVIRONMENT AND TRANSPORT TAXES

Climate Change Levy **A.78** The rates of the Climate Change Levy will be indexed from 1 April 2009. (-)

A.79 As announced in the 2007 Pre-Budget Report, subject to EU state aids approval, Climate Change Agreement participants will continue to pay a reduced rate Climate Change Levy until 2017. (-)

Landfill communities fund **A.80** The value of the landfill communities fund for 2008-09 will increase to £70 million from 1 April 2008. (27)

Landfill tax: waste from contaminated land **A.81** A measure will be introduced later in 2008, with the precise date to be confirmed after consultation, to provide that waste from contaminated land disposed of to landfill on or after 1 April 2012 will not be entitled to the contaminated land exemption. (28)

Landfill tax: dredging exemption **A.82** As announced in the 2007 Pre-Budget Report, with effect from 30 October 2007, the landfill tax exemption was extended to include dredged waste that has been treated with additives. (*)

Land remediation relief **A.83** A measure will be introduced to extend land remediation relief to long-term derelict land and to the removal of Japanese knotweed excluding removal to landfill. These reforms will take effect from 1 April 2009. (29)

Capital allowances **A.84** The list of designated energy saving and water-efficient technologies qualifying for 100 per cent first-year capital allowances will be expanded during 2008, to include one new technology class and four sub-technologies. (30)

A.85 The existing enhanced capital allowances for combined heat and power (CHP) will be extended during 2008 to enable CHP facilities to use solid refused fuel. (*)

Aggregates Levy **A.86** The aggregates levy will increase to £2.00 per tonne from 1 April 2009. (*)

Microgeneration: business rates **A.87** As announced in the 2007 Pre-Budget Report, microgeneration investments will not be subject to ad hoc reassessments of business rates liability in England. This will be implemented from 1 October 2008, and such investments will now only be taken into account at the five-yearly revaluation of business rates. (-)

Fuel Duties **A.88** The increase in main road fuel duty rates of 2 pence per litre, due to take place on 1 April 2008, is to be deferred until 1 October 2008. Consequential changes will be made to road fuel gases and biofuel duty rates. Fuel duty rates will increase by 0.5 pence per litre above indexation on 1 April 2010. (31)

A.89 Rebated oil duties will also be frozen until 1 October 2008, and will then rise in proportion to main road fuel duties. They will do the same on 1 April 2009 and 1 April 2010. (32)

A.90 From 2010-11, the biofuels duty differential will cease and the Renewable Transport Fuel Obligation will provide the total support for biofuels. (33)

A.91 As announced in the 2007 Pre-Budget Report, the hydrocarbon oil duties legislation will be simplified from 1 April 2008 to reduce the number of duty rates and remove obstacles to the introduction of more environmentally friendly fuels. (*)

A.92 Following a pilot project for using biodiesel in rail, the duty payable for biofuels off road will be 9.69 pence per litre from 1 April 2008. (34)

A.93 The compressed natural gas differential will be maintained until 2010-11 and the liquefied petroleum gas differential will decrease by 1 pence per litre on each of 1 October 2008, 1 April 2009 and 1 April 2010. (*)

A.94 As announced in the 2007 Pre-Budget Report, with effect from 23 November 2007, biobutanol used as a road fuel in HMRC approved specific pilot projects to test the use of biofuels will be eligible to duty at 30.35 pence per litre. (-)

A.95 As announced in the 2007 Pre-Budget Report, the Government will not pursue state aids clearance for the introduction of an enhanced capital allowance for the cleanest biofuels plant. (w)

A.96 As announced on 26 July 2007, with effect from 1 September 2007, the scope of the existing relief on oils used for electricity generation was extended to include light oils, and to better align the relief with Climate Change Levy legislation. (v)

Vehicle Excise Duty (VED)

A.97 With effect from 1 April 2009, and as set out in Table 8a, VED for cars, registered on or after 1 March 2001, will be reformed to include six new bands. From 1 April 2010, a new first year VED rate will be introduced. With effect from 1 April 2009, and as set out in Table 8b, the lower rate of VED for cars and light good vehicles registered before 2001 is frozen and the higher rate will rise by £15. With effect from 1 April 2009, the VED rate for light goods vehicles registered after 2001 will rise by £15. With effect from 1 April 2010, the VED rate for cars and light goods vehicles registered before 2001 will be increased in line with indexation. (35)

A.98 As announced in the 2007 Pre-Budget Report, in 2008-09 only, the VED rates for motorbikes in the lower band will be frozen, with higher bands increased by £1-2; and rates for heavy goods vehicles, special types vehicles, combined transport vehicles and all vehicle categories linked to the basic goods rate will be frozen. Changes to VED rates for 2008-09 will take effect from 13 March 2008. (t)

A.99 A measure will be introduced, with effect from 1 January 2009, to define the circumstances under which a rebate may be paid on the unexpired portion of a registered vehicle keeper's licence. (*)

A.100 A measure will be introduced with effect from 1 January 2009, giving a VED incentive for early take-up of Euro V technology diesel vans ahead of mandatory introduction in 2011. The incentive will remain for the lifetime of the vans. (36)

A.101 As announced in the 2007 Pre-Budget Report, a measure will be introduced, with effect from 1 September 2008, to permit enforcement of VED on vehicles parked in public places that are not intrinsically part of a private dwelling, where a Statutory Off-Road Notification has not been made. (r)

Company car tax (CCT)

A.102 With effect from 5 April 2010, the lower threshold for the 15 per cent CCT band will be lowered from 135g to 130g of CO2/km. (37)

Fuel benefit charge (FBC)

A.103 As announced in the 2007 Pre-Budget Report, the FBC multiplier will be increased from £14,400 to £16,900 from 6 April 2008. (u)

A.104 In addition, the Government announces that the FBC multiplier will increase at least in line with indexation from 6 April 2009. (38)

VAT: revalorisation of fuel scale charges

A.105 From 1 May 2008, the VAT fuel scale charges will be increased to reflect fuel price inflation. In addition, the table of CO2 bands will be amended slightly to maintain alignment with those used for direct tax purposes. (39)

Cars capital allowances

A.106 With effect from 1 April 2009 for corporation tax purposes and 6 April 2009 for income tax the capital allowance treatment of business cars will be reformed. Expenditure on cars with CO2 emissions above 160g/km will attract a 10 per cent writing-down allowance (WDA) and expenditure on cars with CO2 emissions of 160g/km or below will attract a 20 per cent WDA. The rules disallowing a proportion of car lease rental payments will also be reformed in line with the new capital allowances rules. The 100 per cent first year allowance for qualifying expenditure on cars with very low CO2 emissions will be extended until 31 March 2013, and the qualifying CO2 emissions threshold will be lowered to 110g/km. The 100 per cent first year allowance for infrastructure expenditure on equipment for refuelling vehicles with natural gas or hydrogen will be extended to 31 March 2013. The scope will also be expanded to include biogas fuel. (40)

Table A.8a: VED bands and rates for cars registered after 1 March 2001 (graduated VED)

VED band	2008-09[1] CO_2 emissions (g/km)	2008-09[1] standard rate	2009-10 CO_2 emissions (g/km)	2009-10 standard rate	2010-11 first year rate	2010-11 standard rate[4]
A	Up to 100	0	Up to 100	0	0	0
B	101 – 120	35	101–110	20	0	20
C	121 – 150	120	111–120	30	0	35
D	151 – 165	145	121–130	90	0	95
E	166 – 185	170	131–140	110	115	115
F	Over 186[2]	210	141–150	120	125	125
G	Over 226[3]	400	151–160	150	155	155
H			161–170	175	250	180
I			171–180	205	300	210
J			181–200	260	425	270
K			201–225	300	550	310
L			226–255	415	750	430
M			Over 255	440	950	455

[1] *2008-09 rates take effect from 13 March 2008.*
[2] *Cars registered before 23 March 2006.*
[3] *Cars registered on or after 23 March 2006.*
[4] *Alternative fuel car discount: 2009-10 £20 bands A-I, £15 bands J-M; 2010-11 £10 all cars.*

Table A.8b: VED bands and rates for private and light goods vehicles registered before 1 March 2001 (pre-graduated VED)

Engine size	2008-09[1]	2009-10
1549cc and below	120	120
Above 1549cc	185	200

[1] Rates take effect from 22 March 2007.

New aviation duty

A.107 As announced in the 2007 Pre-Budget Report, air passenger duty will be replaced on 1 November 2009 by a per plane rather than per passenger duty.(s)

A.108 Total revenue from the new per plane duty will be 10 per cent higher in the second full year of operation, 2011-12, than was forecast at the 2007 Pre-Budget Report. (41)

OTHER INDIRECT TAXES AND DUTIES

Tobacco duties

A.109 From 6 pm on 12 March 2008, tobacco duty rates will be increased in line with indexation. (24)

Table A.9: Changes to tobacco duties

	Effect of tax[1] on typical item (increase in pence)	Unit
Cigarettes	11	packet of 20
Cigars	4	packet of 5
Hand-rolling tobacco	11	25g
Pipe tobacco	6	25g

[1] Tax reffers to duty plus VAT.

Alcohol duties

A.110 Excise duties on alcohol will be increased by 6 per cent over indexation from 17 March 2008 and by 2 per cent above indexation in each subsequent year up to and including 2013. (25)

A.111 HM Revenue and Customs will introduce a common method of calculating the excise duty due on all categories of alcoholic drinks later in 2008. (-)

Table A.10: Changes to alcohol duties

	Effect of tax[1] on typical item (increase in pence)Unit	Unit
Beer	4	Pint of beer @ 4.2% abv
Wine	3	175ml glass typical strength
Wine	14	75cl bottle typical strength
Sparkling Wine	18	75cl bottle typical strength
Spirits	55	70cl bottle @ 37.5% abv
Spirits-based RTDs	3	275ml bottle @ 5.4% abv
Cider	3	Litre bottle typical strength
Sparkling Cider	14	75cl bottle typical strength

[1] *Tax reffers to duty plus VAT.*

Betting and gaming duties

A.112 Gaming duty bands will increase in line with indexation for accounting periods starting on or after 1 April 2008. (*)

A.113 From 4pm on 14 March all rates of Amusement Machine Licence Duty will increase in line with indexation. (26)

PROTECTING TAX REVENUES

Tax avoidance disclosure regime

A.114 Legislation will be introduced to improve the system used to identify users of disclosed tax avoidance schemes through the Scheme Reference Number (SRN) system. In particular, the treatment of co-promoters and intermediaries will be changed to ensure that a user of a disclosed scheme is supplied with the SRN issued to the promoter who has disclosed it. The regulation making powers will come into effect on Royal Assent. The substantive provisions will come into effect on a day to be appointed by Order to coincide with the effective date of the regulations. (42)

Stamp Duty Land Tax (SDLT)

A.115 A measure will be introduced later in 2008, with the precise date to be determined after further consultation, to extend the SDLT disclosure rules to residential property costing £1 million or more. (*)

A.116 A measure will be introduced, with effect from 12 March 2008, to counter schemes designed to avoid SDLT by misusing reliefs for financial institutions that use alternative finance schemes to lease property. (51)

A.117 A measure will be introduced, with effect from 13 March 2008, to counter schemes designed to avoid SDLT by misusing provisions for group relief. (52)

A.118 A measure will be introduced, with effect from 12 March 2008, to counter avoidance involving the sale and acceleration of unclaimed capital allowances on plant or machinery. (-)

A.119 A measure would also be introduced to prevent attempts to exploit rules, introduced in Finance Act 2007, to obtain multiple writing-down-allowances for industrial buildings. (-)

Leased plant or machinery

A.120 As announced in the 2007 Pre-Budget Report and on 13 December 2007, measures were introduced, with effect from the respective dates of announcement, to counter avoidance involving the leasing of plant or machinery. (-)

Intangibles

A.121 Legislation will be introduced, with effect from 12 March 2008, to clarify that the application of the 'related party' rules in the corporate intangible assets regime is unaffected by any insolvency arrangements that any company or partnership may be involved in. (45)

Financial products

A.122 As announced in the 2007 Pre-Budget Report, legislation will be introduced, with effect from 9 October 2007, to counter certain schemes that seek to side step the disguised interest legislation. (-)

A.123 Additional legislation will be introduced, with effect from 12 March 2008, to counter further schemes seeking to side step the disguised interest legislation. (43)

A.124 Legislation will also be introduced, with effect from 12 March 2008, to counter schemes that seek to side step certain rules that apply to transfers of income streams. (-)

A.125 For all these areas of financial products avoidance, the Government is consulting with the intention of introducing principles-based legislation in the Finance Bill 2009.

North Sea management expenses

A.126 A measure will be introduced, with effect from 12 March 2008, to prevent the offsetting of the expenses of managing an investment business against ring fence profits. (46)

Controlled Foreign Companies (CFCs)

A.127 A measure will be introduced, with effect from 12 March 2008, to close a number of artificial avoidance schemes involving partnerships and trusts that seek to avoid a charge under the CFC rules. (44)

Transfers of trading stock

A.128 A measure will be introduced, legislating existing practice, with effect from 12 March 2008, to ensure that goods appropriated to and from stock for non-trading purposes will be treated as being disposed of or acquired at their market value in computing trading profit. (-)

Life insurance

A.129 A measure will be introduced, with effect for periods beginning on or after 1 January 2008, and ending on or after 12 March 2008, to attribute interest paid on deposits received from reinsurers to the correct category of business for corporation tax purposes. (48)

A.130 Existing regulatory powers will be used to ensure that in future waivers by the Financial Services Authority of their rules will not have an inappropriate corporation tax impact. However the Government will discuss specific types of waiver that are of concern with the insurance industry before regulations are made. (-)

A.131 As announced in the 2007 Pre-Budget Report, a measure will be introduced for accounting periods ending on or after 9 October 2007 to prevent life insurance companies getting corporation tax relief for expenses relating to certain reinsurance arrangements where they have not borne the economic cost of those expenses. (p)

Sideways loss relief

A.132 A measure will be introduced on 12 March 2008, with immediate effect, to prevent the use of sideways loss relief by individuals for avoidance purposes. (49)

Unauthorised Unit Trusts

A.133 A measure will be introduced, with effect from Royal Assent, to reinstate payments on account for income tax deducted from distributions made by Unauthorised Unit Trusts for the tax year 2008-09 onwards. (50)

Repeal of redundant anti-avoidance provisions

A.134 As part of the anti-avoidance simplification review redundant provisions on bond washing, employment securities, and other transactions in securities will be repealed. This will take effect for accounting periods beginning on or after 1 April 2008 for corporation tax and from 6 April 2008 for income tax. (*)

Employment-related securities

A.135 Legislation will be introduced, with effect from 12 March 2008, to clarify the position relating to employment related shares and securities and to ensure rules to prevent double taxation are not exploited to reduce the amount of tax and National Insurance paid on employment income. (-)

Double taxation: income tax **A.136** Legislation will be introduced, with effect from 6 April 2008, to ensure that the credit for any foreign tax paid on trade or professional earnings is no more than the UK income tax due in respect of the same earnings. (*)

Modernising trusts **A.137** Legislation will be introduced, with effect from 6 April 2006, to rectify an omission in the 2006 Trusts Modernisation legislation whereby payments from settlor-interested trusts can result in beneficiaries' savings and dividend income being pushed into higher rates of tax. (*)

Three year time limit for VAT claims **A.138** Legislation will be introduced to make clear that from 1 April 2009 all claims for over-declared or under-claimed VAT will be subject to a three year time limit. (-)

Employer contributions to pension schemes **A.139** A measure will be introduced, with retrospective effect, to confirm that the amount a company was permitted to deduct in respect of approved occupational pension scheme contributions for accounting periods starting after 31 March 2004 and ending before 6 April 2006 is limited to the amount paid in that period. (-)

Double taxation treaties **A.140** A measure will be introduced, with effect from 12 March 2008, to clarify existing indefinitely retrospective legislation introduced in 1987 to counter double taxation treaty avoidance schemes. This will clarify that the wording of the UK's double taxation treaties does not allow UK residents to avoid paying UK tax on their profits from foreign partnerships. A further, more general, measure will be introduced, with effect from 12 March 2008, to prevent tax avoidance through the misuse of Double Taxation Treaties by UK residents. (47)

Holiday pay exemption **A.141** As announced in the 2007 Pre-Budget Report, the construction industry will maintain the holiday pay exemption until 30 October 2012. For all other sectors, the exemption was removed from 30 October 2007. (n)

Income shifting **A.142** As announced in the 2007 Pre-Budget Report, the Government intended to bring into effect from 6 April 2008 legislation to prevent a tax advantage being gained from income shifting. Following the recent consultation on this issue the Government has decided to undertake a further consultation and now intends to introduce legislation at Finance Bill 2009. (o)

Interest relief exploitation **A.143** As announced in the 2007 Pre-Budget Report, a measure will be introduced, with effect from 9 October 2007, to counter avoidance through the exploitation of interest relief. (q)

Pension contributions **A.144** As announced in the 2007 Pre-Budget Report, a measure to tackle deferral of corporation tax through structural management of employer contributions to pension schemes will be introduced, with effect from 10 October 2007. (-)

A.145 A measure will be introduced ensuring UK tax relief and charges for overseas pension schemes equate with those for registered pension schemes. This measure will take effect from 12 March 2008 for non-UK money purchase pensions schemes and from 6 April 2008 for non-UK defined benefit pension schemes. (-)

Tax and accountancy **A.146** As announced in the 2007 Pre-Budget Report, regulations have been laid to amend, with effect from 1 January 2008, the tax rules relating to companies' hedging of investments in foreign operations. (*)

Avoidance of income tax using manufactured payments **A.147** As announced on 21 January 2008, a measure was introduced, with effect from 31 January 2008, to prevent individuals from obtaining income tax relief for manufactured payments under arrangements designed to avoid tax. (-)

Modernising tax administration

HMRC tribunals **A.148** Measures will be introduced, with effect from the introduction of Ministry of Justice tribunal reforms, to streamline the way appeals against HMRC decisions are handled, in particular to provide a right to an HMRC review of disputed decisions. (*)

Incorrect and late tax returns **A.149** A measure will be introduced, with effect from periods commencing on or after 1 July 2008, to increase the financial limits above which businesses must separately notify HMRC of errors on previously submitted VAT, insurance premium tax, air passenger duty, landfill tax, climate change levy and aggregates levy returns. [*]

Penalties **A.150** For return periods ending on or after 1 April 2009, where the filing date is after 1 April 2010, the new penalty regime for incorrect returns introduced in 2007 for income tax, capital gains tax, VAT, PAYE and NICs will be extended across all other taxes and duties. From 1 April 2009, the penalty regime for failure to notify HMRC of a new charge will be aligned across all taxes and duties. (11)

Payment and repayment **A.151** A package of measures will be introduced, with effect from Royal Assent, to make it easier for taxpayers to pay what they owe on time and effectively tackle those who seek to avoid their obligations by paying late. The measures involve accepting payment by credit card, setting off repayments of one tax against the debts of another, and aligning and modernising HMRC's civil debt enforcement powers. (*)

Compliance checks **A.152** New record keeping requirements, inspection and information powers, and assessing time limits will be introduced to align and simplify the way HMRC checks compliance for income tax, corporation tax, capital gains tax, PAYE, VAT and NICs. Information powers and penalties for failure to comply with these obligations will come into effect on 1 April 2009. Assessing time limits will need a transitional period and will not therefore become fully operative until 1 April 2010. (-)

Income tax self-assessment **A.153** As announced in the 2007 Pre-Budget Report, the payment on account threshold for income tax self-assessment will double from £500 to £1000 from 6 April 2009. (a)

Excise: review and appeal rights **A.154** As announced in the 2007 Pre-Budget Report, a measure will be introduced, with effect from Royal Assent, extending statutory rights to the independent review and appeal process to cover a wider range of decisions made by HMRC concerning excise duties. (-)

Flooding and other disasters **A.155** A measure will be introduced, with effect from Royal Assent, to help those adversely affected by national disasters. The measure allows for interest and surcharges to be waived on tax paid late in such situations and will be first used as announced, on 25 July 2007, in connection with last year's severe flooding across the UK. (*)

APPENDIX AI: MEASURES ANNOUNCED IN BUDGET 2007 OR EARLIER

A.1.1 This appendix sets out a number of tax, benefit and other changes which were announced in Budget 2007 or earlier and which will take effect from April 2008 or later. The revenue effects of these measures have been taken into account in previous economic and fiscal projections.

Table A.11: Measures announced in Budget 2007 or earlier which take effect from April 2008 or later

		(+ve is an Exchequer yield)			£ million
		2008–09 indexed	2009–10 indexed	2010–11 indexed	2008-09 non-indexed
a	Main rate of Corporation Tax reduced to 28%	–1,390	–2,020	–2,220	–1,390
b	General plant and machinery capital allowances at 20%	+1,490	+2,270	+1,815	+1,490
c	Long-life plant and machinery capital allowances at 10%	–210	–380	–380	–210
d	Integral fixtures capital allowance at 10%	+70	+200	+280	+70
e	Industrial Buildings Allowance: phased abolition	+75	+225	+375	+75
f	New Annual Investment Allowance at £50,000	–30	–920	–670	–30
g	R&D tax credit increase to 130%	–50	–100	–100	–50
h	SME R&D tax credit increase to 175%	–20	–40	–40	–20
I	Payable Enhanced Capital Allowances	–10	–20	–20	–10
j	Remove starting rate of Income Tax on non-savings income	+7,440	+8,840	+8,870	+9,750
k	Increase Aged Allowances by £1,180 and raise for 75s and over to £10,000	–810	–940	–970	-850
l	Increase Child Tax Credit by £150 above indexation	–910	–1,000	–1,050	–860
m	Raising the threshold of the Working Tax Credit by £1,200	–970	–980	–990	–860
n	Increasing the Tax Credit withdrawal rate by 2 per cent	+420	+490	+530	+370
o	Income Tax and NICs: phased alignment of higher thresholds	+1,090	+1,560	+1,750	+1,220
p	Income Tax and NICs: raising the higher rate threshold and upper earnings limit	0	-260	–490	0
q	Basic rate of Income Tax reduced to 20 pence	–8,400	–10,050	–10,180	–8,440
r	Raising the ISA cash limit by £600 and the overall limit by £200	–15	–50	–95	–15
s	Inheritance tax: increase threshold to £350,000 in 2010-11 and indexation thereafter	0	0	–95	0
t	Increasing travellers' allowance from outside the EU	–5	–15	–15	–5
u	Extension of the dividend tax credit	–5	–40	–35	–5
v	Energy Products Directive: expiry of derogation	+10	+30	+30	+10
w	Rationalisation of Empty Property Relief	+950	+900	+900	+950
x	Extension of the Landlords Energy Saving Allowance	*	–10	–10	*
y	Aggregates Levy: encouraging the sustainable use of resources	+50	+50	+50	+60
z	Landfill Tax: encouraging recycling	+170	+320	+440	+170
TOTAL POLICY DECISIONS		**–1060**	**–1,940**	**–2,320**	**+1,420**

Corporation tax rates

A.1.2 As announced in Budget 2007, the main rate of corporation tax will be set at 28 per cent for the financial year 2008-09. (a)

Capital allowances

A.1.3 The capital allowances measures set out in paragraphs A.1.4 to A.1.8 apply to corporation tax from 1 April and income tax from 6 April of the relevant year.

A.1.4 As announced in Budget 2007, with effect from April 2008, capital allowances for general plant and machinery investment will be reduced from 25 per cent to 20 per cent. (b)

A.1.5 As announced in Budget 2007, with effect from April 2008, capital allowances for long-life plant and machinery investment will be increased from 6 per cent to 10 per cent. (c)

A.1.6 As announced in Budget 2007, with effect from April 2008, integral features of a building will be separately identified and will receive capital allowances at a rate of 10 per cent. (d)

Industrial and agricultural buildings allowances

A.1.7 As announced in Budget 2007, the industrial and agricultural buildings allowances will be removed in stages between 2008-2011. The allowances will be reduced to 3 per cent for the financial year 2008-09, 2 per cent for 2009-10, 1 per cent for 2010-11 and 0 per cent from April 2011. (e)

Annual Investment Allowance

A.1.8 As announced in Budget 2007, an Annual Investment Allowance of £50,000 a year for plant and machinery investment (excluding cars) will be introduced from April 2008. (f)

R&D tax credits

A.1.9 As announced in Budget 2007, the enhanced deduction element of the small and medium enterprise (SME) R&D tax credits will increase from 150 per cent to 175 per cent from April 2008. The value of the payable credit available will remain broadly at its current value of 24 per cent of qualifying expenditure. (h)

A.1.10 The rate of large company R&D tax credit will increase from 125 per cent to 130 per cent from 1 April 2008. The rate of relief for the Vaccines Research Relief (VRR) will be reduced from 50 per cent to 40 per cent. Changes to the SME R&D tax credit and VRR are subject to approval from the European Commission. (g)

Enhanced capital allowances

A.1.11 As announced in Budget 2007, payable enhanced capital allowances for energy-efficient and water-efficient technology will be introduced from April 2008. Loss-making companies investing in energy and water efficient technology will be able to claim a payable cash credit of 19 per cent of the loss surrendered, subject to a cap of the higher of £250,000 or the PAYE/NICs liabilities of the company. (i)

Personal tax, tax credits and National Insurance changes

A.1.12 As announced in Budget 2007, from 6 April 2008, the 10 pence starting rate will be removed for earned income but will continue to be available for savings income. (j)

A.1.13 As announced in Budget 2007, from 6 April 2008, the additional age-related income tax allowances for those aged 65 and over will rise by £1,180 above indexation. By April 2011, the age-related allowance for those aged 75 and over will increase to £10,000. (k)

A.1.14 As announced in Budget 2007, from 6 April 2008, the child element of the Child Tax Credit will be increased by £150 a year above earnings indexation. (l)

A.1.15 As announced in Budget 2007, from 6 April 2008, the income threshold at which the Working Tax Credit is received in full will be increased by £1,200 to £6,420 per year. (m)

A.1.16 As announced in Budget 2007, from 6 April 2008, the rate at which tax credits are withdrawn will increase from 37 per cent to 39 per cent. (n)

A.1.17 As announced in Budget 2007, from 6 April 2008, the threshold of earnings above which people pay 1 per cent NICs (the upper earnings limit, UEL) will increase by £75 per week above indexation. The following year the UEL will be aligned with the increased level at which the higher rate of tax becomes payable. The upper profits limit (UPL) rises with the UEL. (o)

A.1.18 As announced in Budget 2007, from 6 April 2009, the higher rate threshold will be increased by £800 above indexation. (p)

A.1.19 As announced in Budget 2007, from 6 April 2008, the basic rate of income tax will be reduced from 22 pence to 20 pence. (q)

Individual Savings Accounts

A.1.20 As announced in Budget 2007, from 6 April 2008, Individual Savings Accounts (ISAs) will be made simpler and more flexible, and the investment limit will rise to £7,200, of which £3,600 can be in cash. (r)

Inheritance tax

A.1.21 As announced in Budget 2007, the inheritance tax nil-rate band will increase to £350,000 in 2010-11. (s)

EU travellers' allowances

A.1.22 It has now been agreed in the EU that the increase in travellers' duty and tax-free allowances will come into force on 1 December 2008. The precise sterling value of the new limit will depend on exchange rates, but is expected to be approximately doubled to £290. (t)

Dividend tax credit

A.1.23 As announced in Budget 2007, from 6 April 2008 the non-payable dividend tax credit will be extended to dividends from non-UK resident companies, provided the investor owns less than a 10 per cent shareholding. (u)

Energy products directive

A.1.24 As announced in Budget 2007, following the non-renewal of derogations from the energy products directive, the Government will implement the required legislative changes for oil re-used as fuel and fuel used in private air navigation and boating. The measures will be implemented from 1 November 2008. (v)

Empty property relief

A.1.25 As announced in Budget 2007, empty property relief in national non-domestic rates is to be reformed from 1 April 2008 so that, when first falling empty, office and retail premises receive 100 per cent relief for three months and industrial and warehouse premises the same for six months. Relief will end for property remaining empty beyond these periods. Charities will be exempted from the effects of this reform. (w)

Landlord's Energy Saving Allowance

A.1.26 As announced in the 2006 Pre-Budget Report, the extension of the Landlord's Energy Saving Allowance to corporate landlords is subject to EU state aids approval. If approval is received, the allowance will be available to landlords on the acquisition and installation of energy saving items in residential properties. (x)

Aggregates levy

A.1.27 As announced in Budget 2007, the rate of aggregates levy will increase to £1.95 per tonne from 1 April 2008. (y)

Landfill tax

A.1.28 As announced in Budget 2007, from 1 April 2008, the standard rate of landfill tax will increase each year by £8 per tonne each year until at least 2010-11. The lower rate of landfill tax will also increase to £2.50 per tonne. (z)

APPENDIX A2: EXPLAINING THE COSTING

A.2.1 This appendix explains how the fiscal impact of the Budget and Pre-Budget Report policy decisions is calculated. In the context of these calculations, the net revenue effects for the measures may include amounts for taxes, national insurance contributions, social security benefits and other charges to the Exchequer, including penalties.

