

Convergence Programme for the United Kingdom: submitted in line with the Stability and Growth Pact

November 2007



HM TREASURY



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ISBN 978-1-84532-369-1

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INTRODUCTION

1.1 Forecasts for the UK economy and public finances set out in this Programme show that the UK's macroeconomic performance continues to be strong, the institutional framework continues to contribute to stability and that the UK public finances are robust and sustainable. The UK economy is experiencing an unprecedented period of growth, and inflation is close to target. This macroeconomic stability puts the UK in a strong position to respond to global economic challenges, and to take advantage of the opportunities of the coming decade.

1.2 The Government has submitted programmes under the Stability and Growth Pact for each of the last eight years. The Stability and Growth Pact requires Member States to provide information on economic developments in their country, for the purposes of the multilateral surveillance procedure under Articles 99 and 104 of the EU Treaty (ex Articles 103 and 104c).

1.3 This regular annual Convergence Programme updates the UK's 2006 Convergence Programme to reflect the latest Government forecasts for the economy and the public finances, which were published in the Pre-Budget Report on 9 October 2007¹. The public finance projections in the Pre-Budget Report have a different status to those included in the Budget – they are an interim forecast update and do not necessarily represent the outcome the Government is seeking. This update therefore also takes account of Budget 2007,² as well as taking account of the 2007 Comprehensive Spending Review. The updated Programme is subject to the usual UK Parliamentary scrutiny and approval under Section 5 of the European Communities (Amendment) Act 1993.

The macroeconomic framework

1.4 The Government's long term economic goal is to maintain macroeconomic stability, ensuring the fiscal rules are met at all times and that inflation remains low. Chapter 2 of this Programme describes how the Government is working to achieve this goal, including the institutional and policy framework which underpins this, and summarises prospects for the UK economy and public finances, full details of which are set out in Chapters 3 and 4.

1.5 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 ensure low and stable inflation, while fiscal policy is underpinned by clear objectives and two strict rules that ensure sound public finances over the medium term while allowing fiscal policy to support monetary policy over the economic cycle. The fiscal rules are 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.

1.6 As set out in Chapter 3, the world economy grew by 5¼ per cent in 2006, the fastest rate since 1990. This reflected strong growth in advanced economies and particularly in the emerging markets, which accounted for more than half of total world growth. This was the third consecutive year of global growth above 4½ per cent. It is

¹ 2007 Pre-Budget Report and Comprehensive Spending Review, HM Treasury, October 2007

² Budget 2007, HM Treasury, March 2007

expected to ease slightly in 2007, though to remain high by historical standards at 5 per cent.

1.7 The disruption in global financial markets has meant economic prospects have become more uncertain. It presents clear risks to the economic forecast, though these are judged to be broadly balanced. Considerable uncertainty surrounds the timing and extent to which the disruption might affect the wider economy, and the longer it persists, the greater the risk of it detracting from growth. However, the UK economy has proved resilient to a number of shocks over the past decade, demonstrating the pay-off to the Government's macroeconomic framework and promotion of open and flexible labour, product and capital markets. As such, growth could slow by less than expected.

1.8 GDP growth in the first half of 2007 was 3¼ per cent on a year earlier. Private sector business surveys suggest the economy carried significant momentum into the second half of 2007. In light of such evidence, the 2007 Pre-Budget Report forecast is for GDP growth of 3 per cent in the year as a whole. The Monetary Policy Committee has raised Bank Rate by more than financial markets expected at Budget 2007, plus disruption in financial markets has made economic prospects more uncertain. Against this backdrop, GDP growth in 2008 is forecast to slow to 2 to 2½ per cent, below its trend rate. The economy is forecast to strengthen, returning to trend in 2009, with growth forecast to be in the range of 2½ to 3 per cent from then onwards.

1.9 Having risen during 2006, consumer price inflation continued to rise during the first quarter of 2007, peaking at 3.1 per cent in March. CPI inflation has fallen back sharply from its peak in March, and is expected to remain close to target over the forecast horizon.

Public Finances **1.10** Chapter 4 summarises the outlook for the public finances including in terms of the economic cycle, Chapter 5 goes on to outline how the public finances are sustainable in the long term and Chapter 6 describes the Government's programme of sustained investment alongside reforms to improve the effectiveness, efficiency and responsiveness of public services.

Prudent interpretation **1.11** The Government supports a prudent interpretation of the Stability and Growth Pact, which takes into account the economic cycle, sustainability and the important role of public investment (as specified in Article 104 of the EU Treaty):

- **The economic cycle.** The golden rule is set over the economic cycle to allow fiscal policy to support monetary policy in maintaining stability 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, in 1997-98. The current budget shows an average surplus as a percentage of GDP over the current economic cycle, ensuring the Government is meeting the golden rule. Beyond the current cycle, the current budget moves clearly into surplus. At this early stage, and based on cautious assumptions, the Government is therefore on course to meet the golden rule over the next economic cycle.
- **Sustainability.** The Government's primary objective for fiscal policy is to ensure sound public finances in the medium term. This means maintaining public sector debt at a low and sustainable level. Despite output having been generally below trend since 2001, net debt remains below 39 per cent of GDP and starts to decline by the end of the projection period, reaching 38.6 per cent of GDP 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. Chapter 5 discusses the sustainability of public finances.

- **Public investment.** The fiscal framework has supported an historically unprecedented increase in public sector net investment, while net debt has been maintained at a low and sustainable level. The golden rule requires the current budget to be in balance or surplus over the cycle, allowing the Government to borrow only to fund capital spending over the course of the cycle. Consistent with the Integrated Guidelines and the UK's Lisbon National Reform Programme, and the 2007 Update on Progress, this updated Convergence Programme also demonstrates the UK Government's commitment to address historical under-investment in public services. The Government's goal is to deliver world class public services through sustained investment and far-reaching reform, as discussed further in Chapter 6. This updated programme also reports on the 2007 Comprehensive Spending Review (CSR).

Economic reform in Europe **1.12** Strengthening economic reform in Europe remains a key priority for the UK. The Single Market has delivered real benefits, but the need for significant reform continues – particularly in network industries like energy. The Government will continue to oppose unnecessary bureaucracy arising from EU rules and to push for the European Commission to increase the level of competition throughout the EU. Reform in each Member State will be important. For these reasons, the Government looks forward to the Review of the Single Market and the update to the Lisbon Strategy for Jobs and Growth in 2008.

Annex A & Annex B **1.13** Annex A provides details of the financial impact of the Budget 2007 and Pre-Budget Report 2007 policy decisions, and subsequent announcements. Annex B provides supplementary information.

OBJECTIVES OF ECONOMIC POLICY

2.1 The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all. Key elements in the Government's long-term economic strategy are:

- maintaining macroeconomic stability;
- raising the sustainable rate of productivity growth;
- providing employment opportunity for all;
- ensuring fairness;
- delivering world-class public services; and
- addressing environmental challenges.

2.2 These objectives, and the elements through which the Government plans to meet them, are consistent with the objectives of the European Community as set out in Article 2 of the Treaty. They are also consistent with the Lisbon Strategy, the Integrated Guidelines, and with a prudent interpretation of the EU Stability and Growth Pact (SGP).

2.3 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 ensure low and stable inflation, while fiscal policy is underpinned by clear objectives and two strict rules that ensure sound public finances over the medium term while allowing fiscal policy to support monetary policy over the economic cycle. The fiscal rules are 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.

STABILITY AND SUSTAINABILITY

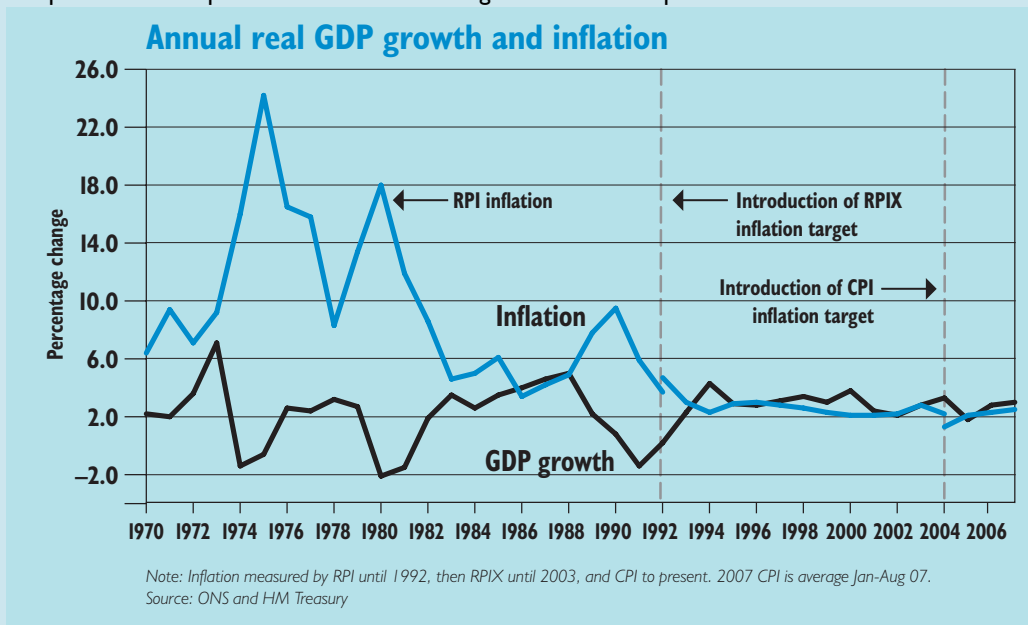
**The
importance of
stability**

2.4 The Government's macroeconomic framework is based on the principles of transparency, responsibility and accountability³ and is designed to maintain long-term economic stability. Stability allows business, individuals and the Government to plan more effectively for the long term, improving the quality and quantity of investment in physical and human capital and helping to raise productivity.