Calculating the costings

A.2.2 The net Exchequer effect of a Budget measure is generally calculated as the difference between applying the pre-Budget and post-Budget tax and benefit regimes to the levels of total income and spending at factor cost expected after the Budget. The estimates do not therefore include any effect the tax changes themselves may have on overall levels of income and spending.

A.2.3 They do, however, take account of other effects on behaviour where they are likely to have a significant and quantifiable effect on the cost or yield and any consequential changes in revenue from related taxes and benefits. These may include estimated changes in the composition or timing of income, spending or other economic determinants. For example, the estimated yield from increasing the excise duty on spirits would include the change in the yield of VAT and other excise duties resulting from the new pattern of spending. The calculation of the expected effect of changes in duty rate on consumer demand for excise goods assumes that any change in duty is passed on in full to consumers. Where the effect of one tax change is affected by implementation of others, the measures are normally costed in the order in which they appear in Tables A1, A2 and A1.1.

A.2.4 The non-indexed base columns shown in Tables A1, A2 and A1.1 show the fiscal impact of changes in allowances, thresholds and rates of duty, including the effect of any measures previously announced but not yet implemented, from their pre-Budget level. The indexed base columns strip out the effects of indexation by increasing the allowances, thresholds and rates of duty in line with published levels of indexation or with their forecast assumptions.

A.2.5 Unless otherwise published the indexed base has been calculated on the assumption that:

- income tax and national insurance allowances and thresholds; the child element, the disabled child element and the severely disabled child element, of the Child Tax Credit; the single person, couple, lone parent and disabled worker elements of the Working Tax Credit; the inheritance tax nil-rate band allowance threshold; and the capital gains tax annual exempt amount all increase in line with RPI in the year to the September prior to the respective Budget;

- The climate change and aggregates levy and the vehicle excise, amusement machine licence, air passenger, fuel, tobacco and alcohol duties all rise in line with the projected annual change in the RPI in the year to the third quarter following the respective Budget; and

- VAT thresholds and gaming duty bands rise in line with the change in the RPI in the year to the December prior to the respective Budget.

A.2.6 Implementation dates are assumed to be: 12 March 2008 for fuel and tobacco duties; midnight on the day after the Budget for vehicle excise duty, midnight on the Monday following 12 March 2008 for alcohol duties; 1 May for amusement machine licence duty; 1 July for insurance premium tax, 6 April for income tax, capital gains tax, inheritance tax and tax credits and 1 April for all other taxes and duties.

A.2.7 The yields of measures that close tax avoidance loopholes or tackle tax fraud represent the estimated direct Exchequer effect of the measures with the existing level of avoidance activity.

A.2.8 These estimates are shown on a National Accounts basis. The National Accounts basis aims to recognise tax when the tax liability accrues irrespective of when the tax is received by the Exchequer. However, some taxes are accounted for when the Exchequer actually receives the tax, reflecting the difficulty in determining the period to which the tax liability relates. Examples of such taxes are corporation tax, self-assessment income tax, stamp duty land tax, inheritance tax and capital gains tax. This approach is consistent with other Government publications.

APPENDIX A3: TAX ALLOWANCES AND RELIEFS

A.3.1 This appendix provides the latest estimates of the revenue cost of some of the main reliefs against tax and national insurance contributions in 2007-08 and preliminary estimates for 2008-09. The figures are shown on a full-year accruals basis unless otherwise specified. The appendix covers only reliefs with estimated annual costs of at least £50 million. The costs of minor tax reliefs can be found on the HMRC website. More details on individual tax allowances and reliefs can be found in the HM Treasury publication, *Tax ready reckoner and tax reliefs.*

A.3.2 The full accrual presentation enables the total revenue effect to be shown in a single year for each measure. This presentation differs from that in the earlier tables in Chapter A which adopt the National Accounts basis used in the presentation of UK public finances.

A.3.3 Some allowances and reliefs are called 'tax expenditures'. This is because they are designed to help or encourage particular individuals, activities or products. So for example the exemption of the first £30,000 of payments on termination of employment helps people being made redundant; the R&D tax credits promote expenditure on research by businesses and the relief for Individual Savings Accounts promotes savings by individuals. Such reliefs are often an alternative to corresponding public expenditure payments that would generate similar effects – i.e. there could be a choice between giving a tax relief as an allowance or deduction against tax, or by an offsetting cash payment.

A.3.4 Other allowances and reliefs can reasonably be regarded (or partly regarded) as an integral part of the tax structure and have a universal or at least a more wide-ranging coverage. These are called 'structural reliefs' and the personal allowances are a good example. To the extent that income tax is based on ability to pay, it does not seek to collect tax from those with the smallest incomes. But, even with such structural reliefs, the Government has some discretion about the level at which the relief is set.

A.3.5 The split between structural reliefs and tax expenditures is inevitably broad-brush and the distinction in not always straightforward. Many reliefs combine both structural and discretionary components. Capital allowances, for example, provide relief for depreciation at a commercial rate as well as an element of accelerated relief. It is this latter element that represents additional help provided to business by the Government and is a 'tax expenditure'.

A.3.6 The figures should only be regarded as broad estimates. The loss of revenue associated with tax reliefs and allowances cannot be directly observed, and so the estimates are often based on simplified assumptions. The cost of a relief also depends on the tax base against which it is measured. Largely because of the difficulties of estimation, the published tables are not comprehensive, but do cover the major reliefs and allowances. This means that figures in Table A3.1 are not directly comparable with those of the main Budget measures shown earlier in this chapter.

A.3.7 It is important to note that each relief is costed separately. In some cases the combined cost of a number of reliefs will differ significantly from the sum of the figures for the individual reliefs. The figures do not allow for any behavioral changes as a result of the reliefs. In practice, if a relief was withdrawn, taxpayers' behavior would often alter so that the actual yield from ending the relief would be very different from, and often smaller than, that shown.

Table A3.1 Estimated costs of principal tax expenditures and structural reliefs

	£ million	
	2006-07	2007-08
TAX EXPENDITURES		
Income tax		
Relief for:		
Approved pension schemes	17,400	17,500
Share Incentive Plan	210	210
Approved savings-related share schemes	280	290
Enterprise Management Incentives	140	160
Approved Company Share Option Plans	170	170
Personal Equity Plans	475	450
Individual Savings Accounts	1,625	1,950
Venture Capital Trusts	105	90
Enterprise Investment Scheme	180	160
Professional subscriptions	85	80
Rent a room	110	120
Exemption of:		
First £30,000 of payments on termination of employment	800	800
Interest on National Savings Certificates including index-linked certificates	150	180
Premium Bond prizes	210	280
Income of charities	1,200	1,250
Foreign service allowance paid to Crown servants abroad	65	60
Personal Tax Credits	4,600	4,700
Corporation tax		
R&D tax credits	490	500
Income tax and corporation tax		
Small budget film tax relief	240	120
Large budget film tax relief	240	130
National insurance contributions		
Disregard for:		
Share Incentive Plan	140	150
Approved savings-related share schemes	190	200
Enterprise Management Initiatives	40	50
Approved company share option plans	50	50
Employer contributions to registered pension schemes	8,300	8,300

Table A3.1(cont.) Estimated costs of principal tax expenditures and structural reliefs

	£ million	
	2006-07	2007-08
TAX EXPENDITURES		
Capital gains tax		
Exemption of gains arising on disposal of only or main residence	15,800	16,300
Inheritance tax		
Relief for:		
Agricultural property	230	240
Business property	350	360
Exemption of transfers to charities on death	390	420
Value added tax		
Zero-rating of:		
Food	11,000	11,300
Construction of new dwellings (includes refunds to DIY builders)	7,600	8,200
Domestic passenger transport	2,400	2,500
International passenger transport (UK portion)	150	150
Books, newspapers and magazines	1,650	1,700
Children's clothing	1,300	1,350
Water and sewerage services	1,250	1,300
Drugs and supplies on prescription	1,300	1,350
Supplies to charities	200	200
Ships and aircraft above a certain size	650	700
Vehicles and other supplies to disabled people	300	350
Reduced rate for:		
Domestic fuel and power	2,800	2,950
Certain residential conversions and renovations	150	150
Energy-saving materials	50	50
Women's sanitary products	50	50
STRUCTURAL RELIEFS		
Income tax		
Personal allowance	42,800	45,100
Corporation tax		
Life companies reduced rate of corporation tax on policy holders' fraction of profit	600	750
Tonnage tax	90	110
Income tax and corporation tax		
Double taxation relief	15,000	15,000

Table A3.1(cont.) Estimated costs of principal tax expenditures and structural reliefs

	£ million	
	2006-07	2007-08
TAX EXPENDITURES		
Value added tax		
Refunds to:		
Northern Ireland Government bodies of VAT incurred on non-business purchases under the Section 99 refund scheme	300	300
Local Authority-type bodies of VAT incurred on non-business purchases under the Section 33 refund scheme (includes national museums and galleries under the Section 33A refund scheme)	7,200	7,650
Central Government, Health Authorities and NHS Trusts of VAT incurred on contracted-out services under the Section 41 (3) refund scheme	4,500	4,500
Hydrocarbon Oils Duty		
Tied Oils scheme (industrial reliefs scheme)	200	200
RELIEFS WITH TAX EXPENDITURE AND STRUCTURAL COMPONENTS		
Income tax		
Age-related allowances	2,400	2,500
Reduced rate for savings	220	290
Exemption of:		
British Government securities where owner not ordinarily resident in the UK	1,460	1,460
Child Benefit (including one parent benefit)	1,160	1,200
Long-term incapacity benefit	400	420
Industrial disablement benefits	40	50
Attendance allowance	130	140
Disability living allowance	410	420
War disablement benefits	360	370
Corporation tax		
Small companies' reduced corporation tax rate	4,500	4,500
Exemption for gains on substantial shareholdings	260	260
Income tax and corporation tax		
Capital allowances	19,400	19,650
Of which:		
First year allowances for SMEs	610	640
Enhanced capital allowances for energy saving technology	130	115
Accelerated capital allowances for Enterprise Zones	50	50
Capital gains tax		
Indexation allowance and rebasing to March 1982	310	250
Taper relief	6,300	7,200
Exemption of:		
Annual exempt amount (half of the individual's exemption for trustees)	2,300	2,400
Gains accrued but unrealised at death	590	570

Table A3.1(cont.) Estimated costs of principal tax expenditures and structural reliefs

	£ million	
	2006-07	2007-08
TAX EXPENDITURES		
Petroleum revenue tax		
Uplift on qualifying expenditure	100	80
Oil allowance	850	700
Safeguard: a protection for return on capital cost	50	30
Tariff receipts allowance	50	20
Exemption for gas sold to British Gas under pre-July 1975 contracts	80	40
Inheritance tax		
Nil rate band for chargeable transfers not exceeding the threshold	10,000	11,300
Exemption of transfers on death to surviving spouses and civil partners	1,900	2,100
Stamp duty land tax		
Exemption of transfers of land and property where the consideration does not exceed the £120,000 threshold in 2005-06 and the £125,000 threshold in 2006-07 and non-residential land and property where the consideration does not exceed the £150,000 threshold	570	520
Exemption of all residential transfers in designated disadvantaged wards where the consideration exceeds £120,000 in 2005-06 and £125,000 in 2006-07 but does not exceed £150,000	55	55
Transfers to charities	120	130
Group relief	1,570	1,500
Transfers to registered social landlords	65	95
Value added tax		
Exemption of:		
Rent on domestic dwellings	3,250	3,500
Supplies of commercial property	150	200
Private education	300	300
Health services	850	900
Postal services	200	200
Burial and cremation	100	100
Finance and insurance	4,200	4,500
Betting and gaming and lottery duties	1,250	1,350
Small traders below the turnover limit for VAT registration	1,100	1,150
Air Passenger Duty		
Non-passengers (e.g. cabin crew)	70	130
Vehicle Excise Duty		
Exemption for disabled motorists	170	170

B THE ECONOMY

The UK economy continued to perform strongly in 2007, growing 3 per cent on a year earlier, in line with Treasury forecasts published since the 2005 Pre-Budget Report, and the fastest growth rate among the G7 economies. Inflation returned to close to target from mid-2007. Employment growth picked up during the year, with employment reaching a record high of almost 29½ million; unemployment continued to fall, and the claimant count reached a 32-year low.

Over the past decade, the UK economy has shown clear evidence of much improved resilience in response to a number of shocks and has become the most stable of the G7 economies, having previously been one of the least stable. This provides a solid platform from which to cope with the economic shocks from the ongoing disruption in global financial markets and increased global commodity prices.

Since the 2007 Pre-Budget Report, concerted action by the world's major central banks has helped somewhat to ease pressures in money markets, but conditions in credit markets have deteriorated and a number of markets remain effectively closed. There has been further evidence of this feeding through to tighter credit conditions facing households and companies. In addition, forecasters have revised down their expectations for growth in the euro area and US, despite the significant monetary policy easing and announced fiscal stimulus in the US. Together, the euro area and US account for around two-thirds of the UK's export markets.

Given the nature of the global financial market shock, the judgements and assumptions on which the Budget economic forecast is based are subject to considerable uncertainty. The forecast assumes the negative impact on output growth will be somewhat larger and more prolonged than assumed in the 2007 Pre-Budget Report. The resilience of the UK economy demonstrates the pay-off to the Government's macroeconomic policy framework and promotion of open and flexible product, labour and capital markets. So beyond 2008, the forecast is that GDP growth will pick up as financial markets normalise and markets adjust.

Inflation is currently close to target, but significant increases in global agricultural commodity and energy prices are expected to lift inflation in the short term. In addition, the recent depreciation of sterling will exert continued upward pressure on prices, so although the economy is forecast to be operating below trend from mid-2008, inflation is not expected to move below target.

The Budget 2008 economic forecast is for:

- **UK GDP growth of 1¾ to 2¼ per cent in 2008, picking up to 2¼ to 2¾ per cent in 2009 before returning close to trend rates of 2½ to 3 per cent from 2010; and**
- **CPI inflation to pick up in the near term, before falling back to 2½ per cent by the end of 2008, returning to target in 2009 and remaining on target thereafter.**

As was the case at the time of the 2007 Pre-Budget Report, there are clear risks to the Budget 2008 economic forecast from the disruption in global financial markets. Its extent and duration, and the feed-through to credit conditions faced by households and companies, and hence their spending, remain highly uncertain. These uncertainties reinforce the case for using the bottom end of the growth forecast range when projecting the public finances, a cautious assumption that is regularly audited by the National Audit Office. With UK private business survey indicators pointing to the economy carrying momentum into 2008, and the possibility that GDP growth in the euro area may exceed current expectations, there are also upside risks to the Budget 2008 GDP growth forecast.

INTRODUCTION[1,2]

B.1 This chapter discusses recent economic and financial market developments and provides updated forecasts for the UK and world economies in the period to 2010. It begins with an overview of developments in the world economy and global financial markets, which sets the global context for recent developments and prospects in the UK. It then outlines the UK economic forecast, before concluding with a more detailed discussion of sectoral issues, the components of growth, and risks and uncertainties surrounding the forecast.

B.2 The Budget 2008 economic forecast is made against a backdrop of considerable uncertainty related to the ongoing disruption in global financial markets, and there are clear risks to the forecast emanating from these developments. The extent and duration of the disruption and the feed-through to credit conditions faced by households and companies, and thus private sector spending, remain highly uncertain. Given the nature of the global financial market shock currently unfolding, the judgements and assumptions on which the Budget 2008 economic forecast is based are subject to exceptional uncertainties. This chapter discusses in detail those judgements and assumptions, and the risks and uncertainties to which they are subject.

THE WORLD ECONOMY

Overview

B.3 The world economy entered 2007 with considerable momentum. In 2006, the world grew at its fastest rate for over 15 years, and strong growth carried through into the first half of 2007. However, prospects for the world economy have deteriorated since the time of the 2007 Pre-Budget Report, primarily due to the tightening of credit conditions associated with the ongoing disruption in global financial markets.

B.4 World output growth is expected to slow from 4¾ per cent in 2007 to 4 per cent in 2008, which, though below the rate of the past four years, remains solid from a historical perspective. Estimates of recent world growth rates are lower than those reported in the 2007 Pre-Budget Report, reflecting updated World Bank estimates of the weight of individual economies in the world economy, as explained in Table B1.

B.5 Growth in 2008 is forecast to moderate relatively more among advanced than emerging economies. As a group, the G7 major industrial economies are expected to grow 1½ per cent on a year earlier, down from 2¼ per cent in 2007, and the weakest rate since 2002. Emerging markets should be supported by domestic demand growth and the improvement in macroeconomic fundamentals that has taken place over recent years. As advanced economies slow significantly, world trade growth is expected to moderate to 7 per cent in 2008, still robust by historical standards. Growth in UK export markets is forecast to slow to 5¾ per cent, reflecting relative weakness in the euro area and US, which together account for around two-thirds of UK export demand. On the assumption that credit conditions start to ease during the second half of 2008 and normalise by mid-2009, growth in the US and euro area is expected to pick up in 2009 and 2010 back towards trend rates.

[1] The UK forecast is consistent with output, income and expenditure data to the fourth quarter of 2007 released by the Office for National Statistics (ONS) on 27 February 2008. This release also contained revisions to earlier quarters of 2007, which the Treasury has carried through to other National Accounts series that the ONS has not yet revised, in particular sectoral saving and borrowing. A fully consistent National Accounts dataset will be published by the ONS on 28 March. A detailed set of charts and tables relating to the economic forecast is available on the Treasury's internet site. Copies can be obtained on request from the Treasury's Public Enquiry Unit (020 7270 4558).

[2] The forecast is based on the assumption that the exchange rate moves in line with an uncovered interest parity condition, consistent with the interest rates underlying the economic forecast.

Table B1: The world economy

	Percentage change on a year earlier, unless otherwise stated				
			Forecast		
	2006	2007	2008	2009	2010
World GDP[1]	4¾	4¾	4	4¼	4½
Major 7 countries[2]:					
Real GDP	2¾	2¼	1½	2	2½
Consumer price inflation[3]	1½	3	2	2½	2¼
Euro area GDP	2¾	2½	1¾	2	2¼
World trade in goods and services	9½	7½	7	7¼	7¾
UK export markets[4]	8½	6¾	5¾	6¼	6¾

[1] *For the Budget 2008 forecast, historical world GDP growth estimates have been revised due to the application of new weights to calculate the Treasury's world growth aggregate. This reflects improvements to World Bank estimates of Purchasing Power Parity exchange rates (PPPs) that are used to weight growth in different regions. The revised PPPs give a lower weight to fast-growing emerging economies and a higher weight to slower-growing advanced economies. The effect of these revisions was to lower estimated world GDP growth in 2006 by about ½ a percentage point compared with the estimate reported in the 2007 Pre-Budget Report.*

[2] *G7: US, Japan, Germany, France, UK, Italy and Canada.*

[3] *Per cent, Q4.*

[4] *Other countries' imports of goods and services weighted according to the importance of imports from the UK in those countries' total imports.*

B.6 Since the 2007 Pre-Budget Report, market interest rate expectations in most advanced economies have shifted further to pricing in monetary policy easing, reflecting the weaker outlook for growth. In a number of countries, central banks have reduced interest rates, while in the US, the Federal Reserve has cut interest rates significantly, by 1½ percentage points, bringing them to a two and a half year low of 3 per cent.

Global financial markets

Financial market disruption

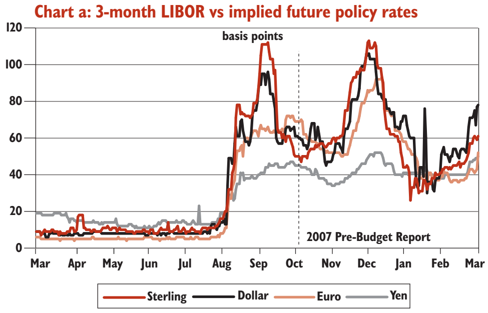
B.7 The Budget 2008 economic forecast is made against a backdrop of considerable uncertainty related to the ongoing disruption in global financial markets. Box B1 sets out the evolving nature of the disruption as it has spread across markets for different financial assets. The implications of these developments for credit conditions facing households and companies in the UK are discussed in more detail later in the chapter.

Box B1: The ongoing disruption in global financial markets

Since July 2007, global financial markets have experienced a period of sustained disruption and volatility that was triggered by concerns in the US sub-prime mortgage market and spread swiftly across countries and markets. Initially, spreads on asset-backed securities and related commercial paper increased sharply. Uncertainty over the precise size and location of potential losses made banks reluctant to lend to one another for more than the shortest periods. This liquidity squeeze has kept the spread between 3-month interbank lending rates and expected policy rates above the level prevailing before July 2007 (chart a). The combination of investors marking down growth and interest rate expectations, and some 'flight to quality' as investors reduced their exposures to private sector risk, pushed short-term government bond yields lower. To a lesser extent interest rate swap rates have also fallen (chart b). This is significant in the UK, where swap rates have played an important role in the mortgage market as the benchmark against which short-term fixed-rate mortgages have been priced.

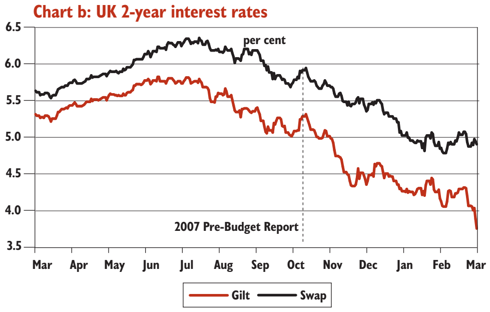
Concerted liquidity provision by the world's major central banks since December has helped somewhat to ease short-term pressures in interbank markets, but strains in credit markets have intensified. Long-term funding markets such as those for residential mortgage-backed securities are still effectively closed, and markets for securitised assets more generally have become increasingly strained. Increased uncertainty in credit markets is evident from credit default swap spreads, which have been rising since the beginning of January, suggesting investors have become more wary of credit risk (chart c). For the most part, the disruption in money and asset-backed securities markets had a muted impact on stock markets through the second half of 2007, and emerging market indices continued to perform strongly. Since January, that situation has changed, with stock markets in advanced and emerging economies declining (chart d).

Chart a: 3-month LIBOR vs implied future policy rates



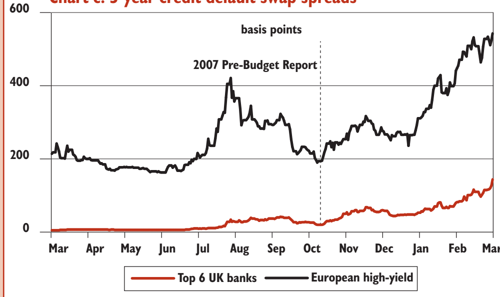
Source: Bloomberg

Chart b: UK 2-year interest rates



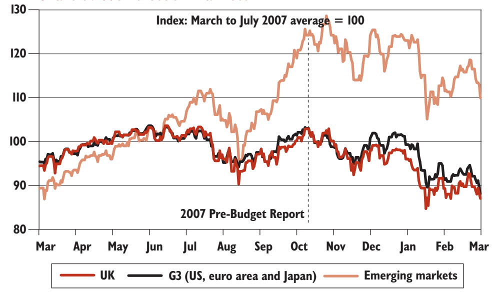
Source: Bloomberg

Chart c: 5-year credit default swap spreads



Source: Bloomberg and Treasury calculations.

Chart d: World stock markets



Source: Bloomberg and Treasury calcuations.

Advanced economies

Euro area

B.8 Solid growth in the euro area continued through 2007, with the economy expanding 2½ per cent, compared with an estimated trend rate of growth of around 2 per cent. Growth continued to reflect the strength of domestic demand, particularly business investment driven by strong profitability and high capacity utilisation rates. Improvements in the labour market have continued, with unemployment falling continuously since early 2005. Against this, business survey and consumer confidence indicators have fallen in recent months, pointing to a slower expansion in the quarters to come. Core and headline inflation increased throughout the second half of 2007, to 2.3 per cent and 3.2 per cent respectively, and the European Central Bank has kept interest rates on hold at 4 per cent.

B.9 Euro area GDP growth is expected to slow to below-trend rates in 2008, before returning to around trend in 2009. Strong labour market conditions are expected to support consumption overall, although weaker consumer confidence and retail sales in recent months suggest private consumption growth will be slower in 2008 than in 2007. Business investment growth is also expected to moderate, reflecting tighter credit conditions. Net exports are expected to weaken as the stronger value of the euro takes effect. Since the 2007 Pre-Budget Report, the consensus forecast for euro area GDP growth in 2008 has been revised down by 0.4 percentage points to 1.6 per cent.

United States

B.10 While US GDP growth in 2007 was broadly in line with expectations, the outlook has deteriorated considerably since the 2007 Pre-Budget Report. The correction in the housing market has become more acute, with one measure of house prices falling for 17 consecutive months and housing activity falling at its fastest rate in over a decade. The labour market has shown signs of weakening more recently, with a fall in payroll numbers and the unemployment rate up to around 5 per cent. There has also been a broad-based tightening of lending standards, which is expected to constrain business investment.

B.11 Headline inflation, which in the US is particularly sensitive to developments in oil prices, increased sharply towards the end of 2007, to over 4 per cent. Core inflation has remained more stable but has also picked up in recent months. Inflation is expected to moderate during 2008 reflecting weaker domestic demand growth.

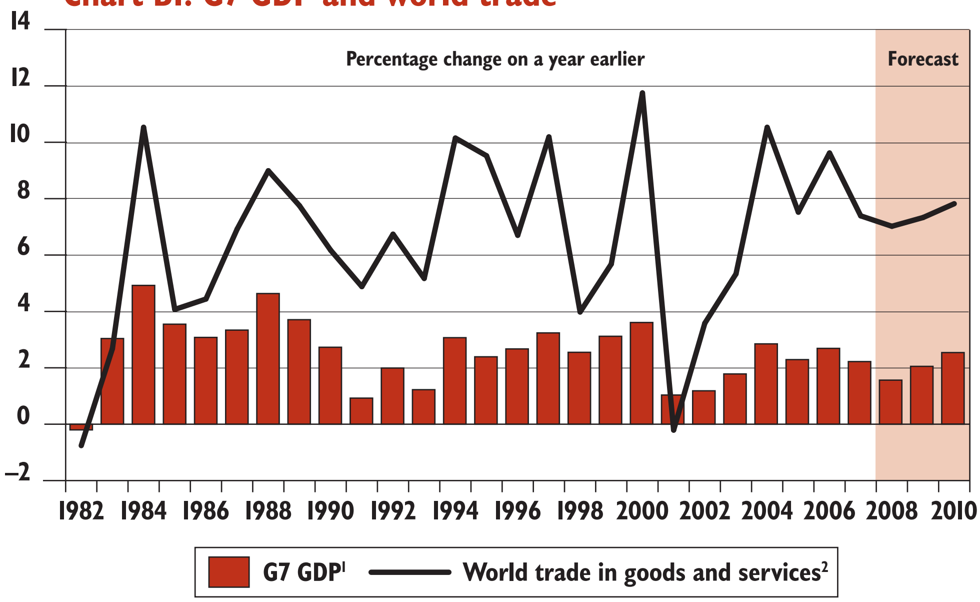
B.12 Against this deteriorating backdrop, authorities in the US have responded to support the economy. The Federal Reserve has cut interest rates by 2¼ percentage points since August 2007. The US Congress has passed a fiscal stimulus package, including more than $100 billion of personal tax rebates and further measures aimed at stimulating business investment. Overall, it is estimated that the package will total around 1 per cent of GDP.

B.13 Forecasters expect the US slowdown to be sharper than was envisaged at the time of the 2007 Pre-Budget Report, with the consensus forecast for US GDP growth in 2008 revised down by 0.8 percentage points to 1.6 per cent. Growth is expected to be very weak in the first half of 2008, before recovering thereafter on the back of more supportive conditions. The consensus forecast is for 2.6 per cent growth in 2009, close to estimates of trend growth in the US of around 2¾ per cent. Weak consumption growth should be boosted temporarily in the second half of 2008 as the fiscal stimulus takes effect. The positive outlook for net exports, supported by a weakening dollar, should mean continuation of the recent improvement in the US current account position.

Japan

B.14 In 2007, recorded GDP growth in Japan remained volatile, although the economy expanded by 2 per cent in the year as a whole. Growth has been supported by net exports, which have so far been insulated from slowing demand in the US by strong demand from other markets. Business investment has moderated slightly and consumption has remained sluggish. Recent confidence surveys suggest the economy is likely to slow in coming quarters.

Since the 2007 Pre-Budget Report, the consensus forecast for GDP growth in Japan has been revised down by 0.5 percentage points to 1.4 per cent. Core inflation in Japan remains negative, but rising energy prices caused headline inflation to pick up at the end of 2007, raising concerns about cost pressures reducing the profitability of export industries.



[1]Real GDP (major 7 countries) at constant prices
[2]Treasury estimates based on OECD data

Emerging economies

Emerging Asia **B.15** Emerging Asia expanded at the fastest rate for over a decade in 2007. Growth in the region is expected to moderate from these very high rates in 2008, but to remain strong overall, supported by rising domestic demand. Although slower growth in advanced economies will impact on the region, many countries have become less reliant on US demand, with the euro area and intra-Asian trade accounting for an increasing share of exports.

China **B.16** Growth of around 11½ per cent in China in 2007 reflected increasing private consumption and strong business investment growth, with net exports making a more modest positive contribution than in recent years, though China's large current account surplus continued to expand. Headline inflation has remained elevated as a result of high food prices, although core inflation has remained low and stable. In response to higher inflation, the People's Bank of China has tightened monetary policy, including by doubling reserve requirements ratios over the past 18 months. GDP growth is expected to moderate towards more sustainable levels of 9 to 10 per cent as growth in export markets slows and tighter monetary policy begins to bite.

India **B.17** In 2007, the increasing contribution of domestic demand to growth in India continued, due to rising private consumption and government spending. GDP growth is expected to moderate through 2008, reflecting weaker contributions from domestic and external demand, to rates closer to estimated trend rates of 8 to 9 per cent. Higher interest rates, appreciation of the Indian rupee, and lower domestic food prices resulting from a bumper harvest, helped to reduce inflation in 2007, although food prices have started to rise again more recently.

Emerging Europe **B.18** In 2007, growth in Central and Eastern Europe slowed somewhat, reflecting strong domestic demand growth but a negative contribution from net exports. Domestic demand has been supported by high wage and credit growth, leading in turn to rising inflation and concerns about overheating in some countries. Growth is expected to continue to moderate in 2008.

Russia **B.19** Growth in Russia remained strong in 2007, driven by private consumption and business investment. Inflation picked up through the second half of 2007, reflecting rising food prices and rapid money growth. Growth is expected to moderate, while lower energy prices and appreciation of the Russian rouble are expected to contribute to weaker net exports and a smaller trade surplus.

Latin America **B.20** Growth in Latin America, and especially Brazil, was stronger than expected in 2007, maintaining the pace of expansion from 2006. Economic activity in the region is expected to moderate somewhat in 2008, reflecting a weaker contribution from net exports. The relatively closed nature of economies in the region, combined with more diversified export markets built from strong growth in trade with Asia and Europe, should limit regional exposure to slower US growth. A high dependency on commodity exports makes the region vulnerable to price fluctuations in those markets. In some countries, higher food prices and fiscal expansion have contributed to inflation remaining elevated.

World trade and UK export markets

World trade **B.21** As forecast at the time of the 2007 Pre-Budget Report, world trade growth slowed in 2007, to 7½ per cent on a year earlier, reflecting a broad-based slowdown across all regions. World trade growth has exceeded its historical average in recent years, driven by the ongoing integration of emerging markets into the world's trading system. In 2007, Asian countries, excluding Japan, and emerging Europe are estimated to have accounted for around half of total world trade growth.

B.22 World trade growth is expected to moderate in 2008 as the world economy slows. A considerable share of emerging economies' trade, particularly within Asia, consists of goods in the intermediate stages of production that are ultimately exported outside the region. As a result, while greater diversification of export markets has made many economies less dependent on US demand than in the past, trade in both advanced and emerging economies is still likely to be affected by slower growth in advanced economies. In line with developments in world output growth, world trade growth is expected to recover somewhat from 2009.

UK export markets **B.23** Growth in UK export markets moderated to around 6¾ per cent on a year earlier in 2007, and is expected to slow to 5¾ per cent in 2008, as G7 growth slows. The moderation is expected to exceed that in world trade overall, since around two-thirds of UK exports go to the US and the euro area, where demand growth is expected to slow more than in emerging markets.

Oil and other commodity prices

B.24 Following several years of strong gains, commodity prices remained very high during 2007. Energy prices have risen most dramatically, although industrial metals prices have also increased strongly. More recently, prices of agricultural commodities have risen sharply. These trends are discussed further in Box B2. Energy, food and metals prices are expected to moderate in 2008, reflecting the combination of additional supply capacity and slowing world demand. As always, the outlook for commodity prices is sensitive to geo-political, regulatory and weather-related risks in the major producer and consumer nations, representing a key risk to the economic forecast.

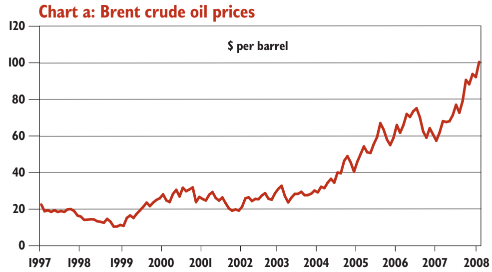
Box B2: Developments in commodity prices

Since 2002, oil and other energy prices have risen rapidly and, following some moderation in the second half of 2006, they continued to do so in 2007 and early 2008. The price of a barrel of Brent crude oil, the European standard, averaged around $73 in 2007 and $93 in February 2008, compared with $25 in 2002 (chart a). Since the 2007 Pre-Budget Report, oil prices have risen above consensus forecasts due to low levels of inventories in advance of increased winter demand, contributing to increases in headline inflation rates in a number of countries towards the end of 2007. Consensus forecasts for oil prices in 2008 show analysts expect prices to fall, as supply growth is expected to exceed demand growth, thereby increasing spare capacity.

Since early 2006, agricultural commodity prices have risen sharply, further lifting headline inflation, particularly in emerging markets. Soybean and grain prices have shown some of the biggest increases, with wheat prices briefly reaching an all-time high of $13 a bushel during the past month (chart b). While increased demand, particularly from large emerging markets, but also for bio-fuels, has contributed to higher food prices, supply disruptions have been the more dominant driver of the recent sharp rises. Grain prices in particular were affected by poor harvests in a number of countries, most notably a serious drought in Australia. In line with the assessment of the United Nations' Food and Agriculture Organisation, food prices are expected to moderate in 2008, reflecting an improvement on last year's poor harvests, and lower energy and transport costs.

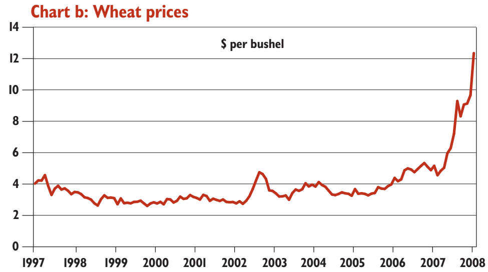
Metals prices have also risen significantly in recent years, driven by strong demand from emerging markets, especially China. Industrial metals prices eased towards the end of 2007, and are expected to continue to moderate in 2008, in line with slower world growth and increasing supply. Steel prices are, however, expected to rise following an agreement between producers to pay up to 70 per cent more for iron ore.

Chart a: Brent crude oil prices



Source: Bloomberg

Chart b: Wheat prices



Source: Bloomberg

Box B3: Government policy on EMU

The Government's policy on membership of the single currency was set out by the former Chancellor in his statement to Parliament in October 1997, as set out in Box B1 of Budget 2007.

The Chancellor's statement to the House of Commons on 9 June 2003 on UK membership of the single currency set out a reform agenda of concrete and practical steps to address the policy requirements identified by the assessment of the five economic tests. This Budget, and *The UK economy: analysis of long-term performance and strategic challenges* published alongside the Budget, set out progress on the Government's reform agenda, including on reforms to enhance the flexibility of labour, capital and product markets in the UK.

On the Stability and Growth Pact, the Government continues to emphasise the need for a prudent interpretation of the Pact as described in Budget 2004. The reforms to the Pact agreed in March 2005 rightly place a greater focus on the avoidance of pro-cyclical policies, and on achieving low debt levels and thereby enhancing the long-term sustainability of public finances, with the flexibility for low debt countries such as the UK to invest in the provision of much needed public services. The Government continues to work closely with Member States and EU institutions as the success of these reforms relies on how they are implemented and used. It is also essential to recognise the importance of national frameworks and national ownership of fiscal policy.

In his statement to the House of Commons on 9 June 2003, the former Chancellor committed the Government to an annual review of progress. The Government does not propose a euro assessment to be initiated at the time of this Budget. The Treasury will again review the situation at Budget time next year, as required by the Chancellor's June 2003 statement.

UK ECONOMIC FORECAST

The Treasury's approach to economic forecasting

B.25 Economic forecasting inevitably involves judgement about the uncertain path of future events, which is informed by analysis of past economic performance. The following paragraphs set out the Treasury's general approach to economic forecasting. Given the nature of the global financial market shock currently unfolding, the judgements and assumptions on which the Budget 2008 economic forecast is based are subject to considerable uncertainties.

B.26 The Treasury's approach to forecasting macroeconomic developments, set out in detail in Budget 2007,[3] accords with the growth cycle approach favoured by many policymakers. The essential building blocks of this approach are the estimate of the 'trend' level and rate of growth of output, and analysis of cyclical movements around that trend, the 'output gap'. The trend growth projection provides the medium-term anchor for the forecast. The current output gap estimate, and an assessment of the economy's momentum based on analysis of the individual output, income and expenditure components of activity, informs judgement on the path of the economy back towards trend.

B.27 The Treasury assesses trend output growth on the basis of non-oil gross value added (GVA) rather than overall GDP because, while the oil and gas sector affects output, it has little direct impact on capacity pressures in the rest of the economy, and hence the sustainable level of non-oil activity or employment.

[3] See paragraphs B.30 to B.35 of Budget 2007.

B.28 Once the effects of known shocks are forecast to have dissipated, and the economy is forecast to have returned to trend, growth is generally held at its trend rate and the output gap at zero. That is not to suggest that the growth rate will actually be constant in later periods of the forecast, but that future shocks to the economy are as likely to be positive as negative so that, on average, the best forecast of growth once present shocks have worked through will be the trend rate.

B.29 The UK's growth performance over the past decade provides evidence of how a flexible economy can prove resilient to shocks, absorbing their impact and rebounding, often sooner than forecasters predict. Such adjustment is a natural process in well-functioning market economies, where shocks deliver price signals that encourage firms and households to reallocate their resources to different activities. The resilience of the UK economy over the past decade is described in Box B4. It is the ability to adjust quickly and smoothly to changing economic circumstances that allows an economy to be resilient to shocks, and thus to achieve and maintain macroeconomic stability. These characteristics inform the Treasury's assessment and judgements on the path of the economy back towards trend over the forecast period.

Overview of recent developments

B.30 Over the past decade, the UK economy has proved strong and stable, with GDP growth averaging almost 3 per cent a year and inflation close to the Government's symmetric inflation target. The economy has continued to adapt flexibly to the changing economic circumstances presented by globalisation and technological change, focusing resources on areas of comparative advantage and creating almost 3 million jobs. As discussed in *The UK economy: analysis of long-term performance and strategic challenges*,[4] published alongside Budget 2008, the flexibility and resilience of the UK economy provides a solid platform from which to meet immediate and longer-term challenges.

[4] *The UK economy: analysis of long-term performance and strategic challenges*, HM Treasury, March 2008.

Box B4: Resilience of the UK economy

Economic shocks are a regular feature of developments in an open economy like the UK. Whether a shock is positive – for example, advances in information and communications technologies – or negative – for example, oil prices rising to $100 a barrel – the economy must adjust to the changing economic landscape. The greater the resilience of an economy in the face of shocks, the shorter the time taken to adjust, and the lower the costs incurred while that adjustment takes place.

Over the past decade, the UK economy has demonstrated much improved resilience, delivering macroeconomic stability and positive growth despite a number of significant global economic shocks:

- **The Asian crisis of 1997, and the Long-Term Capital Management hedge fund collapse and the Russian debt crisis of 1998, created considerable volatility in global financial markets. UK financial sector output slowed, falling briefly, but overall GDP growth remained strong. Financial sector growth recovered quickly in late 1999.**
- **Following the bursting of the dotcom bubble in 2000, and the terrorist attacks of September 2001, global equity prices fell by around 50 per cent. Again, UK financial sector output slowed, and briefly fell, before rebounding strongly. UK GDP growth remained positive throughout, with slower growth of 2¼ per cent in 2001 and 2 per cent in 2002 followed by stronger growth of 2¾ per cent in 2003 and 3 per cent in 2004.**
- **More recently, the combination of the sharp rise in oil prices, euro area weakness and a subdued housing market contributed to measured growth slowing in 2005 to 1¾ per cent, although the cyclical indicators monitored by the Treasury are not consistent with such a significant slowdown between 2004 and 2005. The economy rebounded quickly, with slightly above-trend rates of growth of 3 per cent in both 2006 and 2007.**

A Treasury Economic Working Paper published alongside Budget 2008[a] builds on OECD analysis exploring evidence of resilience in the UK and 13 other OECD countries over the past two decades. While still an area of ongoing research, the paper finds that most economies demonstrated improved resilience in the 1994 to 2005 period compared with 1982 to 1993. For the UK, the analysis suggests the improvement was particularly marked, with the UK estimated to have been the most resilient of the economies studied in the latter period. The paper finds some evidence that improvements in product and labour market flexibility have contributed to greater resilience in the UK and other advanced economies.

After a decade of sound macroeconomic policy and the promotion of flexible and open product, labour and capital markets, there is clear evidence that the UK economy is more resilient than in the past. The pay-off has been seen in much enhanced macroeconomic stability, and provides a strong foundation from which to deal with current economic shocks.

Chart a: GDP growth

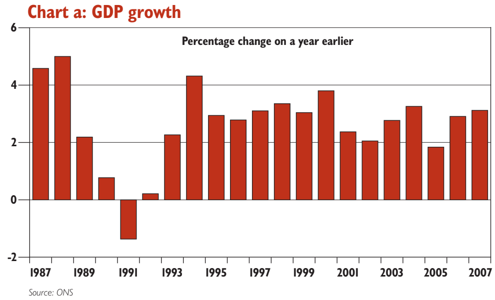
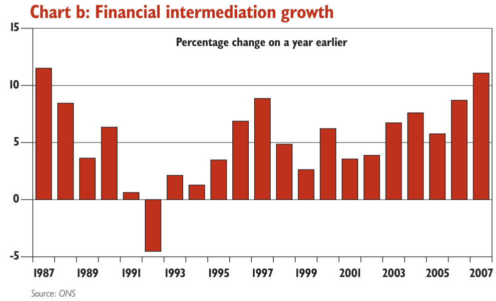


Chart b: Financial intermediation growth



[a] *Resilience in the UK and other OECD economies: Treasury Economic Working Paper No.2*, HM Treasury, March 2008.

GDP growth

B.31 The UK economy continued to perform strongly in 2007, growing 3 per cent on a year earlier, in line with Treasury forecasts published since the 2005 Pre-Budget Report, and the fastest growth rate among the G7 economies. Non-oil GVA growth was slightly higher, at 3¼ per cent on a year earlier.

B.32 The largest contribution to GDP growth came from private consumption, which grew by 3¼ per cent and accounted for around 2 percentage points of whole economy GDP growth. Whole economy investment contributed 1 percentage point to growth, reflecting business investment growth of 6¾ per cent on a year earlier. Including the contribution of stock building, the domestic private sector fully accounted for growth in 2007. With the UK having expanded at a faster rate than its major trading partners, import growth exceeded export growth, with the result that recorded net trade subtracted around ½ a percentage point from overall GDP growth.

Labour market developments

B.33 Employment growth picked up through 2007, from around 50,000 during the first half of the year to almost 250,000 during the second half. On the Labour Force Survey measure, the unemployment rate, which started the year at 5½ per cent, began to fall in the second quarter and reached 5¼ per cent by the end of the year. The claimant count fell in every month of the year, falling below 800,000 in January 2008 for the first time since mid-1975. The claimant count has fallen by more than 160,000 since September 2006. Average earnings growth excluding bonuses, as measured by the Average Earnings Index, was stable and subdued throughout 2007, ranging between 3½ and 3¾ per cent on a year earlier. The experimental Average Weekly Earnings measure suggested somewhat stronger earnings growth, rising from 3¾ per cent on a year earlier in the first quarter of 2007 to 4½ per cent by the final quarter.

Credit conditions

B.34 At the time of the 2007 Pre-Budget Report, the disruption in financial markets was in its early stages and its likely impact on credit conditions facing households and companies was highly uncertain. The forecast assumed some feed-through to tighter conditions and hence to household and company spending in the short term, but that conditions would ease relatively soon. It was noted that the longer the disruption persisted, the greater the risk of it impacting negatively on credit conditions and detracting further from growth. Box B5 sets out the channels through which tighter credit conditions could affect the real economy.

B.35 Since the Pre-Budget Report, there has been clear evidence that the disruption in financial markets has evolved. The intervention of the world's central banks helped to ease pressures in money markets somewhat, but conditions in a number of credit markets have continued to deteriorate. Some markets, notably those related to mortgage-backed securities, remain effectively closed. As the disruption has spread and intensified in credit markets, so credit conditions facing households and companies have tightened. The Bank of England's *Credit Conditions Survey* published in early January showed lenders had tightened conditions significantly for all types of borrower, and that they expected to tighten conditions further in the first quarter of 2008.

B.36 Bank of England data on average quoted interest rates show that the feed-through from market rates to lending rates has been abnormally muted in recent months. For example, the 2-year swap rate has fallen by almost 1 percentage point since October, but the average quoted interest rate on a 2-year fixed rate mortgage, which typically moves in step with the swap rate, has fallen only slightly. There has also been some evidence of reduced availability of mortgage products, and increases in fees and other charges.

Box B5: Credit conditions and the real economy

The ongoing disruption in financial markets has affected credit conditions facing households and companies. Assessing the likely response of banks and other credit issuers to developments in financial markets, and of companies and households to developments in credit conditions, represents the primary uncertainty for the Budget 2008 economic forecast.

- **For banks, the deterioration in wholesale capital markets has increased funding costs. Higher funding costs could be passed on to borrowers through higher retail interest rates or related fees, which might be combined with a degree of credit rationing until markets normalise. Strains on banks' balance sheets caused by writing down the value of sub-prime and other related assets, bringing some previously off-balance sheet assets onto their balance sheets, and falls in commercial property prices, could also lead banks to reduce the availability and raise the price of credit, particularly to riskier borrowers, in order to rebuild their capital.**
- **Tighter credit conditions facing companies and reduced availability of credit tend to reduce investment spending, since higher financing costs lower the net return from investment. Even for firms with sufficient free cashflow to fund investment from internal sources, the cost of capital would still be higher, and so inhibit investment spending.**
- **Tighter credit conditions facing households and reduced availability of credit tend to reduce consumer spending and encourage saving, through the higher cost of borrowing and return on saving. Reduced availability of credit would also tend to increase the number of credit-constrained households and so reduce the ability of households in aggregate to maintain spending in the face of slower income growth.**

At the macroeconomic level, the size of the impact on consumer and investment spending is likely to depend on the household and corporate sectors' financial position. Over the past 5 years, the UK non-financial corporate sector has run a financial surplus, while the UK household sector has run a financial deficit. This suggests that if the tightening in credit conditions were similar across sectors, consumer spending could be affected more than investment spending, although typically investment is more responsive to changing economic conditions.

Developments in credit conditions cannot, however, be considered in isolation. The responses of one sector are likely to impact on factors affecting credit conditions for others. More importantly, the recent tightening of credit conditions has gone hand-in-hand with heightened economic uncertainty, although this is set against recent monetary policy easing by the Bank of England.

Current account

B.37 Data for the current account are typically subject to significant revisions, and data at this time are more than usually uncertain, as discussed later in this chapter. In December 2007, the Office for National Statistics (ONS) published revisions to estimates of investment income flows and the UK's current account deficit. These revisions, described further in Box B8, mean that the UK current account deficit was estimated to have increased from 3¾ per cent of GDP in 2006 to an average of 5 per cent of GDP in the first three quarters of 2007. Sterling has depreciated by around 7 per cent since the 2007 Pre-Budget Report, which can be expected to support demand through its positive effect on demand for UK exports, but could put upward pressure on inflation through its effect on import prices.

Inflation

B.38 Since the beginning of 2007, headline Consumer Prices Index (CPI) inflation has continued to be affected by changes in food and energy prices. Reflecting movements in wholesale gas prices, domestic energy prices increased sharply in early 2007, contributing to above-target inflation, but fell in the second half of the year. Subsequently, lower wholesale gas prices and consequent cuts in utility bills subtracted from inflation rates, and CPI inflation fell back to close to target. In January it stood at 2.2 per cent.

B.39 With wholesale gas prices having risen again, a further round of utility price increases was announced in January and February. Following a change in methodology to reflect more accurately current billing practices of energy providers, the ONS will have incorporated the full effect of these increases by the February CPI release to be published on 18 March. Rising oil prices pushed petrol prices up 19½ per cent on a year earlier by January 2008, while further increases in global agricultural commodity prices had pushed food price inflation up to 6½ per cent. RPI inflation has remained elevated, partly reflecting the effect of past monetary policy tightening on mortgage interest payments, though it eased from 4.8 per cent in March 2007 to 4.1 per cent in January 2008.

Inflation expectations and earnings

B.40 Against a backdrop of higher inflation outturns and higher prices of some regularly purchased items such as energy and food, which figure prominently in household expenditure, survey measures of households' inflation expectations have risen. Supply-chain pressures have been building, with sharp increases in producer input prices being partly passed on into output prices. Evidence from business surveys indicates that companies' output price expectations have picked up, and inflation expectations derived from some financial market instruments have also moved higher. So there remains a risk that wage and price-setters expect inflation to remain above the inflation target beyond the immediate cost shock, and that this will translate into second-round effects from higher inflation outturns to increased wage pressures. Similar cost shocks in 2005 and 2006 were largely absorbed by producers in margins, or offset by bearing down on other costs, including wages. To date there has been no evidence of second-round wage effects: underlying earnings growth has remained stable and subdued.

Monetary and fiscal policy

B.41 With growth above trend for much of 2006 and 2007, the MPC raised Bank Rate by 1¼ percentage points between August 2006 and July 2007. Monetary policy was supported by a fiscal tightening during 2006-07. As the disruption in global financial markets took hold in the second half of 2007, and its effect on credit conditions became clearer, the MPC cut Bank Rate by a ¼ percentage point in both December 2007 and February 2008 to the current level of 5¼ per cent. Market-derived interest rate expectations point to some further easing over the coming year. In the press release accompanying its decision in February, the MPC highlighted the challenging environment in which monetary policy is being set: "The Committee needs to balance the risk that a sharp slowing in activity pulls inflation below the target in the medium term against the risk that elevated inflation expectations keep inflation above target".[5]

UK Statistics Authority

B.42 From April 2008, the Statistics and Registration Services Act 2007 will come into full force, and official statistics will be governed by the new independent UK Statistics Authority, which will answer directly to Parliament. The Authority will take up its role at a time when there will be a premium on understanding data limitations and minimising the extent to which difficulties in interpreting economic developments are compounded by uncertainties over data quality.

[5] *News release: Bank of England reduces Bank Rate by 0.25 percentage points to 5.25 per cent*, Bank of England, February 2008.

Assessment of the output gap

Latest National Accounts data

B.43 Since the 2007 Pre-Budget Report, ONS estimates of non-oil GVA growth in 2006 have been revised up slightly, from 3 per cent to 3¼ per cent on a year earlier. As a result of changes to the estimated quarterly path of output in 2006, with stronger growth in the first and fourth quarters but slightly weaker growth in the third quarter, the trend growth arithmetic,[6] based on the latest National Accounts data and the Treasury's trend output growth assumptions, implies output passed up through trend in the second half of 2006. In 2007, non-oil GVA grew 3¼ per cent, implying that a small positive output gap, of around a ¼ per cent, had opened up by the end of the year.

Evidence from the cyclical indicators

B.44 Evidence from the broad range of cyclical indicators monitored by the Treasury continues to support the 2007 Pre-Budget Report assessment that the economy passed up through trend towards the end of 2006. On balance, the cyclical indicators suggest the economy was slightly above trend during 2007:

- Evidence from quarterly business surveys conducted by the Confederation of British Industry (CBI) and the British Chambers of Commerce (BCC) suggests that capacity utilisation rates are currently at levels consistent with the economy operating slightly above trend. The Bank of England's Regional Agents have reported some easing from above-average capacity utilisation rates since late 2007.

- Indicators of recruitment conditions from the quarterly business surveys convey mixed signals. For the services sector, which accounts for around 75 per cent of private sector employment, the BCC's indicator of recruitment difficulties is at its highest since 1998, whereas for manufacturing it appears to indicate a degree of slack. The Bank's Regional Agents have reported some easing in recruitment difficulties since the time of the 2007 Pre-Budget Report.

- The latest ONS labour market data generally suggest tighter conditions, with strong growth in employment, lower unemployment and further significant falls in the claimant count to a 32-year low. The number of vacancies has continued to rise, despite a small decline in the number of vacancies in the financial sector. Against this evidence of a tightening labour market, average earnings growth has remained subdued, and some measures of domestically generated inflation stable.

Economic cycle

B.45 Although evidence from the cyclical indicators, and the latest National Accounts data, continue to suggest that the economy passed up through trend towards the end of 2006, neither discriminates unambiguously between the third and fourth quarters of 2006 as the point at which the economy was on trend. So for the purposes of the Budget 2008 economic forecast it has been assumed that, on average, the economy was on trend during the second half of 2006. With output judged to be close to trend at the end of 2007, growth forecast to slow to below trend rates in 2008 and 2009, and prospective National Accounts revisions, it remains too soon to assess whether the apparent move through trend in the second half of 2006 marks the end of the economic cycle that is judged to have started in the first half of 1997.

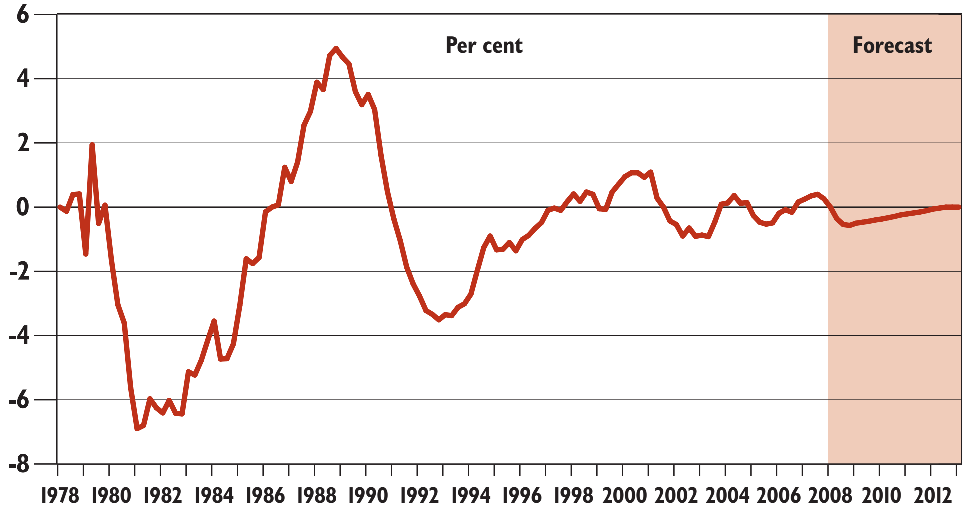
B.46 The current uncertainty over dating of the cycle is expected partly to recede once the ONS National Accounts modernisation programme secures improvements to the quality of the data for recent years. As announced in February 2007,[7] resource re-prioritisation in order to deliver on this programme has necessitated some temporary increase in uncertainty

[6] See paragraph B.32 to B.34 of Budget 2007 for a fuller explanation of the trend growth arithmetic.