³ Further details can be found in *Reforming Britain's economic and financial policy*, Balls and O'Donnell (eds.), 2002.

Box 2.1: UK macroeconomic stability

The Government's frameworks for monetary and fiscal policy have helped to deliver an unprecedented decade of growth and stability for the UK economy. Since 1997, GDP growth has averaged 2.9 per cent while inflation has averaged 1.6 per cent, compared with average growth of 2.3 per cent in the previous decade and average inflation of 4.1 per cent.



Both the monetary and fiscal frameworks are underpinned by flexibility:

- the monetary framework gives the independent MPC the flexibility to respond to events in a forward-looking manner. For example, the open letter system, outlined below, creates a transparent approach to significant deviations of inflation from its target level, giving the MPC an opportunity to respond sensibly to particular economic shocks; and
- the fiscal rules are set over the economic cycle, allowing the automatic stabilisers to operate fully to help dampen economic cycles. This flexibility in fiscal policy, along with a context of low and stable borrowing and debt, has enabled fiscal policy to contribute to macroeconomic stability. The IMF noted the “shallowness of the UK growth slowdown during the last global downturn”,^a which they attributed in part to fiscal responsiveness.

Policy reforms that have increased the responsiveness of the economy also contribute to resilience. The OECD recently noted that the “United Kingdom’s open and flexible approach to economic policy is reflected in support for free trade, openness to foreign direct investment (FDI), a willingness to open its labour markets to citizens from new EU countries that joined in May 2004, and the adoption of regulatory policies that promote efficiency and economic resilience.”^b The 2007 PBR and CSR reports on progress made on enhancing flexibility.

The flexibility introduced by macroeconomic policy and microeconomic reforms since 1997 has allowed the UK economy to withstand a number of global challenges, with policymakers responding proactively in the face of significant risks. During the Asian, Russian and Long Term Capital Management (LTCM) crises of 1997 and 1998, UK GDP growth remained robust; following the bursting of the dotcom bubble after 2000 and in the aftermath of the terrorist attacks of 11 September 2001, the UK economy continued to expand while many other major economies experienced recession.

^a Concluding statement to the 2007 Article IV mission to the UK, IMF, March 2007.

^b OECD Economic Surveys: United Kingdom, OECD, September 2007.

The importance of sustainability

2.5 While a key objective of fiscal policy is to ensure sound public finances over the short and medium term, the Government must also ensure that fiscal policy decisions are sustainable in the long term. Failure to do so would see financial burdens shifted to future generations, with 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*.⁴

2.6 Since 2002 the Government has published the Long-term public finance report on an annual basis to provide a comprehensive analysis of long-term socio-economic and demographic developments, and their likely impact on the public finances, based on the most up to date information available. The population projections provided by the Office for National Statistics (ONS) are central to this analysis. Given that the ONS published its 2006-based population projections on 23 October, the next Long-term public finance report will be published at a later date.

2.7 The most recent assessment, published in the 2006 *Long-term public finance report*, shows that the UK fiscal position is sustainable over the long term. The UK is in a strong position relative to other developed countries to face the challenges of an ageing society.

MONETARY POLICY

Monetary policy framework

2.8 The monetary policy framework introduced in 1997 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 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 the publication of MPC members' voting records, prompt publication of the minutes of monthly MPC meetings, and publication of the Bank of England's quarterly Inflation Report; and
- credibility and flexibility. The MPC has discretion to decide how and when to react to events, within the constraints of the inflation target and the open letter system.

2.9 These arrangements have removed the risk that short-term political factors can influence monetary policy and ensured that interest rates are set in a forward-looking manner to meet the Government's symmetrical inflation target.

2.10 It is important that the macroeconomic policy framework continues to evolve to maintain its status at the forefront of international best practice. In line with the

⁴ *Code for fiscal stability*, HM Treasury, 1998.

principles of transparency and accountability, which underpin the monetary policy framework, the Chancellor announced to the Treasury Select Committee (TSC) on 14 June 2007 three important changes to the process by which external appointments are made to the MPC:

- the timetable for appointing a new external member will now be pre-announced well before an existing member's term is due to come to an end, providing greater clarity and certainty about the appointments process;
- there will be an invitation of 'expressions of interest' from potential candidates, enhancing openness in the process without limiting the field of candidates to individuals that come forward in response to the invitation; and
- in inviting expressions of interest, additional criteria on the kind of candidate the Chancellor is seeking will be published, providing greater transparency on the Chancellor's thinking on the skills required in a specific appointment.

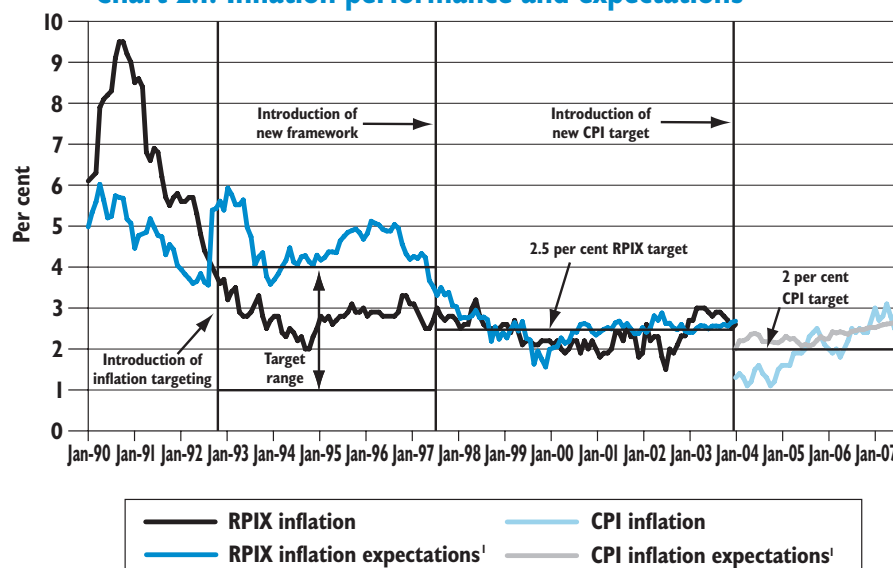
2.11 In addition, to reinforce transparency and increase parliamentary scrutiny, new appointees to the MPC will now be subject to a TSC confirmation hearing before they take up a post on the Committee. This will apply to all appointees to the MPC, including for the Governor and Deputy Governors of the Bank of England.

Performance of the monetary policy framework

2.12 The monetary policy framework has improved the credibility of policy making and continues to deliver clear benefits. Since the new framework was introduced:

- the annual increase in inflation up to December 2003, when RPIX was used as the inflation target measure, remained close to the target value of 2½ per cent, the longest period of sustained low inflation for the past 30 years; and
- inflation expectations have remained close to target following the switch to a 2 per cent CPI target. CPI inflation has averaged 2 per cent since 2003 and has moved away from its target by more than 1 percentage point on only one occasion;
- long-term interest rates have averaged 5 per cent compared with an average of just over 9 per cent in the previous economic cycle. Alongside the UK's macroeconomic stability in recent years, the effective exchange rate has also been relatively stable. The sterling effective exchange rate remains close to levels at Budget 2004.

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.

2.13 Responding to reduced spare capacity and above-trend growth, and with inflation above target, the MPC raised interest rates on five occasions between August 2006 and July 2007, to reach their present level of 5¾ per cent. Inflation has come down swiftly since peaking in March, at 3.1 per cent, and is expected to remain close to target over the forecast horizon.

2.14 In April 2007, the Governor of the Bank of England wrote the first open letter since the inception of the MPC. The open letter system is an integral part of the macroeconomic framework. It requires the Governor to explain to the Chancellor the reasons for any deviation in inflation of more than one percentage point above or below target, plus the action the MPC proposes to take, the expected duration of the deviation and how the proposed action meets the remit of the MPC. The MPC's forward-looking approach has been a cornerstone of economic policy since 1997. The Chancellor, in his response, underlined that the Government will continue to support the MPC in the forward-looking decisions it takes in the future.

FISCAL POLICY

Fiscal policy framework

2.15 The Government's fiscal policy framework is based on the five key principles set out in the *Code for fiscal stability* – transparency, stability, responsibility, fairness and efficiency. The Code requires the Government to state both its objectives and the rules through which fiscal policy will be operated. 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.