[7] *Modernising the UK's National Accounts*, ONS, subsequently published in Economic & Labour Market Review, April 2007.

surrounding the quality of the National Accounts, with the possibility of substantive revisions to come. Over the period of transition to modernised National Accounts, the ONS has introduced additional quality monitoring of the quarterly estimates.

Chart B2: The output gap[1]



[1] *Mechanical output gap estimates based on the latest National Accounts data and the Treasury's trend output assumptions, expressed as actual output less trend output as a percent of trend output (non-oil basis). The Treasury's assessment of the cyclical position of the economy draws on evidence from a broad range of economic indicators, as set out in the 'Technical note on the cyclical indicators', published by the Treasury alongside the 2005 Pre-Budget Report.*

Assessment of trend growth

B.47 The Treasury's neutral estimate of the economy's trend rate of output growth for Budget 2008 remains at 2¾ per cent a year to the end of the projection period, unchanged since the reassessment published alongside the 2006 Pre-Budget Report.[8]

B.48 Table B2 presents estimates of trend output growth and its decomposition to the second half of 2006, and the Treasury's projections thereafter. From now on, the Treasury will present the decomposition of past and projected trend output growth on the basis of the adult population of all people over the age of 16, rather than the working-age population of people aged between 16 and the State Pension age. The reasons for this adjustment are set out in Box B6.

[8] *Trend growth: new evidence and prospects*, HM Treasury, December 2006.

Table B2: Contributions to trend output growth[1,2]

	Estimated trend rates of growth, per cent per annum					
	Trend output per hour worked[3, 4]		Trend average hours worked[3]	Trend employment rate[3]	Population[5]	**Trend output**
	Underlying (1)	Unadjusted (2)	(3)	(4)	(5)	(6)
1986Q2 to 1997H1						
Latest data						
Working-age population[6]	2.13	1.95	–0.11	0.36	0.25	**2.46**
Adult population[6]	2.12	1.93	–0.11	0.37	0.26	**2.46**
Over the recent past						
1997H1 to 2001Q3						
Latest data						
Working-age population	2.89	2.70	–0.45	0.38	0.53	**3.17**
Adult population	2.86	2.61	–0.45	0.49	0.51	**3.17**
2001Q3 to 2006H2						
Latest data[7]						
Working-age population	2.36	2.36	–0.31	0.00	0.70	**2.76**
Adult population	2.26	2.21	–0.31	0.09	0.75	**2.76**
Projection[8]						
2006H2 onwards						
Budget 2008[9]						
Working-age population	2.35	2.30	–0.25	0.1	0.6	**2¾**
Adult population	2.25	2.30	–0.25	–0.1	0.8	**2¾**

[1] Treasury analysis based on judgement that 1986Q2, 1997H1 and 2001Q3 were on-trend points of the output cycle. Figures independently rounded. Trend output growth is estimated as growth of non-oil gross value added between on-trend points for the past, and by projecting components going forward.

Columns (2) + (3) + (4) + (5) = (6).

Full data definitions and sources are set out in Annex A of 'Trend growth: new evidence and prospects', HM Treasury, December 2006.

[2] Interim projections between Budget 2002 and PBR 2007 are provided in an expanded table in 'Budget 2008: the economy and public finances – supplementary material'.

[3] The underlying trend rate is the unadjusted trend rate adjusted for changes in the employment rate, i.e. assuming the employment rate had remained constant.

Column (1) = column (2) + (1-a).column (4), where a is the ratio of new to average worker productivity levels. The figuring is consistent with this ratio being of the order of 50 per cent, informed by econometric evidence and LFS data on relative entry wages.

[4] The decomposition makes allowances for employment and hours worked lagging output. Employment is assumed to lag output by around three quarters, so that on-trend points for employment come three quarters after on-trend points for output, an assumption which can be supported by econometric evidence. Hours are easier to adjust than employment, and the decomposition assumes that average hours worked lag output by just one quarter, though this lag is harder to support by econometric evidence.

[5] UK resident household basis.

[6] Working-age population defined as population aged 16 to State Pension age. Adult population defined as population aged 16 and over.

[7] Estimates based on the assumption that the economy passed up through trend in the second half of 2006.

[8] Neutral case assumptions for trend from 2006H2.

[9] Underlying trend assumptions around which the mid-points of the GDP forecast growth ranges from 2006H2 are anchored.

Population growth

B.49 At the time of the 2006 Pre-Budget Report, the Treasury revised up its estimate of the economy's trend rate of output growth from 2007 onwards. This revision was based on analysis of new evidence that pointed to the contribution of net migration being a ¼ percentage point higher than previously projected. Taken together with the contribution of natural population change, this implies growth of the adult population of ¾ per cent a year over the projection period. The ONS estimate of net inward migration in 2006, published in November 2007, was 191,000, consistent with the assumption underpinning the Treasury's population projection. The ONS 2006-based population projections published in October 2007 assume stronger net migration over the next 5 years, although the Treasury projection accords with the ONS longer-term migration assumption. The ONS, drawing on cross-Departmental support, continues to work to improve the quality of migration statistics, implementing the recommendations of the Inter-departmental Task Force on Migration Statistics.[9]

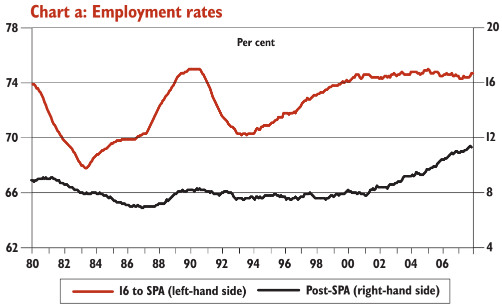
[9] *Report of the Inter-departmental Task Force on Migration Statistics*, ONS, December 2006.

Box B6: Population definitions in the trend growth framework

The definition of population used in the Treasury's trend growth estimates has, until Budget 2008, been the working-age population measure used by the ONS in the Labour Force Survey. The working-age population includes all those aged between 16 and the State Pension age (SPA), currently 16 to 59 for women and 16 to 64 for men. Under the 1995 Pensions Act, the SPA for women will rise by 1 year every other year from 2010, until the SPA for men and women is equalised at 65 in 2020. While this change will only need to be reflected in ONS population definitions when it begins to take effect in 2010, it has already moved into the Treasury's economic projection horizon.

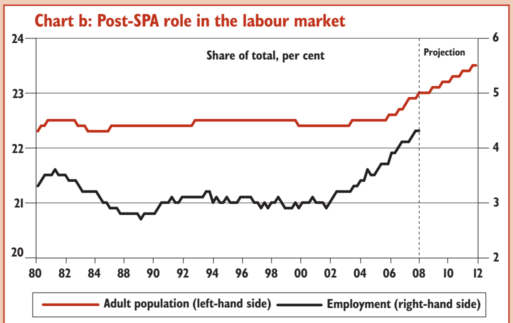
The pattern of employment growth over recent years provides further rationale for reconsidering the population definition used in the trend growth framework, with the employment rate of the post-SPA population rising significantly from 8 per cent to 11¼ per cent since 2001 (chart a). Participation and employment among the post-SPA population are projected to continue to rise. In addition, demographic trends mean the proportion of post-SPA people in the adult population will continue to rise (chart b). As such, the post-SPA share of employment is likely to continue rising. To ensure the Treasury's trend growth framework is fully representative of the changing structure of employment, a wider 'adult population' definition, including all those aged 16 and over, has been adopted to underpin the Budget 2008 and subsequent trend growth projections.

Chart a: Employment rates



Source: ONS

Chart b: Post-SPA role in the labour market



Source: ONS

Labour market

B.50 As set out in Box B6, the proportion of older people in the adult population is set to continue rising. Given lower employment rates among older people, even with rising employment rates for given age cohorts, the changing age structure of the adult population means that, on the adult population basis, the trend employment rate is projected to decline slightly over the forecast horizon. This is consistent with a gently rising trend in the working-age employment rate.

B.51 Employment growth picked up during 2007, rising nearly 300,000 in the year to the final quarter, to a record high of almost 29½ million. As a result, the adult employment rate ended the year at 60¼ per cent, a little above its estimated trend level.

B.52 In line with the trend between the estimated on-trend points in the third quarter of 2001 and the second half of 2006, trend average hours of the adult population are projected to decline by a ¼ per cent a year. The small fall in average hours worked since the start of 2007 has been in line with the projected trend rate, consistent with the economy operating close to trend.

Productivity growth

B.53 The Treasury's projection of productivity growth is informed by the estimate of underlying productivity growth over the recent past, adjusted for the projected change in the employment rate to project actual productivity growth. On this basis, underlying productivity (output per hour worked by the adult population) is projected to grow at a trend rate of 2¼ per cent a year, consistent with the rate of growth between the estimated on-trend points in 2001 and 2006. Together with the employment rate assumption, this implies an actual trend productivity growth projection of 2.3 per cent from 2007 onwards, on the cautious side of the estimated trend from 1997 to 2006, though well above the 1.9 per cent average over the previous cycle.

B.54 Since the second half of 2006, productivity growth, measured in terms of output per hour worked, has averaged around 2¼ per cent, in line with the projected trend rate. As productivity growth tends to fluctuate positively with the cycle, this is consistent with the economy operating close to trend during 2007.

GDP and inflation forecasts

Credit conditions

B.55 The Budget 2008 economic forecast is made against the backdrop of considerable uncertainty related to the ongoing disruption in global financial markets, and in particular the size and persistence of its effects on credit conditions facing households and companies. With only limited evidence available at the time of the 2007 Pre-Budget Report, the forecast assumed some feed-through to tighter credit conditions and hence to household and company spending in the short term. More recent evidence suggests that the intensity and duration of the negative impact on credit conditions are likely to be greater than assumed in the Pre-Budget Report.

B.56 The judgements in the Budget 2008 forecast are conditioned on an updated forecasting assumption that credit markets will remain strained through the first half of 2008, start easing during the second half and only normalise by mid-2009. There is considerable uncertainty surrounding this assumed path. It is consistent with a view that progressively greater information disclosure by the world's financial institutions will help the price discovery process in the credit markets that are currently strained, but that despite the flexibility of financial markets this process will take time. Tighter credit conditions are therefore assumed to constrain growth in household and business spending by somewhat more and for somewhat longer than was forecast in the 2007 Pre-Budget Report.

Table B3: Summary of forecast[1]

		Forecast		
	2007	**2008**	**2009**	**2010**
GDP growth (per cent)	3	1¾ to 2¼	2¼ to 2¾	2½ to 3
CPI inflation (per cent, Q4)	2	2½	2	2

[1] *See footnote to Table B9 for explanation of forecast ranges.*

GDP and the output gap

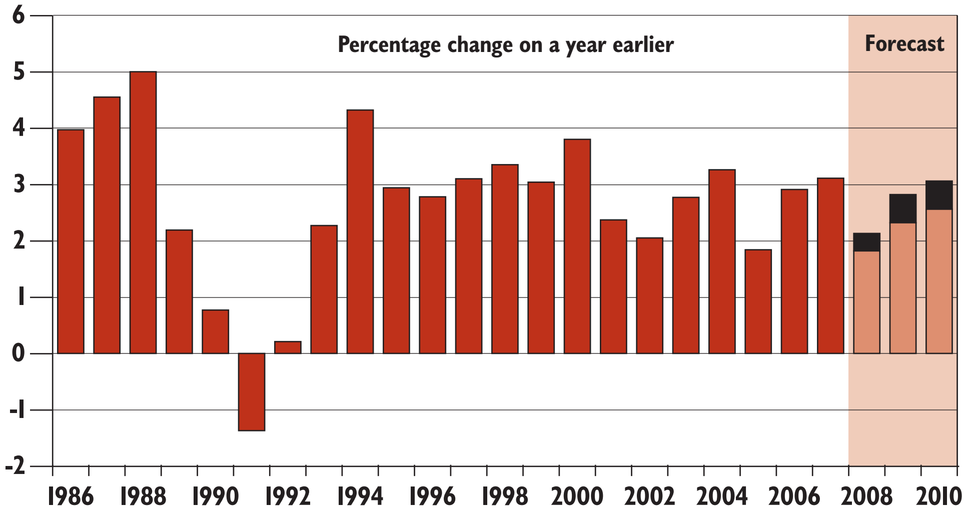
B.57 GDP growth in 2007 was in line with the 2007 Pre-Budget Report forecast of 3 per cent, with growth in the final quarter of 0.6 per cent consistent with the slowing that was expected following the monetary policy tightening in the year to July 2007. The risk of a further tightening of credit conditions identified in the Pre-Budget Report has since materialised, while prospects for growth in the US and euro area, the UK's main export markets, have deteriorated. Growth is therefore forecast to slow a little more in 2008 than forecast in the Pre-Budget Report, and to recover less quickly in 2009. The small positive output gap at the beginning of 2008 is forecast to turn negative during 2008, to stand at around ½ a per cent in the first half of 2009, and to close gradually thereafter.

B.58 During 2008 and early 2009, when the negative effects of tighter credit conditions on output are assumed to be largest, underlying monetary conditions are set to be supportive. Sterling has depreciated around 7 per cent since the 2007 Pre-Budget Report, which is forecast to boost export growth in 2008 and 2009. The Bank of England has reduced Bank Rate by ½ a percentage point since early December 2007, and markets expect some further easing over the coming year. To the extent that these expectations are realised, and given the typical lags involved in the pass-through from interest rate changes to households' and companies' spending, interest rates should progressively support growth from the second half of this year. It is, however, possible that the pass-through of Bank Rate changes to market interest rates and credit conditions will be more muted while the period of disruption in financial markets persists.

B.59 On the assumption that financial markets and credit conditions start easing during the second half of 2008 and normalise by mid-2009, annual growth is expected to pick up from the first half of 2009. Once financial markets begin to function normally again, the forecast assumes that natural adjustment processes of a well-functioning market economy will take further hold, helping to sustain output growth at or slightly above trend rates. As described in Box B4, the UK economy has been able to absorb and adjust to a number of shocks over the decade, as wage and price flexibility have supported output and recovery. It is this resilience in the face of shocks, underpinned by the Government's macroeconomic policy framework and promotion of open and flexible markets, that has contributed to the significant improvement in macroeconomic stability over the past decade. Indeed, the recent strength of employment growth, and continuing absence of wage pressures, suggests the labour market will continue to support the economy through 2008 and beyond.

B.60 Reflecting this combination of factors, GDP growth is forecast to slow from 3 per cent in 2007 to 1¾ to 2¼ per cent in 2008, before picking up to 2¼ to 2¾ per cent in 2009 and 2½ to 3 per cent in 2010. Consistent with assumed developments in credit conditions, GDP growth is forecast to slow to 1½ to 2 per cent on a year earlier in the second half of 2008, picking up to 2 to 2½ per cent in the first half of 2009 and 2½ to 3 per cent by the second half of 2009. Once credit markets have normalised, the assumed gradual closing of the output gap reflects uncertainty over the degree to which the shock may prove to have temporary or more permanent effects, as discussed further in paragraph B.100. Given the declining trend in North Sea output, non-oil GVA grows a little faster than whole economy GDP, and at slightly above-trend rates.

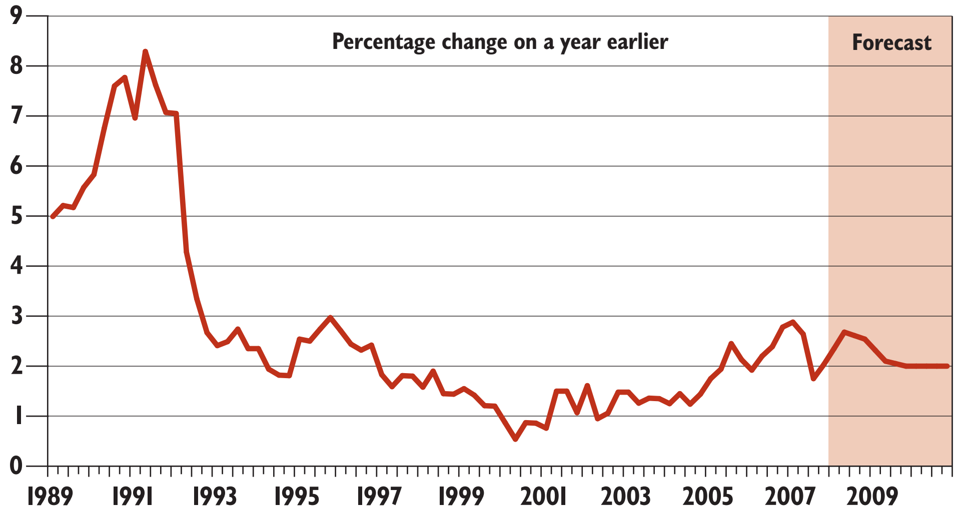
Chart B3: Gross domestic product (GDP)



Inflation **B.61** Inflation is expected to rise in the near term, largely reflecting ongoing increases in food and energy prices, including the effect of already announced rises in household energy bills. These effects on consumer prices reflect developments in global markets for agricultural commodities, crude oil and wholesale gas. Some upward pressure on import prices is expected due to the depreciation in sterling since the 2007 Pre-Budget Report. The impact of higher import prices on CPI inflation will depend on the extent to which producers and retailers choose to pass them on to consumers or to absorb higher costs through lower margins or offset them by bearing down on other input costs, including wages. During recent cost shocks, much of the effect appears to have been absorbed or offset before reaching the level of consumer prices.

B.62 Despite strong domestic demand growth through to the third quarter of 2007 and reduced spare capacity, core inflation measures have remained relatively subdued and CPI inflation fell back to target in the second half of the year, as forecast in Budget 2007. The emerging negative output gap, reflecting slower growth since the final quarter of last year and into 2008, would be expected to put downward pressure on domestically generated inflation, offsetting the upward inflationary pressures from commodity prices and a weaker exchange rate. Inflation is forecast to pick up in the near term, before falling back to 2½ per cent by the end of 2008, returning to target in 2009 and remaining on target thereafter.

Chart B4: CPI[1]



[1] Outturns until 2007Q4; forecasts for every second quarter from 2008Q2 to 2010Q4.

UK DEMAND AND OUTPUT IN DETAIL

Rebalancing of demand

B.63 Between 2000 and 2004, GDP growth in the UK was driven primarily by private consumption growth, which contributed an average of 2¼ percentage points to the 2¾ per cent average annual growth rate. However, in nominal terms, the share of private consumption in total demand declined from its peak in 2001, reflecting relatively subdued consumer price inflation. Since 2005, some domestic demand rebalancing has taken place with investment accounting for a larger share of growth alongside continued strong consumption growth. However, the expected rebalancing of domestic and external demand does not yet appear to have materialised. Latest estimates suggest net trade subtracted ½ a percentage point from growth in 2007, in line with the average between 2000 and 2004. With sterling having depreciated by around 7 per cent since the 2007 Pre-Budget Report, the conditions are in place for external demand to contribute more positively to GDP growth over the forecast horizon.

Table B4: Contributions to GDP growth[1,2]

	Percentage points, unless otherwise stated						
	Average				Forecast		
	2000 to 2004	2005	2006	2007	2008	2009	2010
GDP growth, per cent	**2¾**	**1¾**	**3**	**3**	**1¾ to 2¼**	**2¼ to 2¾**	**2½ to 3**
Main contributions							
Private consumption	2¼	1	1¼	2	1	1½	1¾
Business investment	¼	¼	¾	¾	¼	½	½
Government[3]	¾	½	½	½	½	½	½
Change in inventories	0	0	–¼	½	0	0	0
Net trade	–½	0	0	–½	¼	¼	0

[1] Components may not sum to total due to rounding and omission of private residential investment, transfer costs of land and existing buildings and the statistical discrepancy.

[2] Based on central case. For the purpose of projecting public finances, forecasts are based on the bottom of the GDP forecast range.

[3] The sum of government consumption and government investment.

Households and consumption[10]

B.64 Household consumption is the largest expenditure component of demand in the UK, accounting for around 63 per cent of nominal GDP in 2007, having fallen steadily from above 65 per cent between 2000 and 2002.

Disposable income

B.65 Real household disposable income growth in 2007 is estimated to have been 1¼ per cent on a year earlier. It is expected to pick up to 1½ to 2 per cent on a year earlier in 2008, reflecting the recent strength of employment growth and a positive contribution from net changes in benefits and taxes. Households' purchasing power is likely to be negatively affected during 2008 by commodity-price driven increases in food and energy prices, and the relatively slow pass-through to date of Bank Rate reductions to mortgage rates.

Household spending

B.66 Private consumption growth in 2007 was slightly stronger than expected, at 3¼ per cent on a year earlier. Latest estimates suggest growth was particularly strong in the third quarter, at 0.9 per cent on the previous quarter, before easing to 0.2 per cent in the final quarter of the year. That was below the 0.4 per cent growth of retail sales volumes in the quarter, which, in the absence of subsequent revisions, would suggest that consumer spending on services slowed by more than spending on goods. Such developments would be consistent with reports from the Bank of England's Regional Agents. Reported retail sales volume growth was firm in January 2008, although given the very large seasonal patterns in consumer spending around Christmas, these figures must be interpreted with caution.

B.67 With credit conditions facing households expected to remain restrictive through 2008, and despite strong employment growth in the final quarter of 2007, prospects for household consumption have moderated since the 2007 Pre-Budget Report. Growth is expected to moderate to 1¼ to 1¾ per cent in 2008, and to pick up gradually in 2009 and 2010 in the wake of the assumed normalisation of credit conditions from mid-2009. Household consumption growth is expected to remain slightly below whole economy GDP growth, as domestic demand further rebalances.

[10] In the National Accounts, private consumption comprises final consumption expenditure by households and non-profit institutions serving households (NPISH). Throughout this section, the terms 'household consumption' and 'private consumption' always refer to total final consumption expenditure by both households and NPISH.

Table B5: Household sector[1] expenditure and income

	Percentage change on a year earlier, unless otherwise stated			
		Forecast		
	2007	2008	2009	2010
Household consumption[1]	3¼	1¼ to 1¾	2 to 2½	2¼ to 2¾
Real household disposable income[2]	1¼	1½ to 2	2 to 2½	2¼ to 2¾
Saving ratio[3] (level, per cent)	3	3½	3½	3¾

[1] Including non-profit institutions serving households.

[2] Chained volume measures.

[3] Total household resources less consumption expenditure as a percent of total resources, where total resources comprise households' disposable income plus the increase in their net equity in pension funds.

Saving ratio

B.68 The household saving ratio is estimated to have averaged 3¼ per cent in the first half of 2007. As foreshadowed in the 2007 Pre-Budget Report, in the latest National Accounts release the ONS revised up estimates of the saving ratio in the first half of the year, from an average of 2½ per cent. The saving ratio is expected to average 3 per cent in 2007 as a whole and to firm over the forecast horizon, given the likely effect of tighter credit conditions on households' willingness and ability to borrow in the short term, and an expected rebuilding of balance sheets in the medium term.

Housing market

B.69 Annual house price inflation has slowed, from above 10 per cent in August 2007 to around 2½ per cent in February 2008. This slowdown has come somewhat more quickly than would have been expected on the basis of past relationships with leading indicators such as mortgage approvals and the ratio of sales to the stock of available property reported by the Royal Institute of Chartered Surveyors. These leading indicators have continued to ease since the 2007 Pre-Budget Report, pointing to a period of sluggish or flat house price growth in 2008.

B.70 A feature of the disruption in financial markets has been the effective closure of the residential mortgage-backed securities market in the UK and a number of other advanced economies. This closure has put added strain on banks' funding positions, which appears to have exacerbated the tightening in credit conditions for secured lending to households, particularly from specialist lenders more reliant on securitised funding. This could affect house price inflation in coming months, and seems likely to reduce the volume of activity in property markets.

Box B7: Housing and private consumption in the UK

The relationship between house prices and consumer spending has been the subject of extensive debate and research. In the past, there has been a strong, positive co-movement between the two: increases in house prices tended to be associated with increases in consumption. A major challenge in economics is to distinguish causality from correlation. Do rising house prices *cause* strong consumption growth, or are both caused by common 'third factors', such as falling real interest rates or rising income expectations linked to labour market developments? And if there is a causal relationship, what is the mechanism that links the two?

On the question of causality, at the macroeconomic level, Case, Quigley and Schiller[a] find evidence of a housing wealth effect without considering common factors, but Aron and Muellbauer[b] conclude that "a substantial part of the earlier correlation [between house prices and consumption] was due to variation in common causal factors". Using similar microeconomic data, Attanasio *et al*[c] find that house prices play no independent role in explaining consumption, but Campbell and Cocco[d] reach the opposite conclusion, that they play a large role.

On the question of the mechanism, there are two main channels that have been suggested as linking house prices to consumption. The most obvious is a pure wealth effect; as with any other asset, rising house prices may make households feel wealthier and therefore consume more. However, houses are different to other assets, such as shares, as they also provide a service that is consumed: as house prices rise, the extra wealth gained from the increase in the price of the asset is offset, at the aggregate level, by the increase in the cost of that service, accommodation. Rising house prices distribute wealth away from those who have limited housing assets and still have a lot of housing to consume over their lifetime (the young) to those who own a large amount of housing assets but have less housing services to consume (the old).

An alternative channel is through the collateral effect. As housing equity can be used as collateral to borrow against, a rise in house prices may allow previously credit-constrained households to borrow more and increase consumption. This channel has recently been explored in two working papers by Bank of England staff,[e,f] both of which find some role for collateral in explaining the co-movement of house prices and consumption. However, with the level of housing equity currently very high, other things equal, a slowdown in house price growth would be unlikely to have a large impact on consumption through significantly increasing credit constraints.

If the historic co-movement between house prices and consumption primarily reflects common factors and collateral effects, then a slowdown in growth of house prices need not necessarily imply a slowdown in consumer spending. Moreover, strong recent labour market performance means that conditions are in place for house prices to slow without a significant negative impact on consumption. Nevertheless, there remains the risk that, combined with the broader tightening of credit conditions caused by the disruption in global financial markets, consumer spending could slow more than forecast.

[a] Case, K., Quigley, J. and Schiller, R., *Comparing wealth effects: The stock market versus the housing market*, in Advances in macroeconomics, Volume 5, 2005.

[b] Aron, J. and Muellbauer, J., *Housing wealth, credit conditions and consumption*, presented to the IMF, 2006.

[c] Attanasio, O., Blow, L., Hamilton, R. and Leicester, A., *Booms and Busts: Consumption, house prices and expectations*, IFS working paper 05/24, 2005.

[d] Campbell, J.Y. and Cocco, J.F., *How do house prices affect consumption? Evidence from micro data*. NBER Working paper 11534 (August), 2005.

[e] Benito, A. and Mumtaz, H., *Consumption excess sensitivity, liquidity constraints and the collateral role of housing*. Bank of England Working paper no. 306, 2006.

[f] Benito, A., *Housing equity as a buffer: Evidence from UK households*, Bank of England Working paper no. 324, 2007.

Companies and investment

B.71 Investment in physical assets, by affecting the amount of capital available to each worker, plays an important role in an economy's productivity performance through its influence on how much a unit of labour can produce. On conventional measures, as currently adopted by the ONS, business investment accounts for around 10 per cent of nominal GDP in the UK, but such measures may understate the true role of investment in the economy. As set out in a recent Treasury Economic Working Paper,[11] investment in intangible assets has been growing more rapidly than investment in physical assets, as the UK economy has become increasingly knowledge intensive.

Company finances

B.72 Companies can finance investment internally, using the cashflow generated by their operations, or externally, through bank lending or by issuing equity or debt to investors. Since the 2007 Pre-Budget Report, gross operating surpluses in the corporate sector have continued to grow strongly, up 9 per cent on a year earlier in the fourth quarter of 2007. Analysts' earnings estimates for listed non-financial companies point to continued growth in 2008. This suggests internal sources of finance should remain supportive for business investment growth. By contrast, external financing conditions have deteriorated since the Pre-Budget Report. Equity prices are more than 10 per cent lower, while credit conditions have tightened, particularly for companies with lower credit ratings. Higher rated corporate bond yields have declined as government bond yields have fallen, although spreads have risen recently.

Table B6: Gross fixed capital formation

	Percentage change on a year earlier			
		Forecast		
	2007	**2008**	**2009**	**2010**
Whole economy[1]	5	1¾ to 2¼	2¾ to 3¼	3½ to 4
of which:				
Business[2,3]	6¾	1¾ to 2¼	3¼ to 3¾	3¾ to 4¼
Private dwellings[3]	2	–¼ to ¼	1¼ to 1¾	2¾ to 3¼
General government[3]	4	7	3½	5

[1] Includes costs associated with the transfer of ownership of land and existing buildings.

[2] Private sector and public corporations' non-residential investment. Includes investment under the Private Finance Initiative.

[3] Excludes purchases less sales of land and existing buildings.

Business investment

B.73 Business investment growth remained strong through 2007, growing 6¾ per cent on a year earlier following 7 per cent growth in 2006. The latest data suggest business investment contracted slightly in the fourth quarter of 2007, although this weakness is not consistent with private business survey indicators, and estimates of business investment have historically been subject to significant revision. The price of investment goods relative to all other goods and services has continued to fall, which has allowed the volume of investment to rise as a share of total activity while the share of business investment in nominal spending, as currently measured, has remained broadly stable.

B.74 Recent profit growth has remained strong and surveys of investment intentions, though having eased, remain consistent with sustained growth. It is, however, likely that uncertainty over demand prospects and the potential impact of tighter credit conditions on the finances of some companies will cause business investment growth to slow more than forecast in the 2007 Pre-Budget Report. Due to the weakness of the current estimate of business investment growth in the final quarter of 2007, the Budget forecast shows a significant slowdown in annual business investment growth to 1¾ to 2¼ per cent in 2008. As credit conditions ease

[11] *Intangible investment and Britain's productivity: Treasury Economic Working Paper No.1*, HM Treasury, October 2007.

and normalise during 2009, and uncertainty over demand recedes, business investment is forecast to pick up in 2009 and 2010.

Investment in dwellings

B.75 Private investment in dwellings, which comprises investment in new dwellings and improvements to existing dwellings, grew 8¾ per cent in 2006 and 5½ per cent on a year earlier in the first half of 2007. With activity in the housing market moderating, credit conditions remaining tight and households likely to reduce their overall net borrowing position in 2008, investment in dwellings is forecast to be flat compared with 2007. Growth is forecast to pick up in 2009 and 2010, supported by the Government's target for house building set out in the Green Paper *Homes for the future: more affordable, more sustainable*.[12]

Trade and the balance of payments

B.76 As noted in previous Budget and Pre-Budget Reports, annual growth in recorded exports and imports of goods and services has been distorted by activity related to missing-trader intra-community fraud (MTIC), which significantly inflated the value of measured goods trade in the first half of 2006. Since the second half of 2006, Government measures to tackle MTIC fraud have led to a sharp fall in estimated MTIC-related activity, to a low level. In view of the inevitable measurement difficulties involved in adjusting for MTIC-related activity, the ONS advises that comparisons of trade volumes and prices "should be treated with a great deal of caution".[13] The economic forecast abstracts from MTIC effects by making the neutral assumption that the adjustment for MTIC-related activity remains constant throughout the forecast at the latest quarterly estimate, and that trade grows in line with underlying determinants. Table B7 presents export and import growth forecasts excluding the MTIC adjustment.

B.77 It is difficult to reconcile the trade data for 2006 and 2007 with the evidence from private business survey indicators and domestic demand growth in the UK's main trading partners. At present, measured growth of goods export volumes excluding the MTIC adjustment appears stronger in the first half of 2006, and much weaker in the second half of 2006 and first half of 2007, than other indicators suggest. The path of goods trade growth is also very different from that of services trade growth, again suggesting possible measurement difficulties in estimating underlying goods trade volumes. Net trade volume estimates are likely to be significantly more informative than the gross export and import estimates.

Exports of goods and services

B.78 Over the past decade, in common with other G7 countries, the UK's share of world goods trade has fallen as fast-growing emerging markets have become increasingly integrated into the world trading system. However, the UK's comparative advantage in a range of financial and business services has meant that it is the only G7 country to have achieved a rising share of global trade in services.

B.79 Growth in the measured volume of goods and services exports, excluding the MTIC adjustment, is estimated to have eased from 7¾ per cent in 2006 to just ½ a per cent in 2007. Services exports continued to perform strongly in 2006 and 2007, with growth estimated to have picked up from 6¾ per cent in 2006 to 8 per cent in 2007, while goods exports, excluding the MTIC adjustment, are estimated to have grown 8½ per cent in 2006, but contracted 3¾ per cent in 2007. Export volume growth is estimated to have been stronger in the second half of 2007 than the first.

B.80 In view of the forecast slowdown in UK export markets growth in 2008, underlying growth of export volumes is likely to be below the 4¾ per cent average between 2003 and 2007, though sterling has depreciated by 7 per cent since the 2007 Pre-Budget Report, and measured

[12] *Homes for the future: more affordable, more sustainable*, Communities and Local Government, July 2007.
[13] *UK trade December 2007: First release*, ONS, February 2008.

export growth picked up in the second half of 2007. Reflecting this combination of factors, the volume of goods and services exports is forecast to grow 3¼ to 3¾ per cent in 2008 and to strengthen further in 2009 and 2010 as demand growth in the UK's largest trading partners, the euro area and US, recovers. However, the data uncertainties compound the difficulties of judging prospects for measured export volumes.

Imports of goods and services

B.81 The volume of imports of goods and services, excluding the MTIC adjustment, is estimated to have grown 2½ per cent in 2007, having slowed from 7 per cent in 2006. Slower growth of total goods and services imports in 2007 comprises a modest slowdown in growth of services imports and a larger slowdown in growth of goods imports excluding the MTIC adjustment.

B.82 With slower domestic demand growth in the UK, combined with the expected impact of weaker sterling on import prices, the volume of goods and services imports is forecast to grow by 2 to 2½ per cent in 2008. Import growth is forecast to pick up in 2009 and 2010 in line with the forecast for domestic demand growth. As a result of import growth being forecast to slow a little, and export growth to pick up, net trade is expected to contribute a ¼ percentage point to GDP growth in 2008 and 2009, as shown in Table B4.

Table B7: Trade in goods and services

	Percentage change on a year earlier					£ billion
	Volumes (MTIC-adjusted)[1]		Prices[2]			
	Exports	Imports	Exports	Imports	Terms of trade[3]	Goods and services balance
2007	½	2½	2¼	¾	1¼	–48¾
Forecast						
2008	3¼ to 3¾	2 to 2½	2½	3	–½	–48¾
2009	5 to 5½	3¾ to 4¼	1½	2	–¾	–49¾
2010	5 to 5½	4 to 4½	2¼	2¼	0	–50

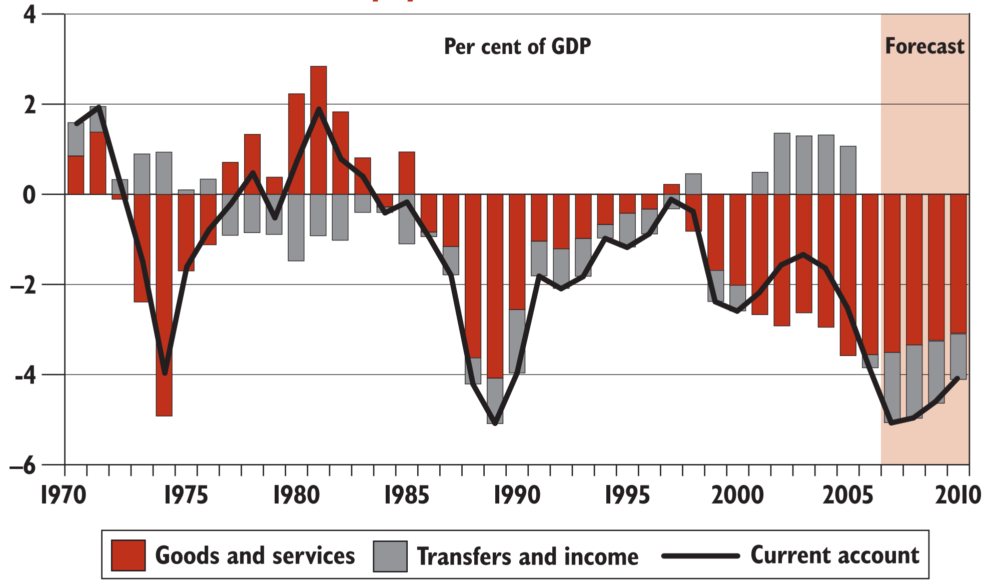
[1] Table B9 contains figures without the MTIC adjustment. The forecast is based on the neutral assumption that the level of the MTIC adjustment stays flat at the latest quarterly estimate throughout the forecast.
[2] Average value indices.
[3] Ratio of export to import prices.

Current account balance

B.83 Data for the current account are typically subject to significant revisions, and data at this time are more than usually uncertain. The deficit on trade in goods is estimated to have increased from 6 per cent of GDP in 2006 to 6¼ per cent in 2007, while the estimated surplus on trade in services increased from 2½ per cent of GDP in 2006 to 2¾ per cent in 2007, reflecting continued strong growth in exports of financial services. The balance of trade in goods and services therefore had little impact on changes in the UK's current account deficit between 2006 and 2007. However, significant revisions to estimates of investment income flows, described in Box B8, mean that the UK current account deficit was estimated to have increased from 3¾ per cent of GDP in 2006 to an average of 5 per cent in the first three quarters of 2007.

B.84 The balance of domestic demand growth in the UK and overseas should begin to reduce the trade deficit as a percentage of GDP through 2008, while the recent depreciation of sterling should have a substantial positive impact on the sterling value of the UK's overseas assets and subsequently on the income earned from those assets. Conditioned on the data uncertainties already set out, the UK's current account deficit is expected to remain at 5 per cent of GDP in 2008 and to decline in 2009 and 2010. External forecasters on average expect the UK current account deficit to narrow in 2008 and again in 2009.

Chart B5: Balance of payments current account



Foreign direct investment

B.85 The UK continued to attract large flows in inward foreign direct investment (FDI) in 2007, amounting to over £68 billion in the first three quarters of the year. That followed more than £80 billion in 2006 and almost £100 billion in 2005, and continues the trend of the UK being the top European recipient of inward FDI, and second in the world after the US. The stock of inward FDI in the UK, equivalent to around 46 per cent of GDP, is considerably higher than in other major advanced economies. The UN Conference on Trade and Development's 2007 World Investment Report[14] shows the stock of inward FDI to be 35 per cent of GDP in France, 17½ per cent in Germany and 13½ per cent in the US. In absolute terms, the UK is host to the second largest stock of FDI in the world after the US.

[14] *World Investment Report 2007 - Transational Corporations, Extractive Industries and development*, UNCTAD, October 2007.

Box B8: The current account and investment income balances

Data for the current account are typically subject to significant revision. Since the 2007 Pre-Budget Report, the ONS has incorporated new annual Foreign Direct Investment survey results into the balance of payments statistics. This led to larger than usual revisions to the UK's investment income balance, which is now estimated to have moved into deficit during 2007 (chart a). The revisions reduced income by £10¼ billion in 2006 and £12¼ billion in the first half of 2007, more than accounting for the revision to the 2006 current account deficit from 3½ to 4 per cent of GDP.

As the world's leading centre for cross-border financial intermediation, the UK's external assets and liabilities as a percent of GDP are much larger than in other advanced economies (chart b). Consequently, small changes in the structure or valuation of assets and liabilities, or rates of return, can cause relatively large changes in estimated net investment income flows. Both factors have featured over the past two years:

- **sterling appreciation in 2006 and early 2007 increased the sterling value of UK liabilities more than UK assets because a greater proportion of assets are denominated in foreign currencies, thus also reducing the sterling value of income received from abroad; and**
- **changes in the implied rates of return on FDI assets and liabilities, and in the large stocks of other investment, chiefly bank deposits, reduced the net income flow to the UK.**

Chart a: UK net income balance

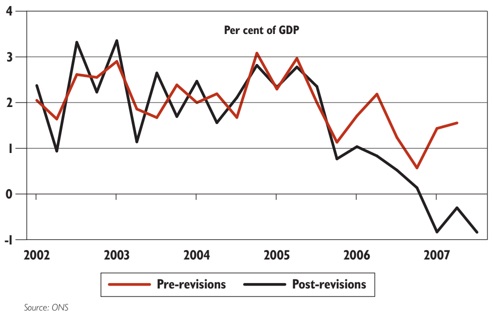
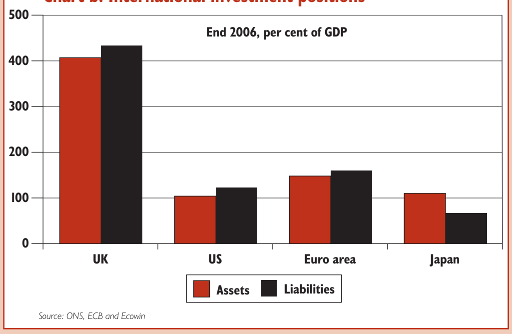


Chart b: International investment positions



Service sector output

B.86 The share of UK output accounted for by the service sector has risen steadily, reaching 75 per cent in 2006, up around 20 percentage points over the past three decades. Financial sector output, as currently measured, accounts for around 9½ per cent of total output and business services another 25 per cent. As explored in *The UK economy: analysis of long-term performance and strategic challenges*, published alongside Budget 2008, the service sector's share of output and exports is higher in the UK, and has risen more over the past decade, than in most other G7 economies. As already noted, the UK economy's flexible response to the challenges and opportunities of globalisation mean that it is the only G7 country that has achieved a rising share of global trade in services.

B.87 Service sector output grew 3¾ per cent in 2007. Within that, the finance and business services sector was particularly strong, growing 4¾ per cent, accounting for around half of measured whole economy output growth in 2007. Box B9 discusses the possible implications of the ongoing disruption in global financial markets for the UK's financial sector.

B.88 In line with growth prospects more generally, but given specific factors likely to impact more heavily on the financial sector, service sector growth is likely to moderate in 2008. The most recent private business survey indicators suggest that the extent of the moderation has so far been limited, with the February 2008 indicators released by the Chartered Institute of Purchasing and Supply increasing to a 5-month high, and the report noting a pick-up in confidence in the financial sector. Looking further ahead, the UK financial sector's track record of rebounding vigorously from previous shocks suggests that service sector growth should recover relatively quickly as financial market conditions normalise.

Box B9: Financial sector performance

In recent years, financial intermediation has been one of the most rapidly growing sectors of the UK economy. International comparisons show the UK's financial sector to account for a significantly larger share of output than Germany's, France's or Italy's, and a similar share as the US. In 2006, financial services exports accounted for 22½ per cent of the UK's services exports, compared with 10½ per cent in the US and 6 per cent in the euro area.

The relative size of the UK's financial sector presents a risk to the growth outlook during a period of disruption in global financial markets. Quarterly growth of financial intermediation output averaged 3½ per cent in the first three quarters of 2007, before slowing to 1¼ per cent in the final quarter. As outlined in Box B4, the sector has proved quick to recover from a number of financial market shocks over the past decade.

Services that banks and other financial institutions charge for directly (such as the provision of insurance products) can be measured, but much of their economic activity involves using their own balance sheets to intermediate or manage risk for the non-financial sector. Measuring such activity with conventional National Accounts concepts can be difficult, particularly when financial instruments are constantly evolving. Moreover, under internationally-agreed National Accounts principles, much of this is measured indirectly via the spread earned between deposit and lending rates, known as Financial Intermediation Services Indirectly Measured (FISIM). At present, FISIM is treated as intermediate consumption in the UK's National Accounts, and is therefore stripped out of whole economy gross value added (GVA). Having delayed implementation to ensure data quality, ONS intend that from Blue Book 2008 FISIM consumed by firms will be counted as intermediate consumption of the relevant industrial sector, while that part attributed to final consumption of households, or to exports, will score in whole economy GVA. The ONS estimate that the revised treatment of FISIM will increase the value of measured whole economy output by an average of around 1½ per cent over 1993 to 2004, though the precise effect, particularly on estimates of recent output volume growth, will not be clear until the new methodology has been fully implemented.

Given current FISIM methodology, and the difficulties of measuring the output of such a rapidly evolving sector, it is possible that measured GVA growth might not fully capture changes in activity associated with financial markets.

Manufacturing and North Sea output

Manufacturing

B.89 Manufacturing accounts for around 13 per cent of total UK output. The sector grew ½ a per cent on a year earlier in 2007, which was somewhat below the rate consistent with evidence from a range of private sector business surveys. Output of the capital and intermediate goods sectors increased most strongly. The recent depreciation of sterling should provide some support to manufacturing growth during 2008, although that will be set against weaker growth prospects in the UK's main trading partners. Manufacturing is forecast to grow ¾ to 1¼ per cent in 2008, picking up to in 2009 on the back of stronger export growth.

North Sea

B.90 Output from the North Sea oil and gas sector fell by 25 per cent over the three years to 2006, reflecting a series of temporary disruptions exacerbating the underlying decline in North Sea output. Despite the Buzzard field beginning production in 2007, North Sea output fell 2¼ per cent on a year earlier. Over the forecast horizon North Sea output is expected to continue its long-run trend decline, falling by over 5 per cent a year on average.

Independent forecasts

B.91 Since the 2007 Pre-Budget Report, the average of independent forecasts for GDP growth in 2008 has been revised down from 2.0 to 1.7 per cent, consistent with the lower end of the Budget 2008 forecast range. The lower average independent forecast reflects downward revisions to components of domestic demand growth, with the contribution from net trade revised marginally higher. The average independent GDP growth forecast for 2009 stands at 1.9 per cent, below the Budget 2008 forecast range. With forecasters on average expecting oil prices to remain above $80 a barrel in both 2008 and 2009, the average forecast for CPI inflation in the final quarter of 2008 is 2.4 per cent, in line with the Budget 2008 forecast. Independent forecasters expect inflation to return to target in 2009.

B.92 Treasury forecasts for GDP growth since 1997 have, on average, exhibited smaller forecast errors than the independent consensus. Judged using this metric, Treasury forecasts continue to compare well against a sample of forecasters that includes leading international organisations (IMF, OECD, EC), research institutes (Oxford Economics, NIESR) and private sector forecasters (Goldman Sachs, HSBC, JP Morgan).

Table B8: Budget and independent[1] forecasts

	Percentage change on a year earlier, unless otherwise stated					
	2008			2009		
		Independent			Independent	
	Budget 2008	Average	Range	**Budget 2008**	Average	Range
GDP growth	1¾ to 2¼	1.7	–0.1 to 2.1	2¼ to 2¾	1.9	–1.3 to 2.7
CPI (Q4)	2½	2.4	1.9 to 3.0	2	2.0	1.3 to 3.3
Current account (£ billion)	–72½	–59.1	–88.0 to –40.2	–71	–53.5	–90.7 to –35.0

[1] *'Forecasts for the UK economy: A comparison of independent forecasts', March 2008, compiled by HM Treasury.*

FORECAST ISSUES AND RISKS

B.93 All economic forecasting judgements are subject to uncertainty, not least because of the wide range of factors that can influence developments in the income and spending of households and companies in the UK and overseas. The Budget 2008 economic forecast is made against a backdrop of exceptional uncertainty related to the duration, intensity and broader effects of the ongoing disruption in global financial markets. There are clear risks to the forecast from the feed-through from these developments to credit conditions facing households and companies.

Global financial markets

B.94 The Budget forecast is conditioned on the assumption that the disruption in financial markets will start to ease during the second half of 2008 and that credit market functions will normalise by mid-2009. The Budget forecast is not dependent on a rapid return to normality, so conditions could improve more quickly than assumed.

Global economy

B.95 While the impact of tighter credit conditions represents a risk to growth in all economies, that risk is clearly greater in the US, where falling house prices have exacerbated the difficulties in reaching market-clearing prices for financial market instruments backed by real estate assets. These downside risks to US growth are offset by the upside risk that the significant monetary and fiscal policy response could provide a greater stimulus to confidence and activity than expected. Significant policy easing, coinciding with further dollar depreciation, does, however, present possible upside risks to inflation. Growth in the euro area could also exceed current expectations, with the latest private sector business surveys picking up a little in some countries, and labour markets providing support to consumption.

B.96 The extent to which domestic demand in emerging markets can make up for weaker external demand from advanced economies presents a clear risk to world output growth and particularly to world trade growth. Macroeconomic fundamentals in many emerging markets have improved significantly, which, coupled with the momentum from strong growth in 2007, could result in emerging market activity exceeding expectations, as it has repeatedly in recent years. With emerging markets accounting for a smaller proportion of UK export markets than of world trade or output, the impact on UK demand of slower than expected growth in emerging markets should be relatively limited.

Free trade and global imbalances

B.97 Risks to the multilateral trading system remain, especially from the proliferation of bilateral and regional trade agreements and, increasingly, from protectionist trade policies. A firm stance against protectionism can help to ensure that trade continues to improve living standards across advanced and emerging economies.

B.98 While the US current account deficit has started to decline, this has not yet been accompanied by a reduction of the large surpluses of some Asian countries. There remains a risk of disorderly unwinding of global imbalances, with the economic costs such a process would entail. To reduce this risk it is important that major world economies allow a continued rebalancing of demand and flexibility in their exchange rates.

UK growth prospects

B.99 For the UK economy, there are clear downside risks to growth if credit conditions were to deteriorate further, raising the price of and limiting access to finance for companies and households by more or for longer than has been assumed. There are upside risks from the weaker exchange rate providing support for export growth, and from the strength of the labour market, which could support income growth and consumer spending by more than has been assumed. Recent private business survey indicators suggest that the economy may have carried more momentum into 2008 than the forecast assumes, which presents a further upside risk to the near-term growth forecast.

B.100 In real time, it is extremely difficult to tell the extent to which the financial market shock will prove to have temporary or more persistent effects, so developments in the price of credit could conceivably have implications for the medium-term supply potential of the economy. If the price were to settle at a new equilibrium significantly higher than that prevailing over recent years, for example as a result of higher pricing of risk reflecting greater risk aversion, it could detract from the average rate of output growth over the medium term by raising the costs of supply. Uncertainty over the extent to which the shock to global credit conditions represents a shock to demand and/or supply will not be resolved for some time.

Supply-side performance

B.101 Over the past decade, the flexibility of UK product and labour markets, supported by sound macroeconomic policy, has delivered strong growth and low inflation. Output per hour productivity growth has averaged 2.4 per cent a year since 1997, compared with 1.9 per cent in the previous two economic cycles. This improved supply-side performance has been achieved despite sterling oil prices rising over four-fold since the late 1990s. Further improvement would be consistent with a GDP growth forecast towards the top of the Budget 2008 forecast range.

UK property markets

B.102 Since the 2007 Pre-Budget Report, commercial property prices in the UK have fallen, annual house price inflation has slowed and the volume of property transactions has declined. While this is expected to impact directly on residential investment and the approximately one-third of business investment that comprises buildings and structures, further unanticipated adjustment in the commercial or residential property markets could present risks to the forecasts for business investment or private consumption through effects on confidence or the value of collateral.

UK inflation

B.103 There are short-term upside risks to inflation from rising wholesale agricultural and energy prices, although in the event of global demand easing by more than expected, this risk could be reversed. The extent to which the monetary policy easing undertaken so far, and further easing expected by financial markets, feeds through to mortgage rates presents a key uncertainty for RPI inflation prospects.

B.104 Recent survey measures of inflation expectations have risen following the period of above-target inflation earlier in 2007. With CPI inflation expected to rise again in the near term, there is a risk that higher inflation expectations could feed through to second-round effects on wage settlements and earnings growth, though there has been no evidence of that as yet, with underlying earnings growth remaining stable and subdued.

Table B9: Summary of economic prospects[1]

		Percentage change on a year earlier, unless otherwise stated				
		Forecast[2,3,4]			Average errors from past forecasts[5]	
	2007	2008	2009	2010	2008	2009
Output at constant market prices						
Gross domestic product (GDP)	3	1¾ to 2¼	2¼ to 2¾	2½ to 3	¾	½
Manufacturing output	½	¾ to 1¼	1¾ to 2¼	1¾ to 2¼	1¼	1¾
Expenditure components of GDP at constant market prices[6]						
Domestic demand	3¾	1½ to 1¾	2 to 2½	2½ to 3	¾	¾
Household consumption[7]	3¼	1¼ to 1¾	2 to 2½	2¼ to 2¾	½	1
General government consumption	2	2¼	2	2	¾	¾
Fixed investment	5	1¾ to 2¼	2¾ to 3¼	3½ to 4	3	2¼
Change in inventories[8]	½	0	0	0	¼	¼
Exports of goods and services[9]	–5½	3¼ to 3½	5 to 5½	5 to 5½	2½	4
Imports of goods and services[9]	–3¼	2 to 2¼	3¾ to 4¼	4 to 4½	3	3
Exports of goods and services (excluding MTIC)	½	3¼ to 3¾	5 to 5½	5 to 5½	–	–
Imports of goods and services (excluding MTIC)	2½	2 to 2½	3¾ to 4¼	4 to 4½	–	–
Balance of payments current account						
£ billion	–70¼	–72½	–71	–66¼	13	14¾
Per cent of GDP	–5	–5	–4½	–4	1	1
Inflation						
CPI (Q4)	2	2½	2	2	¼	½
Producer output prices (Q4)[10]	4¾	2¾	2	2	1¼	1½
GDP deflator at market prices	3	3¼	2¾	2¾	½	½
Money GDP at market prices						
£ billion	1385	1457 to 1461	1531 to 1543	1611 to 1632	11¼	8
Percentage change	6¼	5¼ to 5½	5 to 5½	5¼ to 5¾	¾	½

[1] The forecast is consistent with the income, output and expenditure data for the fourth quarter of 2007, released by the Office for National Statistics on 27 February 2008. See also footnote 1 on the second page of this chapter.

[2] All growth rates in tables throughout this annex are rounded to the nearest ¼ percentage point.

[3] As in previous Budget and Pre-Budget Reports, the economic forecast is presented in terms of forecast ranges, based on alternative assumptions about the supply-side performance of the economy. The mid-points of the forecast ranges are anchored around the neutral assumption for the trend rate of output growth of 2¾ per cent. The figures at the lower end of the ranges are consistent with the deliberately cautious assumption of trend growth used as the basis for projecting the public finances, which is a ¼ percentage point below the neutral assumption.

[4] The size of the growth ranges for GDP components may differ from those for total GDP growth because of rounding and the assumed invariance of the levels of public spending within the forecast ranges.

[5] Average absolute errors for current year and year-ahead projections made in spring forecasts over the past 10 years. The average errors for the current account are calculated as a per cent of GDP, with £ billion figures calculated by scaling the errors by forecast money GDP in 2008.

[6] Further detail on the expenditure components of GDP is given in Table B10.

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

[8] Contribution to GDP growth, percentage points.

[9] Figures up to and including 2007 are distorted by MTIC.

[10] Excluding excise duties.