2.16 These objectives are implemented through two 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.

2.17 The fiscal rules ensure sound public finances in the medium term while allowing flexibility in two key respects:

- the rules are set over the economic cycle. This allows the fiscal balances to vary between years in line with the cyclical position of the economy, permitting the automatic stabilisers to operate freely to help smooth the path of the economy in the face of variations in demand; and
- the rules work together to promote capital investment while ensuring sustainable public finances in the long term. The golden rule requires the current budget to be in balance or surplus over the cycle, allowing the Government to borrow only to fund capital spending. The sustainable investment rule ensures that borrowing is maintained at a prudent 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.

End of year fiscal report

2.18 The End of year fiscal report (EYFR) helps ensure transparency by enhancing the Government's fiscal reporting and analysis. It is retrospective, describing fiscal developments in the previous two financial years, and setting these into an historical context. The EYFR complements the data on and analysis of the public finances that are published at the time of the Pre-Budget Report and Budget, in accordance with the requirements of the *Code for fiscal stability*. It ensures that the UK is fully in line with international best practice, including the International Monetary Fund's *Code of Good Practices on Fiscal Transparency*.⁵

Stability and Growth Pact

2.19 The introduction of the SGP in the late 1990s represented a major step forward in recognising the importance of long-term budgetary discipline and as a framework for coordination by Member States of their fiscal policies. The UK has supported the principle of a strong SGP, recognising that fiscal sustainability is a prerequisite for macroeconomic stability, and that collective fiscal co-ordination is desirable within an integrated economic community, and essential for a successful monetary union. However, in the past, the operation of the SGP highlighted a number of issues that needed to be addressed.

2.20 The UK Government continues to emphasise the need for a prudent interpretation of the SGP. A prudent interpretation takes into account:

- the economic cycle – by allowing the automatic stabilisers to operate fully and symmetrically over the cycle, fiscal policy can support monetary policy in smoothing the path of the economy, so providing the flexibility to take the right decisions over the cycle;

⁵ *Code of Good Practices on Fiscal Transparency*, International Monetary Fund (2001).

- sustainability – taking into account that low debt levels enhance the sustainability of the public finances, allowing greater room for the automatic stabilisers to operate, and providing a sound basis for investment in public services. Assessment of sustainability should also take into account the long-term budgetary impact of ageing populations; and
- public investment – recognising that public investment contributes to the provision of high-quality public services and can help to underpin a flexible, high productivity economy.

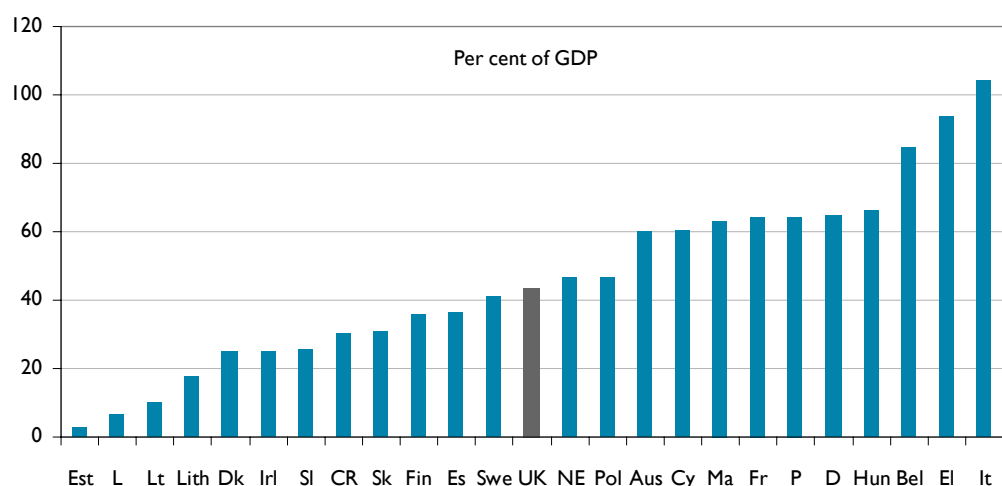
2.21 The reforms to the Pact agreed in March 2005 rightly place a greater focus on the avoidance of pro-cyclical policies, and on achieving low debt levels and thereby enhancing the long-term sustainability of public finances, with the flexibility for low debt countries such as the UK to invest in the provision of much needed public services. The Government continues to work closely with Member States and EU institutions, as the success of the reforms will depend on how they are implemented. It is also essential to recognise the importance of national frameworks and national ownership of fiscal policy.

Performance of the fiscal policy framework

2.22 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 current economic cycle, 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 set out in more detail in Chart 4.1. 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.

2.23 As Chart 2.2 shows, UK debt levels compare favourably with other countries.

Chart 2.2: General government gross debt, 2007



Source: European Commission Autumn Forecasts 2007

Fiscal balances **2.24** Table 4.1 presents a summary of the key fiscal aggregates under the five headings of fairness and prudence, sustainability, economic impact, financing and European commitments. It illustrates the Government's performance against its fiscal rules, and shows that the Government is meeting its strict fiscal rules over the economic cycle.

2.25 A full account of public sector finances is given in Chapter 4. In summary:

- the current budget shows an average surplus as a percentage of GDP over the current economic cycle, ensuring the Government is meeting the golden rule;
- with the economy appearing to have passed through trend in the final quarter of 2006, Pre-Budget Report projections show that the current budget moves into surplus in 2009-10, with the surplus rising to 1.1 per cent of GDP by 2012-13. At this early stage, and based on cautious assumptions, the Government is therefore on course to meet the golden rule in the next economic cycle; and
- public sector net debt is projected to remain low and stable over the forecast period, stabilising below 39 per cent of GDP and so meeting the sustainable investment rule.

WIDER INSTITUTIONAL CONTEXT ---

Caution in the public finance projections **2.26** 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. Details of the audited assumptions are given in Chapter 4.

2.27 One of the key audited assumptions is that for the trend rate of GDP growth, which is assumed to be $\frac{1}{4}$ per cent below the neutral view. This means that the rate of economic growth used to forecast the public finances is the bottom end of the projection range. For example, the forecast for economic growth used in the public finances projections over the period 2007-08 to 2012-13 averages $2\frac{1}{2}$ per cent, $\frac{1}{4}$ per cent below the central case.

Independence for the Office for National Statistics **2.28** Statistics make a crucial contribution to the operation of the macroeconomic framework. Following the commitment made by the Chancellor in November 2005, and a full public consultation, legislation for the reform of the UK statistical system has been successfully delivered. The Statistics and Registration Service Act 2007⁶, which gained Royal Assent in July, establishes an independent Statistics Board, reporting directly to Parliament, responsible for promoting and safeguarding the quality and comprehensiveness of all official statistics that serve the public good, wherever produced in government. The Board will have a statutory duty to set professional standards in a Code of Practice, and to assess independently statistics against this Code. The Board will also replace Ministers as the top layer of governance for the Office for National Statistics. The Government intends that the new system will be up and running in spring 2008.

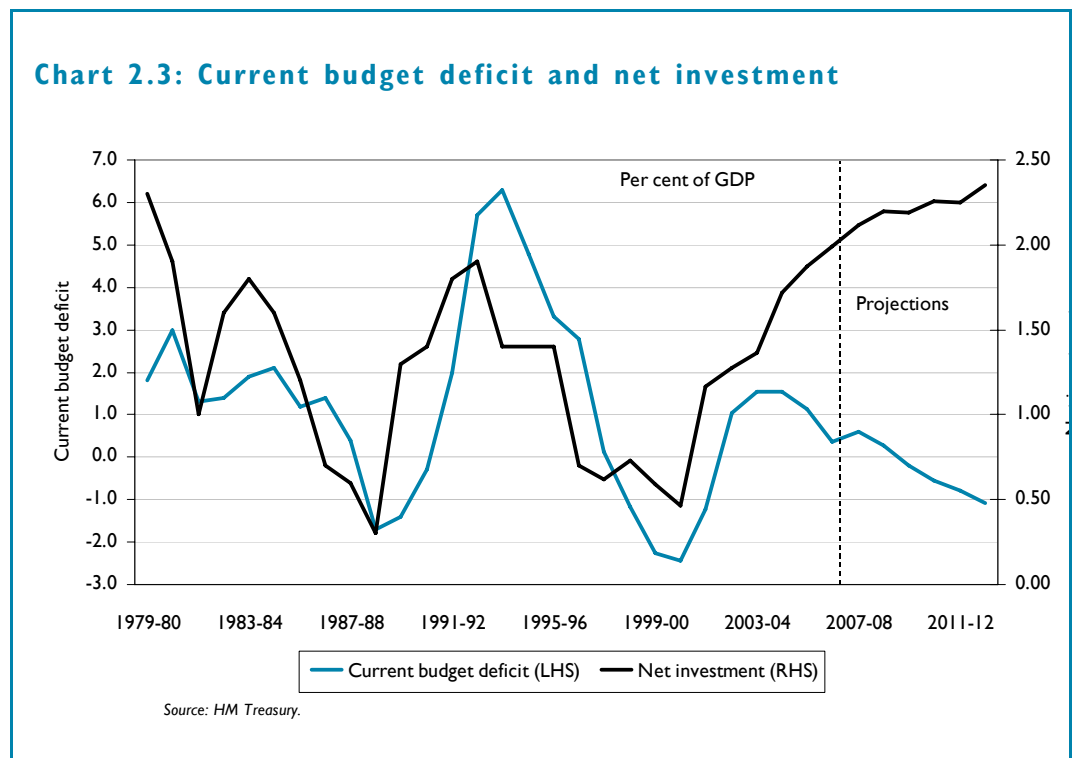
⁶ Further details, including the Act and associated documentation, can be found on the HM Treasury website at <http://www.hm-treasury.gov.uk>.