Table B10: Gross domestic product and its components

	£ billion chained volume measures at market prices, seasonally adjusted									
	Household consumption[1]	General government consumption	Fixed investment	Change in inventories	Domestic demand[2]	Exports of goods and services	Total final expenditure	Less imports of goods and services	Plus statistical discrepancy[3]	GDP at market prices
2007	800.4	255.8	227.4	6.5	1290.6	339.8	1630.4	382.9	0.3	1247.9
2008	811.1 to 813.6	261.8	231.5 to 232.2	5.8 to 6.6	1310.3 to 1314.3	350.9 to 352.0	1661.1 to 1666.2	390.7 to 391.9	0.2	1270.6 to 1274.5
2009	828.1 to 834.7	267.0	237.6 to 239.5	4.3 to 6.5	1337.0 to 1347.6	368.2 to 371.1	1705.2 to 1718.7	405.4 to 408.6	0.2	1300.0 to 1310.4
2010	847.4 to 858.3	272.3	245.7 to 248.9	3.3 to 6.9	1368.8 to 1386.5	386.1 to 391.1	1755.0 to 1777.6	421.8 to 427.3	0.2	1333.3 to 1350.5
2007 1st half	397.4	127.4	113.2	0.6	639.0	168.8	807.9	188.6	0.2	619.5
2nd half	402.9	128.4	114.2	5.9	651.5	171.0	822.6	194.3	0.1	628.4
2008 1st half	404.3 to 405.1	130.1	115.2 to 115.4	4.1 to 4.4	653.8 to 655.0	173.4 to 173.7	827.3 to 828.8	194.5 to 194.9	0.1	632.8 to 634.0
2nd half	406.8 to 408.5	131.7	116.3 to 116.8	1.7 to 2.2	656.4 to 659.2	177.4 to 178.2	833.9 to 837.4	196.2 to 197.0	0.1	637.8 to 640.5
2009 1st half	411.3 to 414.1	132.9	117.9 to 118.7	2.1 to 3.0	664.2 to 668.7	181.8 to 183.0	846.0 to 851.7	200.2 to 201.6	0.1	645.9 to 650.2
2nd half	416.7 to 420.6	134.1	119.8 to 120.8	2.2 to 3.5	672.8 to 679.0	186.4 to 188.1	859.2 to 867.0	205.1 to 207.0	0.1	654.1 to 660.1
2010 1st half	421.6 to 426.5	135.4	121.8 to 123.2	1.7 to 3.3	680.6 to 688.5	190.9 to 193.1	871.4 to 881.5	209.1 to 211.5	0.1	662.5 to 670.2
2nd half	425.8 to 431.8	136.9	124.0 to 125.7	1.6 to 3.5	688.3 to 698.0	195.3 to 198.0	883.6 to 896.0	212.8 to 215.8	0.1	670.9 to 680.3
	Percentage change on a year earlier[4,5]									
2007	3¼	2	5	½	3¾	–5½	1½	–3¼	0	3
2008	1¼ to 1¾	2¼	1¾ to 2¼	0	1½ to 1¾	3¼ to 3½	2 to 2¼	2 to 2¼	0	1¾ to 2¼
2009	2 to 2½	2	2¾ to 3¼	0	2 to 2½	5 to 5½	2¾ to 3¼	3¾ to 4¼	0	2¼ to 2¾
2010	2¼ to 2¾	2	3½ to 4	0	2½ to 3	5 to 5½	3 to 3½	4 to 4½	0	2½ to 3

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

[2] *Also includes acquisitions less disposals of valuables.*

[3] *Expenditure adjustment.*

[4] *For change in inventories and the statistical discrepancy, changes are expressed as a per cent of GDP.*

[5] *Growth ranges for GDP components do not necessarily sum to the ½ percentage point ranges for GDP growth because of rounding and the assumed invariance of the levels of public spending within the forecast ranges.*

C

THE PUBLIC FINANCES

Budget 2008 projections for the public finances show that the Government is meeting its strict fiscal rules over the economic cycle:

- **the current budget shows an average surplus as a percentage of GDP over the economic cycle which began in 1997-98, ensuring the Government is meeting the golden rule. The current budget moves clearly into surplus from 2010-11 onwards; and**
- **public sector net debt remains below 40 per cent of GDP throughout the projection period and starts to decline by 2012-13, meeting the sustainable investment rule.**

The reclassification of Northern Rock to the public sector will bring its assets and liabilities temporarily into the public finances. In line with the *Code for Fiscal Stability*, while Northern Rock remains in the public sector the Government will measure performance against the sustainable investment rule using figures excluding its impact.

INTRODUCTION

C.1 Chapter 2 describes the Government's fiscal policy framework and shows how the projections of the public finances presented in this Budget 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; and
- detailed analyses of the outlook for government receipts and expenditure.

C.2 At the time of the 2007 Pre-Budget Report, there were considerable uncertainties around the impact of the disruption in financial markets on the economy and public finances. Despite this, allowances made in the Pre-Budget Report public finance projections for 2007-08 have proved to be reasonable. Public sector net debt is now forecast to be 37.1 per cent of GDP in 2007-08, lower than projected in the Pre-Budget Report and Budget 2007. Both net borrowing, at £36.4 billion and the current budget deficit of £7.9 billion are lower than estimated in the 2007 Pre-Budget Report projections.

C.3 Since the Pre-Budget Report, disruption in financial markets has continued, and the Budget 2008 forecast assumes the negative impact on growth and the public finances from these developments will be somewhat larger and more prolonged than expected in the 2007 Pre-Budget Report.

[1] For further detail, see *Budget 2008: the economy and public finances – supplementary material*. This includes tables on public expenditure, sub-sector and economic category analyses, and conventions used in presenting the public finances.

C.4 Fiscal policy will continue to support the economy in the short term, with a modest discretionary fiscal tightening as the economy returns to trend ensuring sound public finances in the medium term. Public sector net borrowing is now forecast to be higher from 2008-09 onwards, with the current budget projected to return to surplus from 2010-11, before both return close to levels forecast at the time of the Pre-Budget Report by the end of the forecast period. Budget 2008 projections show that the Government is meeting its strict fiscal rules over the cycle.

C.5 The fiscal projections continue to be based on deliberately cautious key assumptions audited by the National Audit Office (NAO).

Treatment of Northern Rock

C.6 As outlined in Chapter 2, the Office for National Statistics (ONS) has announced its intention to classify Northern Rock as a public corporation with effect from 9 October 2007. This will temporarily increase public sector net debt by the company's gross liabilities to the private sector net of its liquid assets. The ONS are yet to compile an estimate of the change, and so in line with usual practice the forecasts presented in this Budget do not include an estimate of the impact in future years. The Government will, in any future Budgets and Pre-Budget Reports in which the company remains classified as a public corporation, report public sector net debt both including and excluding Northern Rock.

C.7 As set out in Chapter 2, the sustainable investment rule ensures sound public finances and fairness by protecting future generations from the costs of debt incurred by this generation. Northern Rock is temporarily in public ownership and its liabilities are fully backed by other financial assets held by the company, and therefore its impact on public sector net debt does not reflect future calls on the taxpayer or affect sustainability. For the purpose of measuring performance against the sustainable investment rule, the Government will use a measure of public sector net debt excluding Northern Rock's assets and liabilities.

C.8 The *Code for Fiscal Stability* provides for such circumstances. While Northern Rock remains in temporary public ownership, operating at arms length from the Government, the Treasury will provide financing to the company and continue to provide guarantee arrangements where appropriate. It will continue to record a contingent liability for these arrangements. Any economic profit or loss will be included within both measures of public sector net debt (and thus within the sustainable investment rule) when that profit or loss crystallises for central government.

MEETING THE FISCAL RULES

C.9 Table C1 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.

C.10 The fiscal rules are set over the economic cycle to allow fiscal policy to support monetary policy over the short term, while meeting the Government's primary objective of ensuring sound public finances over the medium term. Chapter 2 describes the Government's fiscal policy framework in further detail.

C.11 The Government's judgment is that 1997-98 represented the beginning of a new economic cycle. As explained in Chapter B, the latest National Accounts data and the Treasury's trend output assumptions imply that output passed through trend in the second half of 2006. However, it is too soon to assess whether or not the economic cycle has ended.

Table C1: 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	-0.3	-0.6	-0.7	-0.2	0.3	0.6	1.0
Average surplus since 1997-1998	0.2	0.1	0.1	0.0	0.0	0.0	0.1	0.1
Cyclically-adjusted surplus on current budget	-0.9	-0.3	-0.7	-0.5	0.1	0.5	0.8	1.0
Long-term sustainability								
Public sector net debt[1]	36.0	36.6	37.1	38.5	39.4	39.8	39.7	39.3
Core debt[1]	35.4	35.9	36.6	37.7	38.4	38.6	38.5	38.2
Net worth[2]	27.7	26.0	25.3	23.7	22.2	21.3	20.7	20.9
Primary balance	-1.4	-0.6	-0.9	-1.3	-0.9	-0.3	0.1	0.4
Economic impact								
Net investment	1.9	1.9	2.0	2.2	2.2	2.3	2.2	2.3
Public sector net borrowing (PSNB)	3.0	2.3	2.6	2.9	2.5	2.0	1.6	1.3
Cyclically-adjusted PSNB	2.8	2.2	2.7	2.7	2.2	1.8	1.5	1.2
Financing								
Central government net cash requirement	3.3	2.8	2.7	4.0	3.2	2.5	2.3	1.8
Public sector net cash requirement	3.2	2.7	2.3	2.8	2.9	2.1	1.9	1.4
European commitments								
Treaty deficit[3]	3.1	2.6	2.8	3.2	2.8	2.3	1.9	1.6
Cyclically-adjusted Treaty deficit[3]	2.9	2.5	3.0	3.0	2.5	2.1	1.8	1.5
Treaty debt ratio[4]	42.5	43.3	43.8	46.1	46.9	47.2	47.0	46.6
Memo: Output gap	-0.4	0.0	0.3	-0.5	-0.4	-0.3	-0.1	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

C.12 Progress against the golden rule is measured by the average annual surplus on the current budget as a percentage of GDP since the cycle began. On this basis, and on the basis of cautious assumptions, the Government has met the golden rule for the cycle that began in 1997-98.

C.13 The projections show that the deficit on the current budget remains significantly below the 1.1 per cent deficit recorded in 2005-06 and moves into surplus in 2010-11, with the surplus rising to 1.0 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, shows a rising surplus from 2009-10, as the economy returns to trend.

The sustainable investment rule

C.14 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 is estimated to be 37.1 per cent of GDP in 2007-08, ½ per cent below the 2007 Pre-Budget Report estimate and just over 1 per cent below the Budget 2007 projection. Public sector net debt remains below 40 per cent of GDP throughout the projection period and starts to decline by 2012-13, reaching 39.3 per cent of GDP. Therefore the Government meets its sustainable investment rule while continuing to fund increased long-term capital investment in public services. The projections for core debt, which exclude the estimated impact of the economic cycle, remain below 39 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 **C.15** 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 as a result of the difficulties involved in accurately measuring many government assets and liabilities.

Net investment **C.16** 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 2007-08. As a result of decisions taken in the 2007 Pre-Budget Report and Comprehensive Spending Review, net investment will increase further and then remain at around 2¼ per cent of GDP from 2008-09 onwards.

Net borrowing **C.17** 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 to 2.6 per cent of GDP in 2007-08, a smaller increase than expected in the 2007 Pre-Budget Report. After a further modest rise in 2008-09, net borrowing then falls steadily over the remainder of the forecast period from 2.9 per cent of GDP in 2008-09 to 2.5 per cent in 2009-10, and then to 1.3 per cent of GDP by 2012-13. From 2010-11, public sector net borrowing is more than accounted for by net investment.

Financing **C.18** The central government net cash requirement (CGNCR) was 2.8 per cent of GDP in 2006-07 and is expected to be around 2.7 per cent in 2007-08, lower than forecast in the 2007 Pre-Budget Report. CGNCR is projected to be around 4.0 per cent in 2008-09, with part of the increase reflecting the impact of the refinancing of the Bank of England's loans to Northern Rock, and 3.2 per cent in 2009-10. It then falls steadily to 1.8 per cent of GDP by 2012-13, as net borrowing falls.

European commitments **C.19** Table C1 shows the Treaty measures of debt and deficit used for the purposes of the Excessive Deficit Procedure – Article 104 of the Treaty. The Government supports a prudent interpretation of the Stability and Growth Pact, as described in Box B3 and as reflected in reforms to the Pact agreed in March 2005. This takes into account the economic cycle, the long-term sustainability of the public finances and the important role of public investment. The public finance projections set out in Budget 2008, which show the Government is meeting its fiscal rules over the cycle, maintaining low debt and sustainable public finances, combined with sustained increases in public investment, are consistent with a prudent interpretation of the Pact. As set out in paragraph C.97, the Government will be replacing the Bank of England's loans to Northern Rock with Treasury funding. This will have no impact on public sector net debt but will temporarily increase central government gross debt and hence the Treaty debt ratio by around 1 per cent a year. The Treaty debt ratio remains well below the 60 per cent reference value set out in the Stability and Growth Pact.

C.20 Table C2 compares the latest estimates for the main fiscal balances with those in Budget 2007 and the 2007 Pre-Budget Report.

Table C2: Fiscal balances compared with Budget 2007 and the 2007 Pre-Budget Report

	Outturn[1]	Estimate[2]	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
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 ½*	*-4*	*-1 ½*	*-1*	
Effect of discretionary changes	*0.0*	*-0.4*	*- ½*	*1*	*1 ½*	*1 ½*	
2007 Pre-Budget Report	-4.7	-8.3	-4	3	9	14	20
Effect of revisions and forecasting changes [3]	*0.5*	*0.4*	*-5 ½*	*-7 ½*	*-6 ½*	*-5*	*-3 ½*
Effect of discretionary changes	*0.0*	*0.0*	*0*	*1*	*2*	*2 ½*	*2 ½*
Budget 2008	**-4.3**	**-7.9**	**-10**	**-4**	**4**	**11**	**18**
Net borrowing (£ billion)							
Budget 2007	35.0	33.7	30	28	26	24	
Changes to current budget	*-4.7*	*4.0*	*7*	*2 ½*	*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	23
Changes to current budget	*-0.5*	*-0.4*	*5 ½*	*7*	*5*	*2 ½*	*1*
Changes to net investment	*-0.5*	*-1.2*	*½*	*½*	*0*	*0*	*-1*
Budget 2008	**30.1**	**36.4**	**43**	**38**	**32**	**27**	**23**
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	1.1
Budget 2008	**-0.3**	**-0.7**	**-0.5**	**0.1**	**0.5**	**0.8**	**1.0**
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	1.3
Budget 2008	**2.2**	**2.7**	**2.7**	**2.2**	**1.8**	**1.5**	**1.2**
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	38.6
Budget 2008	**36.6**	**37.1**	**38.5**	**39.4**	**39.8**	**39.7**	**39.3**

[1] *The 2006-07 figures were estimates in Budget 2007.*
[2] *The 2007-08 figures were projections in Budget 2007.*
[3] *Including changes to forecasting assumptions on spending growth in 2011-12 and 2012-13.*

Changes between Budget 2007 and the 2007 Pre-Budget Report

C.21 At the time of the 2007 Pre-Budget Report, outturn for the current budget in 2006-07 showed a deficit of £4.7 billion, which was £4.7 billion lower than expected at Budget 2007, reflecting higher receipts and lower current expenditure for central government and a deficit across the rest of the public sector that was lower than forecast.

C.22 At the 2007 Pre-Budget Report the current budget was revised downwards from 2007-08 onwards, largely due to financial market developments subsequent to Budget 2007. The public finance projections allowed for an impact from financial market disruption on receipts, as a consequence of both subdued financial sector profitability and a slowdown in economic growth in 2008. However, the Pre-Budget Report made clear that the impact was uncertain.

Changes between the 2007 Pre-Budget Report and Budget 2008

C.23 The latest outturn data shows that both the current budget deficit and net borrowing were lower in 2006-07 than indicated in the 2007 Pre-Budget Report, as a result of lower central government current expenditure and revisions to public sector net investment. The current budget deficit is now £5.2 billion lower and net borrowing £4.9 billion lower than expected at Budget 2007.

C.24 The Budget 2008 estimate for the balance on the current surplus for 2007-08 is marginally lower than forecast in the 2007 Pre-Budget Report. Lower than expected public sector current expenditure has been largely offset by lower public sector current receipts. Overall tax receipts are slightly higher than the 2007 Pre-Budget Report estimates. Non-tax receipts are lower but are largely balanced by related changes to public spending.

C.25 The current budget has been revised down by around £6 billion in 2008-09 and around £7 billion in 2009-10, with smaller downward revisions in later years. As the disruption to financial markets has continued, and with its effects expected to persist for a longer duration than assumed at the 2007 Pre-Budget Report, it is likely to have a wider impact on receipts than previously envisaged. The allowance for subdued financial sector profitability incorporated in the Pre-Budget Report projections, which proved reasonable for 2007-08, has been re-assessed for subsequent years. Receipts related to the property market, equity prices and interest rates have also been revised.

C.26 Net borrowing in 2007-08 is expected to be £1.6 billion below the 2007 Pre-Budget forecast, mainly due to lower than projected net investment. Downward revisions to net investment in the early part of the year since the Pre-Budget Report and partly unspent capital reserves largely explain this shortfall. Net debt for 2007-08 is now forecast to be 37.1 per cent of GDP, ½ per cent of GDP lower than the 2007 Pre-Budget Report level and just over 1 per cent below the Budget 2007 forecast.

C.27 Discretionary fiscal measures set out in Chapter 1 allow for a fiscal policy stance that protects economic stability in the short term, and takes action to maintain sound public finances in the medium term. Budget changes are fiscally neutral in 2008-09 and 2009-10. As the economy returns to trend, discretionary tightening reduces the deficit in later years of the projection period.

FORECAST DIFFERENCES AND RISKS

C.28 The fiscal balances represent the difference between two large aggregates of expenditure and receipts, and forecasts are inevitably subject to wide margins of uncertainty. 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 the 2007 Pre-Budget Report.

C.29 As explained in Chapter B, UK GDP is expected to grow by 1¾ to 2¼ per cent in 2008, picking up to 2¼ to 2¾ per cent in 2009 before returning close to trend rates of 2½ to 3 per cent from 2010. The Budget 2008 economic forecast is made against a backdrop of considerable uncertainty related to the ongoing disruption in global financial markets.

C.30 As the disruption has continued in credit markets, so credit conditions facing households and companies have tightened. For the UK economy, there are clear downside risks to growth if credit conditions were to deteriorate further, raising the price of and limiting access to finance for companies and households by more or for longer than has been assumed. There are upside risks from the weaker exchange rate providing support for export growth and from the strength of the labour market, which could support income growth and consumer spending by more than has been assumed. Recent private business survey indicators suggest that the economy may have carried more momentum into 2008 than the forecast assumes.

The use of audited assumptions

C.31 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. As detailed in Table C3, the forecast for economic growth used in the public finances projections over the period 2008-09 to 2012-13 averages a cautious 2¼ per cent.

C.32 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.

C.33 The NAO audit the assumption on equity prices which assumes that prices rise in line with money GDP from their current level. This has a key impact on the Budget forecast, effectively locking in the decline in equity prices since the Pre-Budget Report. Equity prices are assumed to be around 14 per cent below the Pre-Budget Report projection throughout the forecast horizon.

C.34 The Government uses cautious NAO audited assumptions, including a cautious view of trend growth, to build a safety 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 low debt. As a result, this has allowed the Government to safeguard the increase in investment in priority public services, to allow the automatic stabilisers to work fully during a period of global economic uncertainty, and to meet in full the UK's international commitments, while continuing to meet the fiscal rules.

ASSUMPTIONS

C.35 The fiscal projections are based on the following assumptions:

- the economy follows the path described in Chapter B. 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;
- there are no tax or spending policy changes beyond those announced in or before this Budget, and all rates and allowances remain constant in real terms;
- firm Departmental Expenditure Limits (DEL) to 2010-11 are as set out in the 2007 Comprehensive Spending Review, adjusted for the impact of policy decisions and reclassifications;
- total Annually Managed Expenditure (AME) programmes to 2010-11 have been reviewed in this report and adjusted for the impact of policy decisions and reclassifications; and

- growth in public sector current expenditure over 2011-12 and 2012-13 of 1.8 per cent per year in real terms and net investment of 2¼ per cent of GDP in 2011-12 and 2012-13. Taken together, these assumptions mean Total Managed Expenditure (TME) grows by 1.9 per cent over 2011-12 and 2012-13.

Table C3: 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	1 ¾	2 ½	2 ½	2 ½	2 ½
Prices							
CPI	2 ½	2 ¼	2 ¾	2	2	2	2
GDP deflator	2 ¾	3 ¼	3	2 ¾	2 ¾	2 ¾	2 ¾
RPI[1] (September)	3 ½	4	3 ¼	2 ¼	3	2 ¾	2 ¾
Rossi[2] (September)	3	2 ¼	3 ¾	2 ½	2 ¼	2 ¼	2 ¼
Money GDP[3] (£ billion)	1,325	1,405	1,473	1,550	1,632	1,719	1,811

[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.*

C.36 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.

C.37 As well as reclassifying Northern Rock to the public sector, the ONS have also announced that the Bank of England is to be included in statistics for the public sector. This will be retrospective, but as with Northern Rock, the ONS have yet to compile estimates of the change and so in line with usual practice the forecasts presented in this Budget do not include the Bank of England as a public corporation. The Government will include it in future Budgets and Pre-Budget Reports. The ONS have indicated that the impact on the public sector current budget will not be material and that there may be a small reduction to the level of public sector net debt.

The audited assumptions

C.38 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 C1.

C.39 For Budget 2008, the Comptroller and Auditor General has audited the assumption relating to unemployment, which requires projections to be based on outside forecasts when these are higher than recent outturns. He concluded that the assumption proved to be cautious in the later part of the Rolling Review period since Budget 2005, though in the earlier part actual unemployment in the initial parts of the projections exceeded the level projected by outside forecasters. He concluded that the assumption draws on a wide range of external views of the future and is a reasonable one to have used and to continue to use. No other assumptions were due for review in this Budget.

C.40 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 Budget where final decisions have yet to be taken. These include:

- further extensions to maternity and paternity leave;
- further reforms to incapacity benefits; and
- the EU Emissions Trading Scheme.

Box C1: Key assumptions audited by the NAO[a]

Trend GDP growth[d]	2½ per cent a year to 2012-13.
Dating of the cycle[b]	The end date of the previous economic cycle was in the first half of 1997.
Composition of GDP[e]	Shares of labour income and profits in national income are broadly constant in the medium term.
Consistency of price indices[d]	Projections of price indices used to project the public finances are consistent with CPI.
Oil prices[b]	$83.8 a barrel in 2008, the average of independent forecasts, and then constant in real terms.
Equity prices[d]	FTSE All-share index rises from 2959 (close 6 March) in line with money GDP.
VAT[e]	The underlying VAT gap will rise by 0.5 percentage points per year from the estimated outturn for the current year.
Tobacco[e]	The underlying level of duty paid 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[f, g]	Rising from recent average levels of 0.80 million to 0.99 million at the end of 2009, and to 1.00 million at the end of 2010.
Interest rates[c]	3-month market rates change in line with market expectations (as of 28 February).
Funding[e]	Funding assumptions used to project debt interest are consistent with the forecast level of government borrowing and with financing policy.
Privatisation proceeds[c]	Credit is taken only for proceeds from sales that have been announced.

[a] For details of all NAO audits before the 2005 Pre-Budget Report, see Budget 2005, 16 March 2005 (HC 372).
[b] Audit of Assumptions for 2005 Pre-Budget Report, 5 December 2005 (HC 707).
[c] Audit of Assumptions for the Budget 2006, 22 March 2006 (HC 937).
[d] Audit of Assumptions for 2006 Pre-Budget Report, 6 December 2006 (HC 125).
[e] Audit of Assumptions for the Budget 2007, 21 March 2007 (HC 393).
[f] Audit of Assumptions for Budget 2008, 12 March 2008 (HC 345)
[g] Seasonally-adjusted UK claimant unemployment. This is a cautious assumption based on the average of external forecasts and is not the Treasury's economic forecast.

FISCAL AGGREGATES

C.41 Tables C4 and C5 provide more detail on the projections for the current and capital budgets.

Table C4: 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	519.7	549.9	575	608	647	683	721
Current expenditure	507.0	540.1	566	592	622	650	680
Depreciation	16.9	17.7	19	20	21	22	23
Surplus on current budget	**-4.3**	**-7.9**	**-10**	**-4**	**4**	**11**	**18**
Capital budget							
Gross investment[1]	42.7	46.2	52	54	57	60	64
Less depreciation	-16.9	-17.7	-19	-20	-21	-22	-23
Net investment	25.8	28.5	33	35	37	38	41
Net borrowing	**30.1**	**36.4**	**43**	**38**	**32**	**27**	**23**
Public sector net debt - end year	**499.7**	**534.5**	**581**	**627**	**666**	**700**	**731**
Memos:							
Treaty deficit[2]	34.0	39.8	47	43	38	33	28
Treaty debt[3]	574.4	615.9	679	728	771	809	844

[1] *Net of asset sales; for a breakdown see Table 17 in Budget 2008: the economy and public finances - supplementary material.*

[2] *General government net borrowing on a Maastricht basis.*

[3] *General government gross debt on a Maastricht basis.*

Table C5: 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	39.1	39.0	39.2	39.7	39.7	39.8
Current expenditure	38.3	38.4	38.4	38.2	38.1	37.8	37.5
Depreciation	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Surplus on current budget	**-0.3**	**-0.6**	**-0.7**	**-0.2**	**0.3**	**0.6**	**1.0**
Capital budget							
Gross investment[1]	3.2	3.3	3.5	3.5	3.5	3.5	3.5
Less depreciation	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Net investment	1.9	2.0	2.2	2.2	2.3	2.2	2.3
Net borrowing	**2.3**	**2.6**	**2.9**	**2.5**	**2.0**	**1.6**	**1.3**
Public sector net debt - end year	**36.6**	**37.1**	**38.5**	**39.4**	**39.8**	**39.7**	**39.3**
Memos:							
Treaty deficit[2]	2.6	2.8	3.2	2.8	2.3	1.9	1.6
Treaty debt ratio[3]	43.3	43.8	46.1	46.9	47.2	47.0	46.6

[1] *Net of asset sales; for a breakdown see Table 17 in Budget 2008: the economy and public finances - supplementary material.*

[2] *General government net borrowing on a Maastricht basis.*

[3] *General government gross debt on a Maastricht basis.*

C.42 Following a deficit of close to 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 until 2009-10 and then move back into surplus in 2010-11, with increasingly larger surpluses in later years, reaching 1 per cent in 2012-13.

C.43 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.

C.44 Table C5 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 historical underinvestment in public infrastructure. These increases are sustainable within the fiscal rules, with debt falling to 39.3 per cent of GDP by the end of the forecast period.

RECEIPTS

C.45 This section looks in detail at the projections for public sector tax receipts. It begins by looking at the main determinants of changes in the overall projections since the 2007 Pre-Budget Report, before looking in detail at changes in the projections of individual tax receipts. Finally, it provides updated forecasts for the tax-GDP ratio.

Changes in total receipts since the 2007 Pre-Budget Report

C.46 Net taxes and national insurance contributions (NICs) are estimated to be £0.3 billion higher in 2007-08 than expected in the Pre-Budget Report. Higher receipts from income tax and NICs, primarily from stronger than expected self-assessment receipts, more than offset weaker receipts from both VAT and stamp duty land tax. The impact from financial market disruption in the Pre-Budget Report was assumed to be mainly on profitability and bonus payments from the financial sector. Both income tax and corporation tax receipts data have been broadly consistent with the adjustment made in the Pre-Budget Report.

C.47 The Pre-Budget Report assumed that growth in net taxes and NICs in 2008-09 would slow to 5.4 per cent from 6.4 per cent in 2007-08, reflecting both the slowdown in economic growth and subdued prospects for financial sector profitability. Growth in receipts is now expected to slow more markedly to around 4.6 per cent in 2008-09, the lowest rate of growth since 2002-03. Tighter credit conditions are likely to have a wider impact on receipts than envisaged in the Pre-Budget Report. Receipts related to the property market, equity prices and interest rates have all been revised down.

C.48 The decline in residential property transactions and the downturn in the commercial property market means that related tax receipts are likely to be around £1 billion lower in 2007-08 than assumed in the Pre-Budget Report. The disruption in money markets and the effective closure of the mortgage-backed securities market are impacting on the volume of transactions and this is expected to persist during 2008. Allied with further near-term weakness in commercial property and sluggish or flat house price growth, receipts related to the property market, such as stamp duty land tax, inheritance tax and capital gains tax, are expected to be £2¼ billion lower in 2008-09 than in the Pre-Budget Report. With a recovery in property transactions forecast through 2009 and 2010, the shortfall diminishes somewhat.