RELEASING RESOURCES FOR HIGH-QUALITY PUBLIC SERVICES

2.29 Delivering better outcomes in the Government's priority areas will require world-class public services that respond to people's rising aspirations and equip the UK for global change. The Government's approach to improving outcomes from public services comprises: investing for the long term; driving better value for money from public spending; and taking forward the next stage in public service reform by empowering users and frontline professionals to shape services.

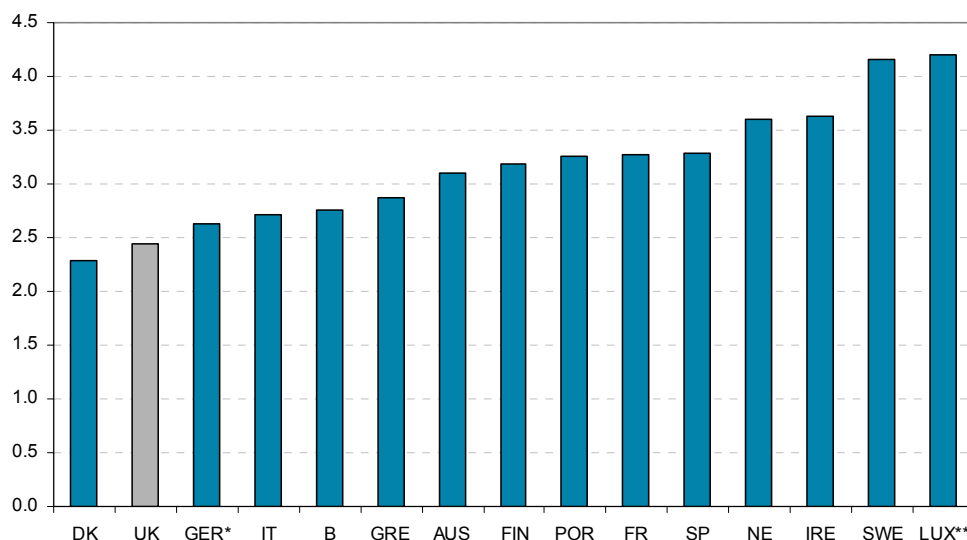
2.30 The Government's fiscal rules have removed the past discrimination against capital spending and ensured that borrowing for investment is conducted in a sustainable way. This framework has helped protect significant increases in the level of public sector net investment from $\frac{1}{2}$ per cent of GDP in 1997-98 to 2.1 per cent of GDP this year – addressing the backlog of under-investment in public services and putting in place some of the vital infrastructure required to promote the UK's economic growth and productivity.

2.31 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 Chart 2.3.



2.32 Chart 2.4 shows UK public investment in comparison with other European countries.

Chart 2.4: Public investment, 1971-2008



* Pre-1991 data are for West Germany.

** Data for Luxembourg are only available for the 1990-2008 period.

Note: Figures for 2007 and 2008 are EC forecasts.

Source: DG ECFIN (AMECO)

Comprehensive Spending Review

2.33 Over the last two years the Government has been consulting with frontline professionals, outside experts and the public to prepare for a second Comprehensive Spending Review (CSR), which a decade on from the first CSR lays the foundations for the transformation of the UK's public services over the next ten years.

2.34 Budget 2007 set the overall spending envelope for the CSR07 period, locking in the historic increases in investment of the past decade while allowing public spending to increase by an average of 2 per cent a year in real terms. The strength of the UK's public finances enables the Government to announce an addition of £2 billion to public sector net investment in 2010-11, to take forward vital investment in public services. With this addition, total public spending over the CSR07 period will rise by an average of 2.1 per cent a year in real terms with:

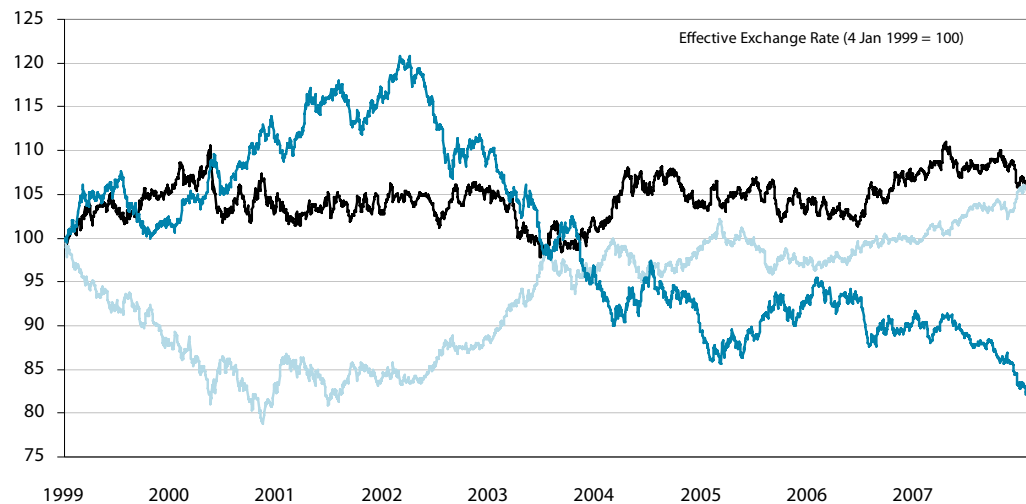
- current spending increasing by an average of 1.9 per cent per year in real terms; and
- net investment rising to 2¼ per cent of GDP.

EXCHANGE RATE STABILITY

2.35 The Government believes that exchange rate stability can only be achieved on the basis of sound economic fundamentals, in particular, low and stable inflation, steady and sustainable growth and sound public finances. The exchange rate should therefore be seen as the outcome of all other economic policies.

2.36 Previous UK experience has shown that an exchange rate target without these fundamentals in place can be counter-productive and lead to less, not more, stability in the medium term. The Government intends to achieve exchange rate stability over the medium term through its policies for achieving greater economic stability. The monetary and fiscal policy frameworks provide an anchor for achieving greater stability.

Chart 2.5: Movements in leading effective exchange rates indices since 1999



2.37 Alongside the UK's macroeconomic stability in recent years, the effective exchange rate has also been relatively stable, as seen in Chart 2.5. The sterling effective exchange rate remains close to levels at Budget 2004.

ECONOMIC AND MONETARY UNION

2.38 The Government's policy on membership of the single currency is set out in Box 2.2.

Box 2.2: Government policy on EMU

The Government's policy on membership of the single currency was set out by the Chancellor in his statement to Parliament in October 1997. In principle, the Government is in favour of UK membership; in practice, the economic conditions must be right. The determining factor is the national economic interest and whether, on the basis of an assessment of the five economic tests, the economic case for joining is clear and unambiguous. An assessment of the five economic tests was published in June 2003. This concluded that: "since 1997, the UK has made real progress towards meeting the five economic tests. But, on balance, though the potential benefits of increased investment, trade, a boost to financial services, growth and jobs are clear, we cannot at this point in time conclude that there is sustainable and durable convergence or sufficient flexibility to cope with any potential difficulties within the euro area."

As part of the policy of 'prepare and decide', the Government coordinates appropriate euro preparations across the UK economy. The Government also supports business in dealing with the euro as a foreign currency. Further information is available on the Treasury's euro website (www.euro.gov.uk).

The Chancellor's statement to the House of Commons on 9 June 2003 on UK membership of the European single currency set out a reform agenda of concrete and practical steps to address the policy requirements identified by the June 2003 assessment, the latest progress report on which was set out in Budget 2007. While the Government did not propose initiating a euro assessment at the time of Budget 2007, the Treasury will again review the situation at Budget time next year, as required by the Chancellor's June 2003 statement.

LONG-TERM ECONOMIC PERFORMANCE

2.39 Public investment makes a crucial contribution to the productivity and flexibility of the wider economy. The 1998 Comprehensive Spending Review and subsequent spending reviews have substantially addressed the legacy of under-investment in the UK's public infrastructure.

Flexibility... **2.40** 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 UK economy is experiencing an unprecedented period of growth, and inflation is close to target. This macroeconomic stability puts the UK in a strong position to respond to global economic challenges, and to take advantage of the opportunities of the coming decade.

...and productivity **2.41** A decade ago, the Government set itself the objectives of achieving high and stable levels of growth and employment and narrowing the productivity gap with the UK's major competitors. The Government has made significant progress in raising the long-run rate of productivity growth, narrowing the productivity gap with its main industrialised competitors over this same period on both the productivity per worker and productivity per hour worked measures.

2.42 The Government has contributed to raising UK productivity by pursuing microeconomic reforms to remove barriers preventing markets from working efficiently. These have been focused on the drivers of productivity. As part of the 2007 Comprehensive Spending Review the Government announces a new Public Service Agreement (PSA) to raise the productivity of the UK economy by:

- enhancing the skills of the UK workforce;
- investing in the UK science base and promoting innovation;
- modernising the UK's critical infrastructure;
- improving the business environment in the UK; and
- narrowing the productivity gap between the regions.

THE WORLD ECONOMY

World GDP growth

3.1 The world economy grew by $5\frac{1}{4}$ per cent in 2006, the fastest rate since 1990. This reflected strong growth in advanced economies and particularly in the emerging markets, which accounted for more than half of total world growth. This was the third consecutive year of global growth above $4\frac{1}{2}$ per cent. It is expected to ease slightly in 2007, though to remain high by historical standards at 5 per cent.

3.2 Although global growth is expected to remain healthy, prospects have moderated in recent months reflecting the effects of financial market disruption. In 2007, G7 growth is expected to slow to 2 per cent, due in particular to the ongoing slowdown in the US, and to remain moderate in 2008. Growth in some emerging markets is expected to ease somewhat from the very high rates of recent years, but to remain strong. Emerging markets are expected to continue to account for the majority of world growth. Against this background, world trade is forecast to grow at $7\frac{3}{4}$ per cent in 2007, feeding through to UK export markets growth of 7 per cent.

Table 3.1: The world economy

	Percentage change on a year earlier, unless otherwise stated				
	2006	Forecast			
		2007	2008	2009	2010
World GDP	$5\frac{1}{4}$	5	5	$4\frac{3}{4}$	$4\frac{3}{4}$
Major 7 countries ¹					
Real GDP	$2\frac{3}{4}$	2	2	$2\frac{1}{2}$	$2\frac{1}{2}$
Consumer price inflation ²	$1\frac{3}{4}$	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{2}$
Euro area GDP	3	$2\frac{1}{2}$	2	2	2
World trade in goods and services	10	$7\frac{3}{4}$	$7\frac{3}{4}$	$7\frac{3}{4}$	$7\frac{3}{4}$
UK export markets ³	9	7	$6\frac{1}{2}$	$6\frac{3}{4}$	$6\frac{3}{4}$

¹ G7: US, Japan, Germany, France, UK, Italy and Canada.

² Per cent, Q4.

³ Other countries' imports of goods and services weighted according to the importance of imports from the UK in those countries' total imports.

Global financial markets

3.3 Since July 2007, there has been considerable financial market disruption around the world, associated with changes in the pricing of risk. The recent period of disruption was triggered by renewed concerns about the US sub-prime mortgage market, following earlier periods of stress in February and March. The impact soon spread to a range of markets for asset-backed securities and related commercial paper. Uncertainty over which institutions were exposed to potential losses, the size of any exposures, and the extent to which banks might have to bring many of these assets back onto their balance sheets, caused money market liquidity to contract and inter-bank lending rates to rise sharply in all major financial centres. As investors' appetite for risk diminished, the value of a range of higher-risk assets fell, including lower-rated corporate bonds, emerging market bonds and equities, and even high-yielding currencies like the Australian and New Zealand dollars. By contrast, the price of US Treasury bills, often seen as a safe haven in times of volatility, increased sharply causing the yield, which moves inversely with the price, to fall well below the US policy rate.

3.4 Central banks have offered more liquidity at slightly longer maturities, including in the three-month money market, and, in some cases, against a broader range of collateral than usual. The spread of three-month inter-bank lending rates over expected policy rates has since fallen, while stock, bond and currency markets have stabilised somewhat. However, while the disruption has eased, inter-bank spreads remain high, while more specialised credit markets remain illiquid.

PROSPECTS FOR UK ECONOMIC GROWTH

Recent developments

3.5 The UK economy grew by 2¾ per cent in 2006. Data released since Budget 2007 show that GDP grew by 0.8 per cent in each of the first and second quarters of 2007, bringing output growth in the first half of the year to 3¼ per cent on a year earlier, towards the upper end of the Budget 2007 forecast range for the year as a whole. Non-oil GVA growth in the year to the second quarter of 2007 was above trend at 3¼ per cent, slightly stronger than expected at the time of Budget 2007.

3.6 The process of rebalancing between the domestic components of demand that began in 2005 has continued. In 2006 as a whole, private consumption grew by 2 per cent, below the 2¾ per cent rate of the whole economy, while business investment grew by 7½ per cent. In the first half of 2007, consumption was up 3 per cent on a year earlier, compared with 3¼ per cent for whole economy GDP, and business investment was 8¾ per cent higher. In terms of the rebalancing between domestic and external demand, net exports continued to subtract from growth in 2006, but appear to have been more neutral in the first half of 2007, though trade data are subject to possible measurement difficulties discussed below. On the output side, while the service sector remained the main source of growth, manufacturing has also contributed positively to growth over the past year and a half, while oil production picked up during the first half of 2007 after an extended period of negative growth.

Financial markets

3.7 Global financial market disruption has had an impact on UK financial markets, in common with other major financial centres. Most notable has been the rise in short-term interest rates on lending between financial institutions, where the spread between Bank Rate and the three-month sterling LIBOR⁷ interest rate, normally around 20 basis points, rose to more than 100 basis points in the first half of September before easing. At the current rate of around 6¼ per cent, three-month interest rates remain low compared with the 9½ per cent average of the early 1990s and the 12 per cent average of the 1980s.

Money growth and credit conditions

3.8 Beyond any direct impact of financial market disruption on incomes and profits in the financial sector, recent developments could affect the wider economy through their impact on credit conditions for households and companies. Growth rates of the broad money supply and lending to the private sector remained strong during the year to August 2007, though they have eased slightly from the historically high rates seen during the second half of 2006. The Bank of England's new Credit Conditions Survey, published for the first time on 26 September, suggested that recent financial market disruption had yet to impact on credit conditions facing households, although there was evidence that it was to some extent affecting the price and availability of credit to the corporate sector. Bank of England data on effective interest rates on deposits and lending for August 2007 presented a similar picture, with more muted increases in borrowing rates for households than for companies.

⁷ The 'London inter-bank offered rate', LIBOR, is the rate at which banks are willing to lend to one another on an unsecured basis.

Trend growth 3.9 The Treasury's neutral estimate of the economy's trend rate of output growth for the 2007 Pre-Budget Report remains at $2\frac{3}{4}$ per cent a year to the end of the projection period, the same assumption that underpinned the previous two economic forecasts.⁸ Table 3.2 presents estimates of trend output growth and its decomposition to the end of 2006, and the Treasury's projection thereafter.

Table 3.2: Contributions to trend output growth¹

	Estimated trend rates of growth, per cent per annum					Trend output
	Trend output per hour worked ^{2,3}		Trend average hours worked ³	Trend employment rate ³	Population of working age ⁴	
	Underlying (1)	Unadjusted (2)	(3)	(4)	(5)	(6)
1986Q2 to 1997H1						
Latest data	2.13	1.95	-0.11	0.36	0.25	2.46
Over the recent past						
1997H1 to 2001Q3						
Latest data	2.89	2.70	-0.46	0.38	0.53	3.17
2001Q3 to 2006Q4						
Budget 2002 ⁵	2.10	2.00	-0.1	0.2	0.6	$2\frac{3}{4}$
PBR 2006 and Budget 2007	2.25	2.15	-0.2	0.2	0.7	$2\frac{3}{4}$
Latest data ^{6,7}	2.35	2.32	-0.27	0.06	0.65	2.77
Projection⁸						
2006Q4 onwards						
PBR 2006 and Budget 2007	2.25	2.15	-0.2	0.2	0.6	$2\frac{3}{4}$
PBR 2007 ⁹	2.35	2.30	-0.25	0.1	0.6	$2\frac{3}{4}$

¹Treasury 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 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.

³ 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. Hours worked and the employment rate are measured on a working-age basis.

⁴ UK resident household basis.

⁵ Interim projections between Budget 2002 and PBR 2006 are provided in an expanded table in '2007 Pre-Budget Report: the economy and public finances – supplementary charts and tables', HM Treasury, October 2007.

⁶ Estimates based on the assumption that the economy passed up through trend in the final quarter of 2006.

⁷ Estimates have been adjusted in line with the mid-year population estimates published in August 2007. Labour market statistics consistent with the latest population estimates will be published by the ONS in due course.

⁸ Neutral case assumptions for trend from 2006Q4.

⁹ Underlying trend assumptions around which the mid-points of the GDP forecast growth ranges from 2006Q4 are anchored.