C.49 Equity prices held up prior to the Pre-Budget Report, despite the disruption in other financial markets. However, equity prices have fallen since the Pre-Budget Report. The forecast uses an NAO audited assumption for equity prices, which assumes that prices will rise in line with money GDP from their current level. Equity prices are around 14 per cent lower than assumed in the Pre-Budget Report forecast throughout the forecast period. This will have a direct impact on stamp duty on shares, onshore corporation tax, and with a lag, capital gains tax and inheritance tax. Receipts are expected to be £1¼ billion lower in 2008-09 and £2¼ billion lower in 2009-10, with the shortfall diminishing a little over the rest of the forecast horizon.

C.50 With financial market disruption impacting on near-term growth prospects, market expectations of interest rates have fallen relative to the Pre-Budget Report, particularly for 2008 and 2009. Interest rates will impact on tax on savings income and on interest and dividend receipts, with lower receipts over the forecast period. There will be an offsetting effect on the public finances from lower debt interest payments within AME.

Tax by tax analysis

C.51 Table C6 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 the 2007 Pre-Budget Report.

Table C6: Current receipts

	£ billion			Changes since 2007 PBR £ billion		
	Outturn 2006-07	Estimate 2007-08	Projection 2008-09	Outturn 2006-07	Estimate 2007-08	Projection 2008-09
HM Revenue and Customs						
Income tax (gross of tax credits)	147.8	155.6	160.2	0.0	1.6	-1.6
Income tax credits	-4.4	-4.7	-5.2	0.0	-0.2	-0.3
National insurance contributions	87.3	97.4	104.6	0.0	0.9	3.5
Value added tax	77.4	80.5	83.8	0.0	-0.9	-2.0
Corporation tax[1]	44.8	47.0	51.9	0.0	0.2	0.4
Corporation tax credits[2]	-0.5	-0.6	-0.6	0.0	0.0	0.0
Petroleum revenue tax	2.2	1.7	1.7	0.0	0.1	0.2
Fuel duties	23.6	24.9	25.7	0.0	0.0	-0.5
Capital gains tax	3.8	4.8	5.0	0.0	0.0	-0.4
Inheritance tax	3.6	3.9	3.2	0.0	0.0	-0.1
Stamp duties	13.4	14.3	13.5	0.0	-0.8	-2.4
Tobacco duties	8.1	8.1	7.6	0.0	0.0	-0.2
Spirits duties	2.3	2.3	2.3	0.0	0.0	0.0
Wine duties	2.4	2.6	2.9	0.0	-0.1	0.1
Beer and cider duties	3.3	3.3	3.4	0.0	0.0	0.1
Betting and gaming duties	1.4	1.5	1.5	0.0	0.0	0.0
Air passenger duty	1.0	2.0	2.1	0.0	0.0	0.0
Insurance premium tax	2.3	2.3	2.4	0.0	-0.1	-0.1
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	2.5	0.0	0.1	0.1
Total HMRC	**423.6**	**451.2**	**470.5**	**0.0**	**0.8**	**-3.2**
Vehicle excise duties	5.1	5.6	6.1	0.0	0.1	0.2
Business rates	21.0	21.8	23.7	0.0	-0.1	-0.4
Council tax[3]	22.2	23.7	24.9	0.0	0.0	0.0
Other taxes and royalties[4]	13.9	14.7	15.7	0.0	-0.6	-0.2
Net taxes and NICs[5]	**485.8**	**517.1**	**541.0**	**0.0**	**0.3**	**-3.5**
Accruals adjustments on taxes	5.0	1.4	2.0	0.3	0.0	-0.4
Less own resources contribution to EC budget	-4.6	-5.0	-4.7	0.0	-0.3	0.1
Less PC corporation tax payments	-0.3	-0.2	-0.2	0.0	0.0	0.0
Tax credits adjustment[6]	0.6	0.6	0.7	0.0	0.0	0.0
Interest and dividends	6.3	7.9	7.0	0.1	0.3	-0.5
Other receipts[7]	26.9	28.1	29.4	0.3	-1.6	-1.6
Current receipts	**519.7**	**549.9**	**575.2**	**0.6**	**-1.2**	**-5.8**
Memo:						
North Sea revenues[8]	9.0	7.7	9.9	0.0	0.2	0.9

[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

C.52 Cash receipts of income tax and national insurance contributions (NICs) in 2007-08 are expected to be £2.5 billion above their 2007 Pre-Budget Report projection. This largely stems from higher receipts from self-assessment, which, because of the tax payment lag, reflect 2006-07 tax liabilities and incomes. PAYE and NIC receipts from wages and salaries are also higher than expected, reflecting the pick up of employment growth during 2007 and relatively buoyant receipts from the financial and business services sectors. Early indications are that receipts from City bonuses are showing a moderate decline from 2006-07, consistent with the assumption made in the Pre-Budget Report.

C.53 Growth in income tax and NICs is expected to slow from 7.7 per cent in 2007-08 to 4.6 per cent in 2008-09. The forecast allows for a more substantial reduction in receipts from the financial sector in 2008-09 than in 2007-08, due to the ongoing disruption in the sector. With a longer period of output below trend incorporated into the Budget forecast, earnings growth is expected to be subdued for longer than assumed in the Pre-Budget Report. This lowers PAYE and NICs receipts. Tax on savings income is likely to be lower in 2008-09 as a result of lower projected interest rates, as set by the NAO audited assumption.

Non-North Sea corporation tax

C.54 Non-North Sea corporation tax receipts are estimated to have grown by about 8 per cent in 2007-08. However, growth in receipts during 2007-08 has been held back by over £2 billion higher repayments than in 2006-07. This partly reflects that some companies overpaid tax for recent accounting periods by more than expected and also efforts by HMRC to finalise tax liabilities relating to historic accounting periods. The latter is likely to be a temporary effect. The strongest growth in receipts in 2007-08 was from small companies and the life assurance sector. The increase in life sector receipts is mainly the result of flat bond prices through 2007, compared to falls in 2006. Financial sector receipts related to 2007 profits were in line with Pre-Budget Report expectations, with the full year profits helped by the buoyant profit growth recorded in the first half of 2007.

C.55 Corporation tax receipts from onshore companies are expected to grow by about 7 per cent in 2008-09. Lower repayments than in 2007-08 add to growth in 2008-09, although the Budget 2008 forecast assumes that these remain at a higher level than previously assumed. Corporation tax from small companies is paid with a lag and is expected to remain strong in 2008-09 reflecting robust profit growth in 2007. However, onshore corporation tax receipts, particularly in the life assurance sector will be affected by the decline in equity prices while, as in the 2007 Pre-Budget Report, the forecast assumes the disruption in financial markets will have a larger impact on receipts in 2008-09 than in 2007-08. Thereafter, financial sector profits are projected to recover as financial markets are assumed to normalise.

North Sea revenues

C.56 With oil and gas prices rising ahead of the Pre-Budget Report, it was expected that North Sea revenues would improve over the remainder of the year and this was evident in the final January corporation tax instalment payment made by North Sea firms on their 2007 profits. Despite the increase in oil and gas prices in the final three months of 2007, North Sea revenues were just £0.2 billion higher in 2007-08 than expected in the Pre-Budget Report. This reflected high levels of North Sea operating and investment expenditure pushed up by high cost inflation.

C.57 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 $83.8 a barrel in 2008, nearly $16 a barrel higher than assumed in the Pre-Budget Report. With dollar oil prices currently trading at close to $100 a barrel, this assumes a fall back in prices over the rest of the year. North Sea revenues are expected to be £0.9 billion higher in 2008-09 than projected in the Pre-Budget Report and up 28 per cent on 2007-08. As in 2007-08, the impact from higher oil and gas prices is partly offset by lower production forecasts and overall capital and operating expenditure which is now expected to persist at a substantially higher level than previously expected.

Capital gains tax and inheritance tax

C.58 Capital gains tax receipts are particularly sensitive to equity price changes. Financial assets account for almost two-thirds of chargeable gains and there is a gearing effect because capital gains tax is charged on the gain rather than the whole disposal price. This means capital gains tax receipts arising from the sale of shares rise or fall by more than the movement in equity prices. The strong rise in equity prices, along with a buoyant economy and housing market during 2006-07 led to strong growth in capital gains tax in 2007-08.

C.59 As most capital gains tax is paid in the final quarter of the financial year following the year in which the gains were realised, the main impact from lower equity prices will not be felt until 2009-10. Inheritance tax receipts are also likely to be adversely affected by recent equity price and property market developments

Stamp duties

C.60 Stamp duties in 2007-08 are expected to be around £0.8 billion below their Pre-Budget Report forecast, almost entirely due to a shortfall in stamp duty land tax, primarily reflecting a decline in residential property transactions and weakness in the commercial property sector. Property transactions processed in December and January were down 13 per cent on a year earlier, while commercial property prices on transactions liable for stamp duty have fallen, in line with the declines recorded in external indices of commercial property prices.

C.61 Stamp duties are expected to fall by around 6 per cent in 2008-09, reflecting falls in both stamp duty land tax and stamp duty on shares. With leading indicators such as mortgage approvals, new buyer enquiries and the ratio of reported sales to stocks of available property all easing since the Pre-Budget Report, a period of sluggish or flat house price growth is expected in 2008. Property transactions are expected to be low in 2008 and the forecast allows for a further near-term decline in commercial property prices. With the economy picking up in 2009 as financial markets normalise, a rebound in residential transactions and an upturn in commercial property is projected. The fall in equity prices in early 2008 means that stamp duty on shares is likely to be down in 2008-09.

VAT

C.62 The Pre-Budget Report assumed that the year-on-year growth in VAT receipts would slow over the remainder of 2007-08, in part reflecting a deceleration in consumer spending growth. However, receipts growth has slowed by more than expected, with VAT likely to be £0.9 billion lower in 2007-08 than projected in the Pre-Budget Report.

C.63 Growth in VAT receipts is expected to be 4.1 per cent in 2008-09. Modest real growth in household consumption of 1¼ to 1¾ per cent during 2008 is likely to constrain VAT receipts growth. In addition, recent price trends such as rising food inflation (usually zero-rated), higher gas and electricity prices (subject to the reduced rate of VAT) but falling inflation on consumer durables (usually standard-rated) could shift the composition of spending away from standard-rated goods. The forecast assumes a fall in the share of consumer spending subject to the standard rate of VAT in 2008-09. VAT receipts in 2008-09 are also likely to be affected by repayments relating to the recent judicial ruling on the 3-year cap for making claims of previously overdeclared or underclaimed VAT. The forecast also incorporates a 0.5 percentage point rise in the underlying VAT gap (the difference between the theoretical tax liability and actual receipts), in line with the NAO audited assumption.

Excise duties

C.64 Fuel duties in 2007-08 are expected to be in line with the Pre-Budget Report projection, but £0.5 billion lower in 2008-09. This reflects the Budget decision to delay the pre-announced duty rise for six months and that higher pump prices, related to the rise in oil prices are likely to reduce the demand for fuel. With fuel duties charged on a per litre basis, this reduces fuel duty receipts by around £0.3bn in a full year.

C.65 Tobacco duties in 2007-08 are expected to be as forecast in the Pre-Budget Report, but this partly reflects receipt brought forward from 2008-09, and receipts in later years have been reduced slightly. Receipts fell by around 0.7 per cent in 2007-08 and are expected to fall 6.0 per cent in 2008-09, despite the revalorisation of duties announced in this Budget. The forecast has allowed for an impact from the smoking ban in enclosed workplaces and this assumes a greater impact in 2008-09, the first full year of the ban. Alcohol duties are expected to be £0.1 billion below their 2007 Pre-Budget Report forecast in 2007-08. Thereafter, alcohol duties are increased by the measures announced in this Budget.

Council tax **C.66** 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.

Other receipts **C.67** Other receipts have been revised down by over £1 billion in 2007-08. This reflects reductions in general government depreciation and a lower forecast for VAT refunds. Under National Accounts rules, current receipts include gross operating surpluses for all taxes. For non-market bodies, such as most of general government, this is imputed and equals depreciation. The forecasts for general government depreciation have been reduced by around £1 billion in each year, reflecting significant downward revisions to ONS published outturns. The reductions in depreciation and VAT refunds reduce both current expenditure and current receipts and are neutral across the public finances as a whole.

Tax-GDP ratio

C.68 Table C7 shows projections of receipts from major taxes as a per cent of GDP and Table C8 sets out current and previous projections of the overall tax-GDP ratio, based on net taxes and national insurance contributions. Chart C1 shows the tax-GDP ratio from 1982-83 to 2012-13.

C.69 With fiscal policy accommodating the impact on the public finances of the continued disruption in global financial markets, the tax-GDP ratio falls in 2008-09.

C.70 The tax-GDP ratio then starts to rise in 2009-10, before stabilising just below the Pre-Budget Report projections from 2010-11. The rises in 2009-10 and 2010-11 partly reflect the recovery in financial sector receipts as conditions normalise. It also reflects the measures announced in this Budget and the normal fiscal forecasting conventions on tax allowances and fiscal drag.

Table C7: 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)	11.1	11.1	10.9	11.0	11.2	11.3	11.5
National insurance contributions	6.6	6.9	7.1	7.0	7.0	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	-0.4	-0.4
North Sea revenues[3]	0.7	0.5	0.7	0.6	0.6	0.6	0.5
Value added tax	5.8	5.7	5.7	5.7	5.7	5.7	5.6
Excise duties[4]	3.0	2.9	2.8	2.8	2.8	2.8	2.7
Other taxes and royalties[5]	6.9	7.0	7.0	7.0	7.1	7.1	7.1
Net taxes and NICs[6]	**36.7**	**36.8**	**36.7**	**36.9**	**37.3**	**37.4**	**37.4**
Accruals adjustments on taxes	0.4	0.1	0.1	0.2	0.2	0.2	0.3
Less EU transfers	-0.3	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3
Other receipts[7]	2.5	2.6	2.5	2.5	2.5	2.5	2.5
Current receipts	**39.2**	**39.1**	**39.0**	**39.2**	**39.7**	**39.7**	**39.8**

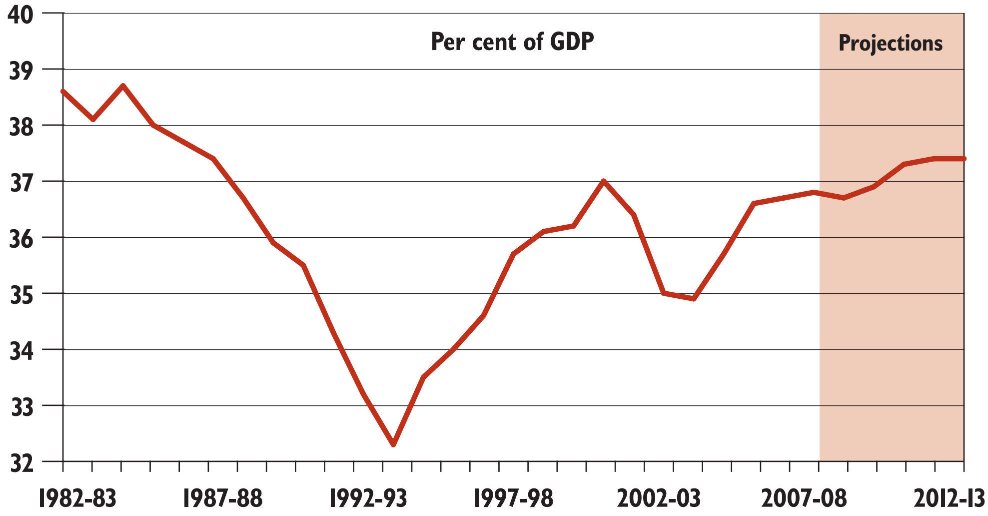
1 *National Accounts measure, gross of enhanced and payable tax credits.*
2 *Tax credits scored as negative tax in net taxes and national insurance contributions.*
3 *Includes petroleum revenue tax and North Sea corporation tax.*
4 *Fuel, alcohol and tobacco duties.*
5 *Includes council tax and money 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 C8: Net taxes and national insurance contributions[1]

	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
Budget 2008	**36.7**	**36.8**	**36.7**	**36.9**	**37.3**	**37.4**	**37.4**

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.*

Chart C1: Tax-GDP ratio[1]



[1] *Net taxes and national insurance contributions as defined in Table C8.*

PUBLIC EXPENDITURE

C.71 This section looks in detail at the projections for public expenditure. The spending projections cover the whole of the public sector, using the National Accounts aggregate Total Managed Expenditure (TME).

C.72 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 and capital expenditure.

Changes in TME since the 2007 Pre-Budget Report

C.73 The latest available information suggests that TME for 2007-08 will be around £2¾ billion lower than in the 2007 Pre-Budget Report. Current spending is below the 2007 Pre-Budget Report level with slightly higher near-cash DEL spending more than offset by lower AME. The 2007 Pre-Budget Report estimate for 2007-08 included a capital DEL reserve of £1.5 billion and a capital AME margin of £0.9billion, which largely went unallocated, explaining most of the reduction in capital expenditure.

C.74 Apart from transfers between AME and DEL, the only forecasting changes to TME during the 2007 Comprehensive Spending Review period are to AME. Before allowing for measures, current spending in AME is £¼ billion higher in 2008-09, £¼ billion lower in 2009-10 and £2 billion up in 2010-11. These changes are explained in more detail in later paragraphs. Gross capital expenditure in AME is slightly lower in total over these three years, but downward revisions to depreciation mean that net investment is slightly higher than in the 2007 Pre-Budget Report.

C.75 Chart C2 shows TME as a percent of GDP from 1971-72 to 2010-11.

Chart C2: Total Managed Expenditure

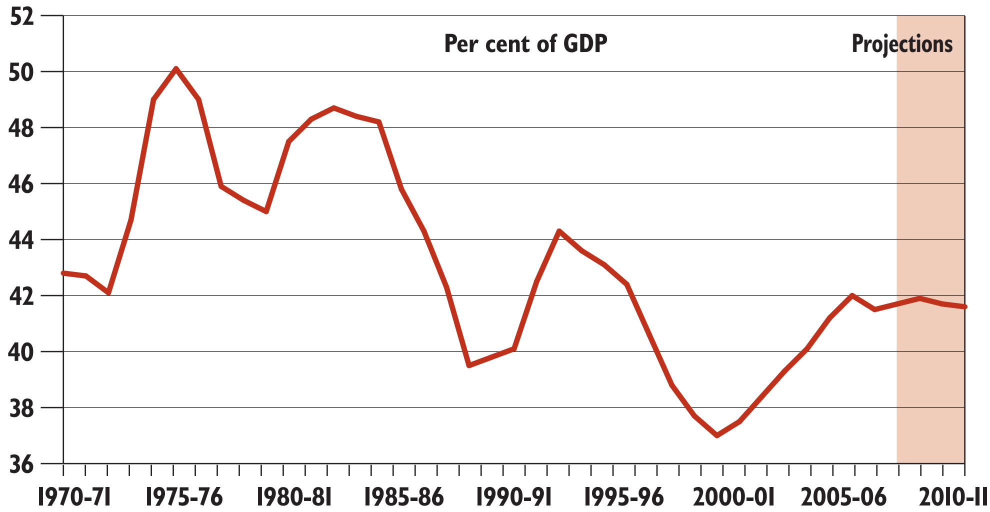


Table C9: Total Managed Expenditure 2006-07 to 2010-11

	£ billion				
	Outturn	Estimate	Projections		
	2006-07	2007-08	2008-09	2009-10	2010-11
CURRENT EXPENDITURE					
Resource Departmental Expenditure Limits	**291.2**	**313.2**	**324.3**	**338.7**	**354.6**
of which:					
Near-cash Departmental Expenditure Limits	272.7	290.3	303.8	316.8	331.1
Non-cash	18.5	22.9	20.5	21.9	23.6
Resource Annually Managed Expenditure	**215.9**	**227.0**	**242.0**	**253.6**	**267.7**
of which:					
Social security benefits [1]	131.3	138.5	146.4	153.7	159.7
Tax credits [1]	16.3	17.1	19.0	20.0	20.5
Net public service pensions [2]	1.2	2.3	2.9	3.6	4.0
National Lottery	0.7	0.9	0.9	0.7	0.8
BBC domestic services	3.3	3.3	3.5	3.6	3.7
Other departmental expenditure	3.2	2.9	2.0	1.9	1.9
Net expenditure transfers to EC institutions [3]	4.7	5.4	5.5	6.2	6.7
Locally-financed expenditure [4]	23.4	24.7	25.7	26.7	27.8
Central government gross debt interest	27.6	29.9	30.3	30.3	34.0
AME margin	0.0	0.0	0.9	1.8	2.7
Accounting adjustments	4.1	1.9	5.1	5.0	6.0
Public sector current expenditure	**507.0**	**540.1**	**566.2**	**592.3**	**622.4**
CAPITAL EXPENDITURE					
Capital Departmental Expenditure Limits	**38.9**	**43.9**	**48.1**	**50.7**	**55.3**
Capital Annually Managed Expenditure	**3.8**	**2.3**	**3.4**	**3.5**	**2.1**
of which:					
National Lottery	0.7	0.8	0.6	0.9	0.8
Locally-financed expenditure [4]	4.7	4.2	4.6	4.0	3.4
Public corporations' own-financed capital expenditure	5.4	4.7	5.2	5.6	5.7
Other capital expenditure	-0.2	-0.3	0.6	0.8	1.1
AME margin	0.0	0.0	0.1	0.2	0.3
Accounting adjustments	-6.8	-7.1	-7.6	-7.9	-9.1
Public sector gross investment	**42.7**	**46.2**	**51.5**	**54.3**	**57.4**
Less public sector depreciation	-16.9	-17.7	-18.6	-19.6	-20.7
Public sector net investment	**25.8**	**28.5**	**32.9**	**34.7**	**36.7**
TOTAL MANAGED EXPENDITURE [5]	**549.8**	**586.4**	**617.8**	**646.5**	**679.8**
of which:					
Departmental Expenditure Limits	320.1	345.3	360.9	377.8	397.5
Annually Managed Expenditure	229.7	241.1	256.9	268.7	282.3

[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 EC 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	3.4	3.0	5.2	5.5
Net contribution to EC Budget	3.5	4.1	3.8	6.1	6.4

[4] This expenditure is mainly financed by council tax revenues. See footnote to table C6 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 C10: Changes to Total Managed Expenditure since the 2007 Pre-Budget Report

	£ billion				
	Outturn	Estimate	Projections		
	2006-07	2007-08	2008-09	2009-10	2010-11
CURRENT EXPENDITURE					
Resource Departmental Expenditure Limits	**0.0**	**2.4**	**0.0**	**-0.1**	**0.0**
of which:					
Near-cash Departmental Expenditure Limits	0.4	0.3	0.4	0.3	0.4
Non-cash	-0.4	2.1	-0.4	-0.4	-0.4
Resource Annually Managed Expenditure	**0.4**	**-3.4**	**0.3**	**-0.2**	**2.0**
of which:					
Social security benefits	-0.5	-0.4	0.4	1.4	1.5
Tax credits	0.0	0.5	0.8	1.2	1.2
Net public service pensions	0.0	0.1	0.3	0.7	0.5
National Lottery	-0.1	0.1	0.2	0.1	0.1
BBC domestic services	0.1	0.0	0.0	0.0	0.0
Other departmental expenditure	0.0	0.1	0.3	0.7	0.8
Net expenditure transfers to EC institutions	0.0	-0.2	0.0	0.5	0.1
Locally-financed expenditure	-2.1	-0.6	-0.6	-0.8	-1.3
Central government gross debt interest	0.0	-0.1	1.1	-0.9	1.0
AME margin	0.0	-0.1	0.0	0.0	0.0
Accounting adjustments	2.9	-2.6	-2.3	-3.1	-1.9
Public sector current expenditure	**0.4**	**-1.0**	**0.2**	**-0.3**	**2.0**
CAPITAL EXPENDITURE					
Capital Departmental Expenditure Limits	**-0.2**	**-0.8**	**0.0**	**0.0**	**0.0**
Capital Annually Managed Expenditure	**-0.6**	**-1.0**	**0.1**	**0.1**	**-0.5**
of which:					
National Lottery	-0.1	-0.1	-0.2	-0.1	-0.1
Locally-financed expenditure	-0.3	0.6	0.5	0.2	0.4
Public corporations' own-financed capital expenditure	-0.4	-0.2	0.2	0.5	0.4
Other capital expenditure	0.2	0.1	0.2	0.2	0.3
AME margin	0.0	-0.9	0.0	0.0	0.0
Accounting adjustments	0.0	-0.6	-0.7	-0.5	-1.6
Public sector gross investment	**-0.7**	**-1.8**	**0.1**	**0.2**	**-0.5**
Less public sector depreciation	0.3	0.6	0.6	0.6	0.5
Public sector net investment	**-0.5**	**-1.2**	**0.6**	**0.7**	**0.0**
TOTAL MANAGED EXPENDITURE	**-0.3**	**-2.8**	**0.3**	**-0.1**	**1.5**
of which:					
Departmental Expenditure Limits	-0.3	0.7	-0.2	0.4	0.6
Annually Managed Expenditure	0.0	-3.5	0.5	-0.5	0.9

DEL and AME analysis

DEL **C.76** The detailed allocation of DEL is shown in table C11. In line with previous practice, resource and capital DEL for 2007-08 include an allowance for shortfall reflecting likely underspends against departmental provisions.

C.77 Estimated outturn for resource DEL is higher than forecast in the 2007 Pre-Budget Report in 2007-08, largely reflecting increased non-cash spending that is mainly due to some departments drawing down elements of their end of year flexibility. These changes are offset by accounting adjustments in AME and have no impact on TME or on National Accounts measures of expenditure.

C.78 Capital DEL in 2007-08 is expected to be lower than forecast in the 2007 Pre-Budget Report, reflecting an unallocated DEL reserve and lower than planned capital expenditure by the Department of Health (DH), Department for Children, Schools and Families (DCSF), and some other departments.

C.79 The latest figures also include a number of classification and budgetary changes. The main changes are:

- the transfer of the Independent Living Fund from Department of Work and Pensions (DWP) AME to DEL, to improve control over this expenditure;
- a reduction in the Department for Transport (DfT) resource DEL to offset the interest payments on borrowing in respect of Metronet, which now fall in AME;
- inclusion of health trust depreciation in Northern Ireland Executive (NIE) resource DEL, which increases non-cash DEL and is offset in the accounting adjustments; and
- the reclassification of Department for Innovation, Universities and Skills (DIUS) non-cash transactions relating to student loans from DEL to AME, which aligns the accounting and budgeting treatments.