GDP growth forecast 3.10 Private sector business surveys suggest the economy carried significant momentum into the second half of 2007. In light of such evidence, the 2007 Pre-Budget Report forecast is for GDP growth of 3 per cent in the year as a whole, in line with the Budget 2007 forecast.

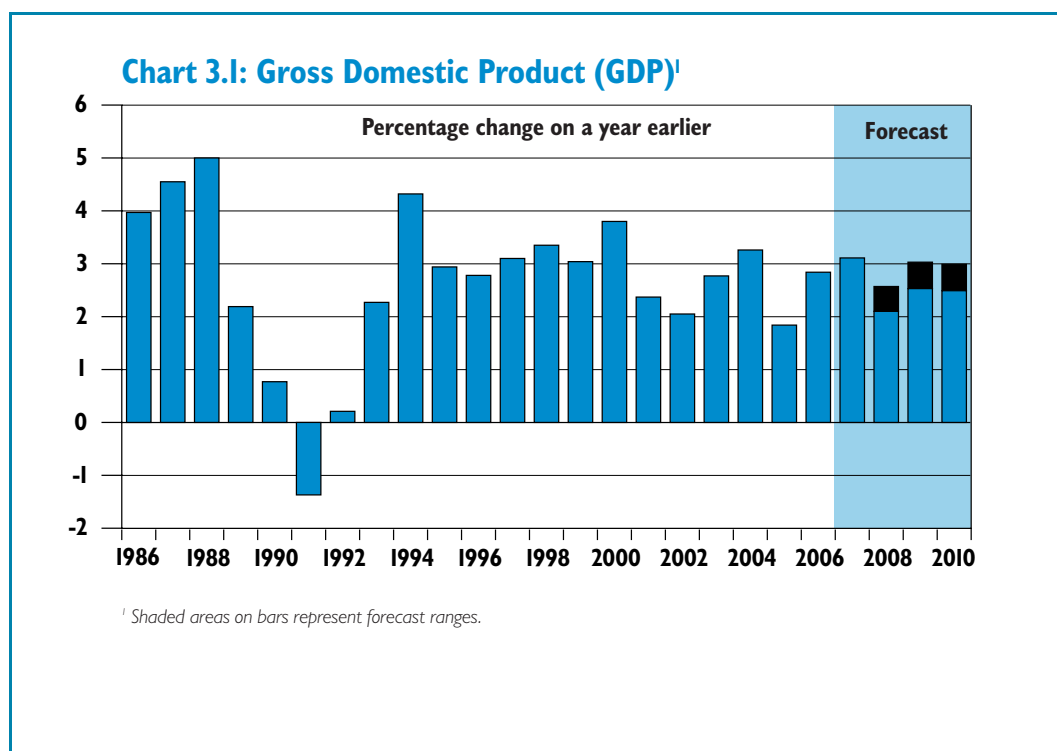
3.11 The MPC has raised Bank Rate by more than financial markets expected at Budget time, which can be expected to impact on growth in 2008. In addition, disruption in financial markets has meant economic prospects have become more uncertain, and events need to unfold further before the impact on the economy can be

⁸ For a full discussion of the most recent review of the Treasury's trend growth projections, see *Trend growth: new evidence and prospects*, HM Treasury, December 2006.

rigorously quantified. For the purposes of the economic forecast, it has been assumed that there will be some feed-through to tighter credit conditions and to household and company spending in the short term. Market expectations of future Bank Rate have moved lower since July 2007, and now point to some easing over coming months. The UK economy has proved resilient to a number of shocks over the past decade, demonstrating the pay-off to the Government's macroeconomic framework and promotion of open and flexible labour, product and capital markets, but it would be unreasonable to assume the effects of an unexpected shock could be absorbed immediately.

3.12 Against this backdrop, GDP growth in 2008 is forecast to slow to 2 to 2½ per cent, below its trend rate, consistent with keeping inflationary pressures in check. The economy is forecast to return to trend in 2009, with growth forecast to be in the range of 2½ to 3 per cent from then onwards.

3.13 Chart 3.1 shows the evolution of GDP.

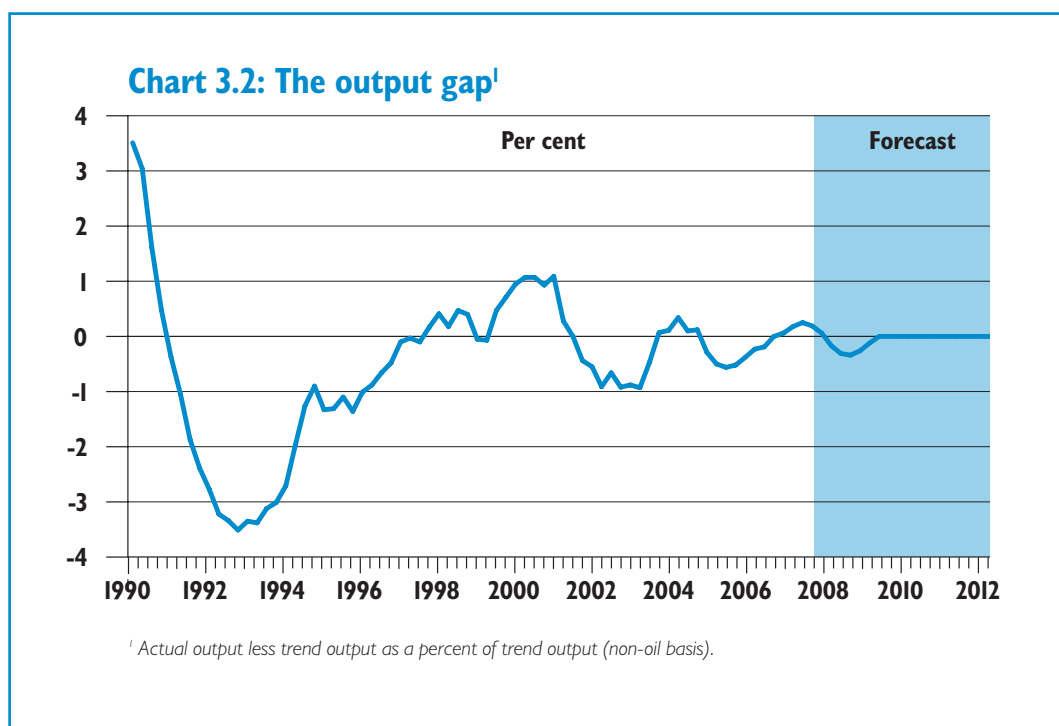


Economic cycle and the output gap

3.14 Since Budget 2007, upward revisions to estimates of non-oil GVA growth in 2006, combined with estimates of 0.8 per cent growth in each of the first two quarters of 2007, show the UK economy to have been growing at slightly above-trend rates for seven consecutive quarters through to mid-2007. Evidence from the broad range of cyclical indicators monitored by the Treasury⁹ suggests the economy may currently be operating slightly above trend and that output may have moved up through trend towards the end of 2006.

3.15 The latest National Accounts data and the Treasury's trend output assumptions imply output passed through trend in the final quarter of 2006 and that a small positive output gap, of around a ¼ per cent, has opened up. However, it is too soon to assess whether or not the economic cycle has ended.

⁹ Details of these indicators can be found in the *Technical note on cyclical indicators*, HM Treasury, December 2005.



Inflation 3.16 Having risen during 2006, consumer price inflation continued to rise during the first quarter of 2007, peaking at 3.1 per cent in March. The rise in headline inflation was initially driven by energy price developments, caused by high oil and wholesale gas prices. On top of that, food price inflation was pushed higher by the effects of the unusually hot UK summer in 2006 and, thereafter, global supply and demand pressures. RPI inflation increased by more than CPI inflation, peaking at 4.8 per cent in March, mainly reflecting the impact of tighter monetary policy on mortgage interest payments.

3.17 CPI inflation has fallen back sharply from its peak in March, mainly due to the ongoing effect of utility price cuts, and some supermarket-led reductions in food prices. RPI inflation has also eased. Volatile movements in the price of furniture and furnishings, with monthly changes more than twice as large during 2007 than on average over the preceding decade, have made short-term forecasting of inflation more difficult. Nevertheless headline inflation has eased as expected.

3.18 Despite record employment levels and high oil prices, inflation expectations have remained anchored to target, and there has been little sign of any significant upward pressure on wages. The Government has demonstrated its commitment to ensuring that wage pressures remain consistent with the 2 per cent CPI inflation target by delivering overall headline awards for Pay Review Body groups in 2007-08 that average 1.9 per cent.

3.19 CPI inflation is forecast to remain close to the 2 per cent inflation target throughout the forecast horizon reflecting the offsetting effects of a number of factors. These include upward cost pressures from food and oil prices, and downward pressures from the ongoing effect of monetary policy tightening over the past year and below-trend growth in 2008.

EMPLOYMENT

3.20 Employment grew by around 275,000 in the year to the fourth quarter of 2006, with roughly 30 per cent of that increase accounted for by workers of above the State Pension age. As a result, while the working-age employment rate was broadly stable through the year at around 74½ per cent, the employment rate for older workers increased from 10½ to 11 per cent. Despite that increase, the employment rate among all adults has remained broadly stable at around 60 per cent. Employment rose by 84,000 in the three months to July and stands at a record high above 29 million. Private sector employment growth has been solid, up around 175,000 on year earlier in the second quarter, while public sector employment has fallen by more than 40,000 over the same period. Employment rates among the working-age and older workers have remained stable in 2007.

3.21 Indicators of recruitment difficulties, which at the time of Budget 2007 signalled spare capacity remaining in the labour market, have picked up, providing evidence of diminishing slack. The Bank of England Regional Agents' score for recruitment difficulties has risen progressively since January 2007, and by August had moved fractionally above its long-run average. Other indicators provide further evidence of diminishing slack and strong demand for labour. For example, claimant count unemployment has fallen for 11 consecutive months, and by more than 100,000 since September 2006. The Labour Force Survey unemployment rate has edged down, although it remains above its lows in 2005. The number of vacancies has risen to a six-year high.

CONSUMPTION

3.22 Real household disposable incomes grew by 1¼ per cent in 2006, with growth having moderated from 2005. Growth of wages and salaries remained solid, with the slowdown primarily explained by growth in net property income, the difference between interest and dividends received and paid by households, which fell from 20 per cent in 2005 to 1 per cent in 2006. Growth of real incomes is expected to firm from 2007.

3.23 Private consumption grew by 2 per cent in 2006, and by 3 per cent on a year earlier in the first half of 2007, somewhat stronger than expected at Budget time. It is expected to grow by 3 per cent in 2007, slightly above the Budget 2007 forecast range. Retail sales volumes in July and August were up by 1½ per cent on the second quarter. This suggests that consumption may continue to grow at rates close to that of the whole economy in 2007, although retail sales account for only around a third of total consumer spending.

3.24 With Bank Rate currently somewhat higher than financial markets expected at the time of Budget 2007, consumption growth is forecast to slow, with growth of 1¾ to 2¼ per cent in 2008, lower than forecast at Budget time, before returning to rates of growth just below that of the whole economy from 2009. So far there appears to have been little evidence of financial market disruption feeding through to credit conditions for households, and the September GfK consumer confidence survey suggested households remained relatively upbeat about the prospects for their own finances over the coming 12 months.

INVESTMENT

3.25 Business investment growth picked up from 3 per cent in 2005 to 7½ per cent in 2006, the fastest rate since 1998. Although quarterly growth rates slowed in the first half of 2007, the level of investment remained high, up 8¾ per cent on a year earlier, and business investment is forecast to grow by 6 per cent in the year as a whole. Strong profitability, combined with survey evidence of positive investment intentions and capacity constraints beginning to bind, point to ongoing business investment growth. However, with evidence that the cost of capital has risen since Budget time, business investment growth is forecast to slow in 2008, to 3¼ to 3¾ per cent.

3.26 Investment in dwellings increased by 8½ per cent in 2006, contributing around 1½ percentage points to the 8¼ per cent growth of whole economy investment, and is forecast to grow by 4¼ per cent in 2007. Growth in later years of the forecast is expected to be slightly above that of whole economy GDP, supported by the Government's target for house building set out in the Green Paper *Homes for the future: more affordable, more sustainable*.¹⁰

TRADE AND THE BALANCE OF PAYMENTS

3.27 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 inevitable measurement difficulties involved in estimating MTIC-related activity, the Office for National Statistics advises that comparisons of trade volumes and prices "should be treated with a great deal of caution".¹¹ The forecast abstracts from MTIC effects by assuming that beyond the latest quarter of data, export and import volumes grow in line with underlying trade, excluding MTIC-related activity. The forecast is therefore based on the neutral assumption that the level of MTIC-related activity remains constant throughout the forecast at the latest quarterly estimate.

3.28 Growth in the volume of exports of goods and services excluding MTIC-related activity is estimated to have moderated progressively over the past year and a half, from 11½ per cent on a year earlier in the first half of 2006 to 3 per cent in the second half and minus 1 per cent in the first half of 2007. Growth in services export volumes picked up from 4½ per cent in 2006 to 8¾ per cent in the first half of 2007, so all of the slowdown was explained by lower, then negative, growth in goods export volumes. The slowdown in measured goods trade volumes this year has been at odds with evidence from a broad range of private sector business surveys, which are consistent with growth having picked up. The latest monthly estimates of export growth point to a stronger third quarter of 2007.

3.29 Given the pattern of measured export growth so far in 2007, the volume of exports excluding MTIC-related activity is forecast to grow by 3¼ per cent in 2007, below the Budget 2007 forecast range. Growth is expected to pick up to rates of around 4½ to 5¼ per cent from 2008. One channel through which global financial market disruption could affect the UK economy is its impact on the financial sectors of key

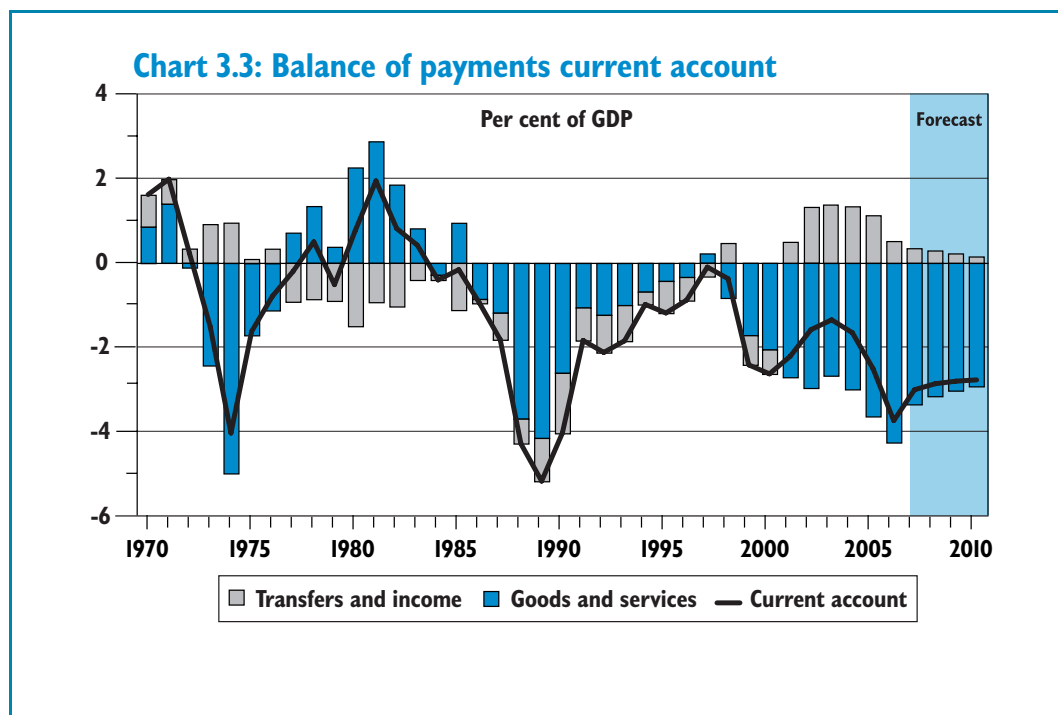
¹⁰ *Homes for the future: more affordable, more sustainable*, Communities and Local Government, July 2007.

¹¹ *UK Trade First Release – August 2007*, Office for National Statistics, October 2007.

trading partners. For example, exports of financial services to the US made up around 7½ per cent of total UK exports in 2006.

3.30 Estimates of imports of goods and services excluding MTIC-related activity have followed a very similar pattern to exports, with annual growth slowing from 9¼ to 4½ to 1¼ per cent over successive half-year periods. Again, the volume of services imports picked up in the first half of 2007, from 3½ per cent on a year earlier in 2006 to 7¼ per cent, so the slowdown has been entirely accounted for by the volume of goods imports. Together these developments suggest that some of the recent moderation in the growth of goods trade volumes could be related to the measurement difficulties outlined above. Since the estimated slowdown has been of a similar magnitude for imports and exports, estimates of net trade should be broadly unaffected.

3.31 As with exports, import growth excluding MTIC-related activity in 2007 is expected to slow from 2006, to 3¾ per cent on a year earlier. With UK consumption and investment growth forecast to ease in 2008, import growth is forecast to pick up slightly less than export growth, to around 3¾ to 4½ per cent. As a result, having subtracted a ¼ percentage point from growth in 2006 and 2007, the contribution of net trade to growth is forecast to return to neutrality from 2008.



3.32 The UK's deficit on trade in goods and services narrowed to 3½ per cent of GDP in the first half of 2007 from 3¾ per cent in 2006, reflecting a slightly larger surplus on trade in services and a broadly stable deficit on trade in goods. On the goods side, the UK's balance of trade in crude oil returned to surplus in the first half of 2007 from a small deficit in 2006. The UK's surplus on investment income was 1½ per cent of GDP in the first half of 2007, unchanged from 2006. Within that, the surplus on FDI-related earnings picked up from 3¼ to 3¾ per cent of GDP, as UK companies continued to earn significantly higher returns on their investments overseas than are earned by foreign companies on their assets in the UK.