Table C11: Departmental Expenditure Limits - resource and capital budgets

	£ billion				
	Outturn	Estimate	Plans		
	2006-07	2007-08	2008-09	2009-10	2010-11
Resource DEL					
Children, Schools and Families	42.1	44.9	46.9	49.2	51.9
Health	80.4	89.2	94.0	99.9	106.3
of which: NHS England	78.5	87.1	91.7	97.4	103.7
Transport	6.9	6.8	6.4	6.4	6.6
Innovation, Universities and Skills	14.0	15.5	16.4	17.2	18.2
CLG Communities	3.6	4.2	4.3	4.5	4.6
CLG Local Government	22.5	22.7	24.7	25.6	26.4
Home Office	8.3	8.7	9.1	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	36.7	33.6	35.2	36.7
Foreign and Commonwealth Office	1.8	1.9	1.8	1.6	1.6
International Development	4.2	4.6	4.9	5.5	6.4
Business, Enterprise and Regulatory Reform	2.2	2.9	2.4	2.3	2.3
Environment, Food and Rural Affairs	3.1	3.1	2.9	3.0	3.0
Culture, Media and Sport	1.5	1.7	1.6	1.7	1.8
Work and Pensions	7.9	8.1	8.0	7.8	7.5
Scotland	22.4	23.8	24.4	25.4	26.5
Wales	11.7	12.5	13.0	13.6	14.2
Northern Ireland Executive	7.2	7.6	8.1	8.4	8.7
Northern Ireland Office	1.2	1.4	1.2	1.2	1.2
Chancellor's Departments	5.0	4.8	4.8	4.6	4.5
Cabinet Office	1.7	1.9	2.1	2.2	2.4
Independent Bodies	0.7	0.8	0.9	0.9	1.0
Moderisation Funding	-	-	0.5	0.4	0.1
Reserve	-	-	2.3	2.8	2.9
Allowance for shortfall	-	-0.4	0.0	0.0	0.0
Total resource DEL	**291.2**	**313.2**	**324.3**	**338.7**	**354.6**
Capital DEL					
Children, Schools and Families	4.1	5.5	6.0	6.4	7.7
Health	3.2	3.6	4.7	5.5	6.2
of which: NHS England	3.1	3.3	4.6	5.3	6.1
Transport	6.5	7.1	7.3	7.6	8.1
Innovation, Universities and Skills	1.9	2.0	2.0	2.2	2.3
CLG Communities	5.4	6.1	7.0	7.3	7.5
CLG Local Government	0.2	0.0	0.1	0.1	0.1
Home Office	0.6	0.8	0.9	0.8	0.9
Justice	0.5	1.0	0.7	0.8	0.7
Law Officers' Departments	0.0	0.0	0.0	0.0	0.0
Defence	7.1	8.1	7.9	8.2	8.9
Foreign and Commonwealth Office	0.2	0.2	0.2	0.2	0.2
International Development	0.8	0.7	0.9	1.4	1.6
Business, Enterprise and Regulatory Reform	1.2	1.1	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	0.5	1.0	0.4	0.6
Work and Pensions	0.2	0.1	0.1	0.1	0.1
Scotland	3.0	3.5	3.2	3.3	3.6
Wales	1.3	1.5	1.6	1.7	1.8
Northern Ireland Executive	0.8	1.0	1.0	1.1	1.2
Northern Ireland Office	0.1	0.0	0.1	0.1	0.1
Chancellor's Departments	0.3	0.3	0.3	0.3	0.3
Cabinet Office	0.3	0.4	0.4	0.4	0.4
Independent Bodies	0.1	0.1	0.1	0.1	0.1
Reserve	-	-	0.7	0.7	0.8
Allowance for shortfall	-	-0.7	0.0	0.0	0.0
Total capital DEL	**38.9**	**43.9**	**48.1**	**50.7**	**55.3**
Depreciation	**10.0**	**11.8**	**11.5**	**11.6**	**12.4**
Total Departmental Expenditure Limits	**320.1**	**345.3**	**360.9**	**377.8**	**397.5**
Total Education spending	70.7	76.2	81.9	86.1	91.5

AME C.80 The main assumptions underpinning the AME projections are set out in Box C1 and Table C3. The main changes to these assumptions since the 2007 Pre-Budget Report are higher RPI and Rossi inflation, especially in 2008, and higher claimant count unemployment, based on the average of independent forecasts, which does not reflect the Treasury's forecast. The AME forecasts for social security benefits and tax credits also reflect the ONS 2006-based population projections, published after the 2007 Pre-Budget Report.

Social security benefits C.81 Social security expenditure in AME is reduced by around £0.3 billion a year because of the classification change that moves spending on the Independent Living Fund out of AME and into DEL. Other than this transfer, expenditure is forecast to be much the same in 2007-08 as in the 2007 Pre-Budget Report but higher in subsequent years due to higher forecasts for inflation in September 2008, which affect the levels of benefits from 2009-10 onwards, higher claimant count unemployment and increases in maternity and child benefits arising from higher projections of the number of births.

Tax credits C.82 The forecast for expenditure on Child and Working Tax credits has increased since the 2007 Pre-Budget Report. The revised projection incorporates revisions in line with higher than expected in-work entitlement, due to changes in the composition of the population in receipt of tax credits, lower than expected growth in earnings among those in receipt of tax credits, and higher birth rates.

Public service pensions C.83 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 2008-09 reflects actuarial advice on the rate and level at which benefits are expected to come into payment, the rate of future employer and employee contributions and the latest information relating to scheme demographics. The increase in the forecast level of net expenditure across the period since the 2007 Pre-Budget Report is largely due to revised projections of pensionable pay leading to lower forecasts of contributions received.

National Lottery C.84 National Lottery figures reflect the latest view on timing of drawdown by the distributing bodies and on the split between capital and current expenditure.

Other departmental expenditure C.85 Other departmental expenditure is higher than in the 2007 Pre-Budget Report mainly because of higher grants from central government to local authorities in respect of police and fire pension schemes.

EU contributions C.86 Net expenditure transfers to EU Institutions, which consist of Gross National Income (GNI) based contributions less the UK abatement, are lower than was estimated at the time of the 2007 Pre-Budget Report in 2007-08, unchanged in 2008-09, and higher in both 2009-10 and 2010-11. The main factors are the use of later information on the size of the final EC Budget for 2007, the likely pattern of payments to the 2008 EC Budget and increases in estimates of contributions resulting from changes in the exchange rate forecast. Other factors include changes to forecast receipts from the EC, which affect the UK abatement in the year after the receipts accrue.

Locally financed expenditure C.87 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. The main determinant of the LASFE forecast is council tax and the council tax projections used to derive current LASFE from 2007-08 onwards are based on stylised assumptions and are not government forecasts. The current forecast also reflects historical information on movements in reserves, interest receipts and debt repayment. Capital LASFE reflects forecasts on the level of capital expenditure financed by the use of capital receipts, revenue sources of capital finance and prudential borrowing. Capital LASFE is net of local authority asset sales.

C.88 The definition of current LASFE has changed further since the 2007 Pre-Budget Report to improve compatibility with data supplied by local authorities to the Department for Communities and Local Government and the Devolved Administrations. There have been consequential adjustments to the accounting adjustments component of AME. These adjustments explain most of the change in current LASFE since the 2007 Pre-Budget Report.

C.89 The differences between the capital LASFE forecast at the Budget and Pre-Budget Report can largely be attributed to revised forecasts of the use of capital receipts, current expenditure to finance capital expenditure, prudential borrowing and the level of asset sales. These revisions have had the effect of increasing capital LASFE in each year to 2010-11.

CG debt interest

C.90 Forecasts for central government gross debt interest payments have been revised in light of the latest economic assumptions. With the exception of 2009-10, the projections over the CSR period have increased since the 2007 Pre-Budget Report, largely because higher forecast inflation leads to an increase in debt interest payment costs on index-linked gilts. Forecast market interest rates have fallen since the 2007 Pre-Budget Report, which has the effect of reducing debt interest payment costs. However, apart from in 2009-10 these reductions are more than offset by the effects of the rise in inflation and higher borrowing.

C.91 As set out in Chapter 2, the Government will replace the Bank of England loan to Northern Rock with direct Treasury funding. The overall effect of this refinancing will be broadly neural for TME. Increased debt interest paid to the private sector by HM Treasury will be offset by reduced net debt interest paid to the private sector by the Bank of England, making the transaction neutral for the public sector as a whole. Interest payments paid by Northern Rock to HM Treasury mean that the effect of the refinancing is also neutral for both the central government and public corporations sub-sectors.

PC capital expenditure

C.92 This includes the latest forecast for capital expenditure financed by public corporations themselves. This excludes expenditure financed by departments, which is already included in DEL and elsewhere in AME.

Accounting adjustments

C.93 The accounting adjustments reconcile the budgeting aggregates DEL and AME with the National Accounts definition of AME, 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. A breakdown of these accounting adjustments is given in Table 15 of *Budget 2008: the economy and public finances – supplementary material*. Changes to the accounting adjustments since the Pre-Budget Report are mainly due to:

- lower forecasts for general government depreciation, where the forecast has been reduced by around £1 billion in each year from 2007-08, reflecting significant downward revisions to ONS published outturns; and
- reductions in forecast levels of VAT refunds.

C.94 The reductions in depreciation and VAT refunds reduce both current expenditure and current receipts, and are neutral across the public finances as a whole. The changes to accounting adjustments in 06-07 reflect revisions to total TME.

FINANCING REQUIREMENT

C.95 Table C12 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 sector's net financial indebtedness) but do affect its financing requirement. In 2008-09, net lending within the public sector includes the refinancing of the Bank of England's loans to Northern Rock. The resultant change in the Bank of England's net position with the private sector is included in the figure for market and overseas borrowing for the public corporations sub-sector.

Table C12: Public sector net cash requirement

	£ billion							
	2007-08				2008-09			
	General government				General government			
	Central government	Local authorities	Public corporations	Public sector	Central government	Local authorities	Public corporations	Public sector
Net borrowing	**38.3**	**1.7**	**-3.6**	**36.4**	**43.7**	**2.8**	**-4.0**	**42.5**
Financial transactions								
Net lending to private sector and abroad	3.9	0.0	-0.3	3.5	1.2	0.1	-0.3	1.0
Cash expenditure on company securities	-1.4	-2.2	1.7	-1.9	0.5	-1.8	1.8	0.5
Accounts receivable/payable	-0.7	0.2	0.3	-0.2	2.0	0.2	0.3	2.5
Adjustment for interest on gilts	-4.6	0.0	0.0	-4.6	-4.6	0.0	0.0	-4.6
Miscellaneous financial transactions	-0.2	1.5	-1.5	-0.2	-0.2	0.0	0.0	-0.2
Own account net cash requirement	35.3	1.1	-3.4	33.0	42.6	1.3	-2.2	41.7
Net lending within the public sector	2.5	-2.2	-0.3	0.0	16.7	-2.2	-14.5	0.0
Net cash requirement[1]	**37.7**	**-1.1**	**-3.7**	**33.0**	**59.3**	**-0.9**	**-16.7**	**41.7**

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

2007-08 **C.96** Table C13 updates the financing arithmetic for both 2007-08 and 2008-09 in line with the updated fiscal forecasts. The central government net cash requirement (CGNCR) for 2007-08 is now forecast to be £37.7 billion, an increase of £0.4 billion from the 2007 Pre-Budget Report forecast of £37.3 billion. The net financing requirement is expected to be £57.3 billion, a decrease of £1.0 billion from the 2007 Pre-Budget Report. It is also £4.2 billion above total financing, resulting in the forecast level of the Debt Management Office's (DMO's) short-term net cash position at end March 2008 falling to –£3.7 billion.

2008-09 **C.97** The projection for the CGNCR in 2008-09 is £59.3 billion. Following the decision to take Northern Rock into a period of temporary public ownership, the Government will, during 2008-09, replace the Bank of England's loan to Northern Rock with direct Treasury funding, in order to comply with restrictions in the Treaty Establishing the European Community on central bank financing of government undertakings. The projection for the CGNCR in 2008-09 includes the impact of this refinancing. The net amount outstanding on the Treasury loan as at 31 March 2009 is currently projected to be £14 billion, but this amount is subject to revision and will be updated at the 2008 Pre-Budget Report.

C.98 Gross gilt redemptions are £17.3 billion and National Savings and Investments' (NS&I's) net contribution to financing is estimated to be £4.0 billion. The net financing requirement for 2008-09 is forecast to be £78.8 billion. It also includes the impact of the partial repayment in 2007-08 of £6 billion of the Ways and Means Advance at the Bank of England. The Government's decision to repay up to £7 billion of the remaining balance of its Ways and Means Advance at the Bank of England is not reflected in the net financing requirement in 2008-09 but is included as a planned change in the short-term debt level.

DMO **C.99** The DMO will aim to meet this financing requirement by:

- gross gilt issuance of £80.0 billion; and
- an increase in the Treasury bill stock by £5.8 billion to £22.0 billion.

C.100 Gross debt issuance is expected to be £85.8 billion, with the additional amount raised (in excess of the net financing requirement) required to meet the further planned repayment of £7 billion of the Ways and Means Advance.

C.101 Gross gilt issuance will be skewed towards short and long-maturity conventional gilts and index-linked gilts. In 2008-09, issuance of short-maturity gilts is expected to be £25.0 billion (or 31 per cent of total issuance), issuance of long-maturity conventional gilts is forecast to be £24.2 billion (or 30 per cent of total issuance) and issuance of index-linked gilts is expected to be £18.0 billion (or 23 per cent of total issuance).

Table C13: Financing arithmetic for 2007-08 and 2008-09

	£ billion			
	2007-08			2008-09
	April 2007 Revised Remit[1]	October 2007 Pre-Budget Report	March 2008 Budget	March 2008 Budget
Central government net cash requirement	**37.6**	**37.3**	**37.7**	**59.3**
Gilt redemptions[2]	29.2	29.2	29.2	17.3
Financing for the official reserves[3]	0.0	0.0	0.0	2.0
Buy-backs[4]	0.0	0.1	0.1	0.0
Planned short-term financing adjustment[5]	-4.1	-4.1	-4.1	4.2
Gross financing requirement	**62.7**	**62.5**	**62.9**	**82.8**
Less Assumed net contribution from NS&I	2.8	4.2	5.6	4.0
Net financing requirement	**59.9**	**58.3**	**57.3**	**78.8**
Financed by:				
1. Debt issuance by the Debt Management Office				
(a) Treasury bills[6]	**1.5**	**-0.1**	**0.6**	**5.8**
(b) Gilts	**58.4**	**58.4**	**58.5**	**80.0**
2. Other planned changes in short-term debt[7]				
Changes in Ways & Means[8]	0.0	0.0	-6.0	-7.0
3. Unanticipated changes in short-term cash position[9]	**0.0**	**0.0**	**-4.2**	**0.0**
Total financing	**59.9**	**58.3**	**53.1**	**78.8**
Short-term debt levels at end of financial year				
Treasury bill stock in market hands[10]	17.1	15.5	16.2	22.0
Ways & Means	13.4	13.4	7.4	0.4
DMO net cash position	0.5	0.5	-3.7	0.5

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

[2] *The total assumes the 5½% 2008-12 conventional gilt will be redeemed in September 2008.*

[3] *The total includes the sterling refinancing of the US $3.0 billion 5 year bond issued in July 2003, that matures on 8 July 2008. The total also reflects a small increase in the level of the hedged reserves.*

[4] *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.*

[5] *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. In 2008-09 the planned short term financing adjustment includes the impact of the partial repayment of £6 billion of the Government's Way and Means Advance at the Bank of England in 2007-08.*

[6] *The £0.7 billion change in forecast Treasury bill sales in 2007-08 since the 2007 Pre-Budget Report has been accounted for by bilateral sales of Treasury bills with a maturity date later than 31 March 2008. Bilateral Treasury bill sales have been conducted in accordance with paragraph 4.8 of the Debt and reserves management report 2007-08.*

[7] *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.*

[8] *This number reflects the Governments decision to repay up to £7 billion of the remaining balance of the Way and Means Advance in 2008-09.*

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

[10] *The DMO has operational flexibility to vary the end-financial year stock subject to its operational requirements from 2007-08.*

C.102 Full details of the DMO's financing remit including further information on the structure of gilts issuance and the gilt auction calendar for 2008-09 can be found in the *Debt and reserves management report 2008-09* which is published alongside this Budget and is available on HM Treasury's website.

PUBLIC SECTOR FINANCIAL REPORTING

C.103 As announced in Budget 2007, in order to bring benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice, the annual financial statements of government departments and other public sector bodies will in future be prepared using International Financial Reporting Standards (IFRS) adapted as necessary for the public sector. Following consultation with departments and the Financial Reporting Advisory Board on the technical work needed to implement this change, the Government now intends to move to IFRS from 2009-10 to minimise burdens and to ensure a smooth transition. Whole of Government Accounts (WGA) will now also be published for the first time for 2009-10 to allow time to complete the alignment of local and central government accounting policies and to enable WGA to be published on an IFRS basis.

ADDITIONAL ANALYSES

C.104 Historical series for the main fiscal aggregates are included in Table C14. Further information on general government transactions and more detailed breakdowns of the public sector are included in *Budget 2008: the economy and public finances – supplementary material,* along with a detailed description of the conventions used in presenting the public finances.

HISTORICAL SERIES

Table C14: Historical series of public sector balances, receipts and debt

	Per cent of GDP								
	Public sector current budget	Cyclically adjusted surplus on current budget	Public sector net borrowing	Cyclically adjusted public sector net borrowing	Public sector net cash requirement	Net taxes and national insurance contributions	Public sector current receipts	Public sector net debt[1]	Public sector net worth[2]
1970-71	6.9		-0.6		1.2	36.4	43.4		
1971-72	4.2		1.1		1.4	35.1	41.6		
1972-73	2.0		2.8		3.6	32.7	39.2		
1973-74	0.4	-0.7	4.9	6.0	5.8	32.1	39.8		
1974-75	-0.9	-2.5	6.6	8.1	8.9	34.8	42.4	52.1	
1975-76	-1.4	-1.6	7.0	7.2	9.2	35.5	43.0	53.8	
1976-77	-1.1	-0.6	5.5	5.1	6.3	35.4	43.4	52.3	
1977-78	-1.3	-1.2	4.3	4.2	3.7	34.4	41.7	49.0	
1978-79	-2.5	-2.3	5.1	4.9	5.2	33.4	40.4	47.1	
1979-80	-1.8	-1.7	4.1	4.0	4.7	33.8	40.9	43.9	
1980-81	-3.0	-1.5	4.9	3.4	5.2	35.8	42.6	46.0	
1981-82	-1.3	2.5	2.3	-1.5	3.3	38.5	46.0	46.2	
1982-83	-1.4	2.9	3.0	-1.3	3.2	38.6	45.7	44.8	
1983-84	-1.9	1.8	3.8	0.1	3.2	38.1	44.6	45.1	
1984-85	-2.1	0.9	3.7	0.7	3.1	38.7	44.5	45.3	
1985-86	-1.2	0.6	2.4	0.6	1.6	38.0	43.4	43.5	
1986-87	-1.4	-1.2	2.1	1.9	0.9	37.7	42.2	41.0	
1987-88	-0.4	-1.7	1.0	2.3	-0.7	37.4	41.3	36.8	73.5
1988-89	1.7	-1.0	-1.3	1.3	-3.0	36.7	40.8	30.5	78.6
1989-90	1.4	-1.4	-0.2	2.6	-1.3	35.9	40.0	27.7	70.5
1990-91	0.3	-1.2	1.0	2.6	-0.1	35.5	39.1	26.2	59.9
1991-92	-2.0	-1.5	3.8	3.3	2.3	34.3	38.7	27.4	52.5
1992-93	-5.7	-3.7	7.5	5.6	5.9	33.2	36.7	31.9	39.8
1993-94	-6.3	-4.1	7.8	5.5	7.0	32.3	35.8	37.0	29.1
1994-95	-4.8	-3.4	6.2	4.8	5.3	33.5	36.9	40.7	28.3
1995-96	-3.3	-2.5	4.7	3.8	4.3	34.0	37.7	42.6	21.0
1996-97	-2.8	-2.2	3.5	2.9	2.9	34.6	37.1	43.3	17.1
1997-98	-0.1	0.0	0.7	0.6	0.2	35.7	38.1	41.3	14.5
1998-99	1.2	1.1	-0.5	-0.4	-0.7	36.1	38.3	39.2	13.6
1999-00	2.3	2.0	-1.7	-1.4	-0.9	36.2	38.7	36.4	16.7
2000-01	2.4	1.8	-1.9	-1.3	-3.7	37.0	39.4	31.4	22.7
2001-02	1.2	1.0	0.0	0.1	0.4	36.4	38.4	30.3	29.5
2002-03	-1.0	-0.6	2.3	1.9	2.3	35.0	37.0	31.5	28.1
2003-04	-1.5	-1.2	2.9	2.6	3.5	34.9	37.2	32.8	28.4
2004-05	-1.6	-1.6	3.3	3.3	3.2	35.7	37.9	34.7	28.7
2005-06	-1.1	-0.9	3.0	2.8	3.2	36.6	38.9	36.0	27.7
2006-07	-0.3	-0.3	2.3	2.2	2.7	36.7	39.2	36.6	26.0

[1] *At end-March; GDP centred on end-March.*

[2] *At end-December; GDP centred on end-December.*

Table C15: Historical series of government expenditure

	£ billion (2006-07 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	186.0	35.5	56.8	242.8	32.8	6.3	10.0	42.8
1971-72	195.1	30.9	53.3	248.4	33.5	5.3	9.2	42.7
1972-73	203.7	29.8	53.3	257.0	33.3	4.9	8.7	42.1
1973-74	223.6	33.4	59.6	283.2	35.3	5.3	9.4	44.7
1974-75	247.1	35.9	63.6	310.6	39.0	5.7	10.0	49.0
1975-76	252.6	35.3	63.1	315.7	40.1	5.6	10.0	50.1
1976-77	259.2	28.9	57.7	316.9	40.1	4.5	8.9	49.0
1977-78	255.6	19.8	48.8	304.4	38.6	3.0	7.4	45.9
1978-79	263.1	17.2	46.9	310.0	38.6	2.5	6.9	45.4
1979-80	269.6	16.0	46.1	315.7	38.4	2.3	6.6	45.0
1980-81	277.8	12.9	43.5	321.3	41.0	1.9	6.4	47.5
1981-82	290.2	6.9	37.3	327.5	42.8	1.0	5.5	48.3
1982-83	296.6	10.9	40.4	337.0	42.8	1.6	5.8	48.7
1983-84	305.8	13.3	42.7	348.5	42.5	1.8	5.9	48.4
1984-85	313.9	11.7	39.6	353.5	42.8	1.6	5.4	48.2
1985-86	314.6	9.1	34.8	349.4	41.2	1.2	4.6	45.8
1986-87	319.6	5.5	31.3	350.9	40.4	0.7	4.0	44.3
1987-88	323.2	4.9	29.3	352.5	38.8	0.6	3.5	42.3
1988-89	315.5	3.0	27.4	342.8	36.4	0.3	3.2	39.5
1989-90	317.3	11.1	35.1	352.4	35.8	1.3	4.0	39.8
1990-91	319.7	12.1	34.0	353.7	36.2	1.4	3.9	40.1
1991-92	338.4	15.8	34.2	372.6	38.6	1.8	3.9	42.5
1992-93	354.8	16.4	34.4	389.2	40.3	1.9	3.9	44.3
1993-94	365.3	13.0	30.9	396.3	40.2	1.4	3.4	43.6
1994-95	376.7	13.4	31.2	407.9	39.8	1.4	3.3	43.1
1995-96	381.2	13.4	30.8	412.0	39.2	1.4	3.2	42.4
1996-97	381.4	7.0	22.8	404.2	38.3	0.7	2.3	40.6
1997-98	379.3	5.9	21.1	400.4	36.8	0.6	2.0	38.8
1998-99	379.4	7.2	21.8	401.1	35.7	0.7	2.0	37.7
1999-00	386.4	6.4	21.1	407.5	35.1	0.6	1.9	37.0
2000-01	405.9	6.1	20.9	426.8	35.7	0.5	1.8	37.5
2001-02	416.8	13.5	28.5	445.3	35.9	1.2	2.5	38.4
2002-03	436.6	15.2	30.7	467.3	36.7	1.3	2.6	39.3
2003-04	458.9	16.8	32.5	491.4	37.4	1.4	2.7	40.1
2004-05	479.6	21.6	37.5	517.2	38.2	1.7	3.0	41.2
2005-06	498.2	24.2	40.7	538.9	38.8	1.9	3.2	42.0
2006-07	507.0	25.8	42.7	549.8	38.3	1.9	3.2	41.5

[1] *Net of sales of fixed assets.*

List of abbreviations

AEF	Aggregate External Finance
AME	Annually Managed Expenditure
AMLD	Amusement Machine Licence Duty
APD	Air passenger duty
APR	Annual Percentage Rates
BERR	Department for Business, Enterprise & Regulatory Reform
CAP	Common Agricultural Policy
CBI	Confederation of British Industry
CCAs	Climate change agreements
CCL	Climate change levy
CCS	Carbon capture and storage
CERT	Carbon Emissions Reduction Target
CGT	Capital Gains Tax
CGNCR	Central government net cash requirement
CHP	Combined Heat and Power
CIPFA	Chartered Institute of Public Finance and Accountancy
CO2	Carbon dioxide
CPI	Consumer Prices Index
CSR	Comprehensive Spending Review
CTC	Child Tax Credit
CTF	Child Trust Fund
CVS	Corporate Venturing Scheme
DBERR	Department for Business, Enterprise & Regulatory Reform
DCMS	Department of Culture, Media and Sport
DCSF	Department for Children, Schools and Families
DEFRA	Department for Environment, Food and Rural Affairs
DEL	Departmental Expenditure Limit
DFID	Department for International Development
DfT	Department for Transport
DH	Department of Health
DIUS	Department for Innovation, Universities and Skills
DMO	Debt Management Office
DVLA	Driver and Vehicle Licensing Agency
DWP	Department for Work and Pensions

EC	European Communities
ECA	Enhanced Capital Allowance
ECF	Enterprise Capital Fund
EEA	European Economic Area
EEC	Energy Efficiency Commitment
EFSR	Economic and Fiscal Strategy Report
EIS	Enterprise Investment Scheme
EMI	Enterprise Management Incentive
EPC	Economic Policy Committee
ESA	Employment and Support Allowance
ESA95	European System of Accounts 1995
EU	European Union
EU ETS	EU Emissions Trading Scheme
FDI	Foreign direct investment
FE	Further Education
FRS	Financial Reporting Standard
FSA	Financial Services Authority
FSBR	Financial Statement and Budget Report
G7	A group of seven major industrial nations (comprising: Canada, France, Germany, Italy, Japan, UK and US).
G8	The G8 is an informal group of eight countries: Canada, France, Germany, Italy, Japan, Russia, the UK and the US.
GAAP	Generally Accepted Accounting Practices
GAD	Government Actuary's Department
GCSE	General Certificate of Secondary Education
GDP	Gross domestic product
GGNB	General government net borrowing
GLA	Greater London Authority
GNI	Gross National Income
GVA	Gross Value Added
HB	Housing Benefit
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IAS	International Accounting Standards
IB	Incapacity Benefit
IFRS	International Financial Reporting Standards
IFS	Institute for Fiscal Studies
IHT	Inheritance Tax
ILO	International Labour Organisation

IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
ISA	Individual Savings Account
ISB	Invest to Save Budget
JSA	Jobseeker's Allowance
LASFE	Local authority self-financed expenditure
LDA	London Development Agency
LFS	Labour Force Survey
LHA	Local Housing Allowance
LIBOR	London Inter-Bank Offered Rate
LTPFR	Long Term Public Finance Report
MDRs	Marginal deduction rates
MIG	Minimum income guarantee
MoD	Ministry of Defence
MORI	Market and Opinion Research International
MPC	Monetary Policy Committee
MTIC	Missing Trader Intra-Community
NAO	National Audit Office
NEA	National Enterprise Academy
NHS	National Health Service
NICs	National Insurance Contributions
NIE	Northern Ireland Executive
NIESR	National Institute of Economic and Social Research
NMW	National Minimum Wage
NVQ	National Vocational Qualification
ODPM	Office of the Deputy Prime Minister
OECD	Organisation for Economic Cooperation and Development
OFCOM	Office of Communications
OFGEM	Office of Gas and Electricity Markets
OFT	Office of Fair Trading
OGC	Office of Government Commerce
ONS	Office for National Statistics
OPEC	Organisation of Petroleum Exporting Countries
PAC	Public Accounts Committee
PAYE	Pay As You Earn
PBR	Pre-Budget Report
PCOFCE	Public corporations' own financed capital expenditure

PCT	Primary Care Trust
PEP	Personal Equity Plan
PFI	Private Finance Initiative
PGS	Planning gain Supplement
PSA	Public Service Agreement
PSNB	Public sector net borrowing
PSND	Public Sector Net Debt
PSNI	Public sector net investment
R&D	Research and Development
RDA	Regional Development Agency
REITs	Real Estate Investment Trusts
RES	Regional Economic Strategy
RPI	Retail Prices Index
RPIX	Retail Prices Index excluding mortgage interest payments
RTFO	Renewable Transport Fuels Obligation
SBRI	Small Business Research Initiative
SDLT	Stamp Duty Land Tax
SDRT	Stamp Duty Reserve Tax
SERPS	State Earnings Related Pension Scheme
SFLG	Small Firms Loan Guarantee
SME	Small and medium-sized enterprise
STEM	Science Technology Engineering and Mathematics
TME	Total Managed Expenditure
TSB	Technology Strategy Board
UKTI	UK Trade and Investment
VAT	Value Added Tax
VCT	Venture Capital Trust
VED	Vehicle excise duty
WGA	Whole of Government Accounts
WTC	Working Tax Credit

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