3.33 The UK's current account deficit narrowed from 3¼ per cent of GDP in 2006 to 3 per cent of GDP in the first half of 2007. It is expected to continue to narrow in 2008 and to stabilise at around 2¾ per cent of GDP.

INDEPENDENT FORECASTERS

3.34 Since the 2006 Pre-Budget Report, the average of independent forecasts for GDP growth in 2007 has increased from 2.4 to 2.9 per cent, rising to within the Treasury's forecast range maintained since the 2005 Pre-Budget Report. The increase mainly reflects upward revisions to the average forecast for fixed investment growth, from 3.4 to 5.3 per cent, and for private consumption growth, from 2.3 to 2.8 per cent. In its September 2007 interim assessment, the OECD revised up its forecast of UK growth in 2007 from 2.7 to 3.1 per cent.¹² According to the October survey by Consensus Economics, growth in the UK in 2007 is currently projected to exceed that of all other G7 economies and to outperform the euro area.¹³

3.35 The average independent GDP growth forecast for 2008 stands at the lower end of the 2007 Pre-Budget Report forecast range, at 2.0 per cent. Since Budget 2007, the average independent forecast for 2008 has been revised down by around a $\frac{1}{4}$ percentage point. The average of independent forecasts for inflation is for it to remain at target this year and next.

3.36 Treasury forecasts for GDP growth since 1997 have, on average, outperformed the independent consensus. They 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).

¹² *What is the outlook for OECD countries? An interim assessment*, Organisation for Economic Cooperation and Development, September 2007.

¹³ *Consensus forecasts*, Consensus Economics Inc., October 2007.

SUMMARY OF ECONOMIC PROSPECTS

Table 3.3: Summary of economic prospects¹

	Percentage change on a year earlier, unless otherwise stated					Average errors from past forecasts ⁵
	2006	2007	Forecast ^{2,3,4}		2010	2008
Output at constant market prices						
Gross domestic product (GDP)	2¾	3	2 to 2½	2½ to 3	2½ to 3	¾
Manufacturing output	1¼	1	1½ to 2	1¾ to 2¼	1¾ to 2¼	1½
Expenditure components of GDP at constant market prices⁶						
Domestic demand	3	3¼	2 to 2½	2½ to 3	2¼ to 2¾	¼
Household consumption ⁷	2	3	1¾ to 2¼	2¼ to 2¾	2¼ to 2¾	1
General government consumption	2	2½	2½	2	2	1
Fixed investment	8¼	5¾	3¼ to 3¾	3¼ to 3¾	3¼ to 3¾	2¾
Change in inventories ⁸	–¼	0	–¼ to 0	0 to ¼	0	¼
Exports of goods and services ⁹	10¼	–3¼	4½ to 5	4¾ to 5¼	4¾ to 5¼	2¼
Imports of goods and services ⁹	9¾	–2	3¾ to 4¼	4 to 4½	4 to 4½	3
Exports of goods and services (excluding MTIC)	7	3¼	4½ to 5	4¾ to 5¼	4¾ to 5¼	–
Imports of goods and services (excluding MTIC)	6¾	3¾	3¾ to 4¼	4 to 4½	4 to 4½	–
Balance of payments current account						
£ billion	–42	–41	–41	–42½	–44¼	10¾
Per cent of GDP	–3¼	–3	–2¾	–2¾	–2¾	¾
Inflation						
CPI (Q4)	2¾	2	2	2	2	–
Producer output prices (Q4) ¹⁰	2	3	2	2	2	1
GDP deflator at market prices	2½	3¼	2¾	2¾	2¾	½
Money GDP at market prices						
£ billion	1302	1386	1453 to 1461	1530 to 1546	1609 to 1634	11
Percentage change	5½	6½	5 to 5½	5¼ to 5¾	5¼ to 5¾	¾

¹ The forecast is consistent with National Accounts data for the second quarter of 2007, released by the Office for National Statistics on 26 September 2007.

² All growth rates in tables throughout this annex are rounded to the nearest $\frac{1}{4}$ percentage point.

³ 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 2 $\frac{3}{4}$ 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 $\frac{1}{4}$ 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 year-ahead projections made in autumn forecasts over the past 10 years. The average errors for the current account are calculated as a percent 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 A10 of the 2007 Pre-Budget Report and Comprehensive Spending Review.

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 estimates of MTIC-related activity.

¹⁰ Excluding excise duties.

4.1 The Government's objective is to build a strong economy and a fair society, in which there is opportunity and security for all. A decade ago the Government laid the foundations for achieving this through a series of fundamental reforms to the macroeconomic framework, the public spending framework and the tax and benefit system. These have underpinned a decade of investment and reform, which has helped to achieve a sustained period of economic expansion, low unemployment and significant improvements in public services. This chapter sets out projections for the public finances, which continue to be based on prudent and cautious assumptions.

4.2 Table 4.1 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.

Table 4.1: 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	-0.4	-0.6	-0.3	0.2	0.6	0.8	1.1
Average surplus since 1997-98	0.1	0.1	0.0	0.1	0.1	0.1	0.2
Cyclically-adjusted surplus on current budget	-0.2	-0.7	-0.2	0.3	0.6	0.8	1.1
Long-term sustainability							
Public sector net debt ¹	36.7	37.6	38.4	38.8	38.9	38.8	38.6
Core debt ¹	35.8	36.9	37.6	38.0	38.1	38.1	37.9
Net worth ²	26.0	25.3	24.1	23.4	22.8	22.5	22.4
Primary balance	-0.7	-1.0	-0.9	-0.4	-0.1	0.2	0.3
Economic impact							
Net investment	2.0	2.1	2.2	2.2	2.3	2.3	2.3
Public sector net borrowing (PSNB)	2.3	2.7	2.5	2.0	1.7	1.5	1.3
Cyclically-adjusted PSNB	2.2	2.8	2.4	1.9	1.7	1.5	1.3
Financing							
Central government net cash requirement	2.8	2.7	2.6	2.4	2.0	2.0	1.6
Public sector net cash requirement	2.7	2.4	2.4	2.3	1.8	1.8	1.5
European commitments							
Treaty deficit ³	2.6	2.9	2.8	2.4	2.1	1.8	1.6
Cyclically-adjusted Treaty deficit ³	2.4	3.0	2.7	2.3	2.1	1.8	1.6
Treaty debt ratio ⁴	43.4	43.9	44.8	45.1	45.3	45.2	44.9
<i>Memo: Output gap</i>	-0.1	0.2	-0.3	0.0	0.0	0.0	0.0

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

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

³ General government net borrowing on a Maastricht basis.

⁴ General government gross debt on a Maastricht basis.

MEETING THE FISCAL RULES

Golden rule 4.3 The average surplus on the current budget since the start of the 1997-98 cycle is positive in every year of the projection period. The economy appears to have passed through trend in the final quarter of 2006. On this basis, and based on cautious assumptions, the Government would have met the golden rule with a margin of £18 billion, higher than estimated at the Budget.

4.4 With the economy appearing to have passed through trend in the final quarter of 2006, the projections show that the current budget moves into surplus in 2009-10, with the surplus rising to 1.1 per cent of GDP by 2012-13. At this early stage, and based on cautious assumptions, the Government is therefore on course to meet the golden rule in the next economic cycle.

4.5 The deficit on the current balance in 2006-07 is £4.7 billion lower than expected at the Budget, due to continued success in tackling MTIC fraud and growth in consumer expenditure feeding through to higher-than-expected VAT payments. The deficit is also reduced by lower government expenditure than expected at the Budget, in particular spending by local authorities. The 2006-07 outturn for net borrowing is £3.9 billion lower than the Budget 2007 estimate.

4.6 From 2005-06 to 2006-07 the deficit on the current balance fell by £9.3 billion, or 0.8 per cent of GDP. Net borrowing in 2006-07 fell by 0.7 per cent of GDP compared with 2005-06. The fall in borrowing is slightly less than the fall in the current deficit, due to the 0.1 per cent of GDP rise in net investment in 2006-07.

Sustainable investment rule 4.7 Despite output having been generally below trend since 2001, net debt remains below 39 per cent of GDP and starts to decline by the end of the projection period, reaching 38.6 per cent of GDP 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.

The economic cycle 4.8 Since Budget 2007, upward revisions to estimates of non-oil GVA growth in 2006, combined with estimates of 0.8 per cent growth in each of the first two quarters of 2007, show the UK economy to have been growing at slightly above-trend rates for seven consecutive quarters through to mid-2007. Evidence from the broad range of cyclical indicators monitored by the Treasury, the latest National Accounts data and the Treasury's trend output assumptions imply output passed through trend towards the end of 2006 and that a small positive output gap, of around a ¼ per cent, has opened up. However, it is too soon to assess whether or not the economic cycle has ended.

European commitments 4.9 Table 4.1 shows the Treaty measures of debt and deficit used for the purposes of the Excessive Deficit Procedure – Article 104 of the Treaty. The projections are consistent with the Government's prudent interpretation of the Stability and Growth Pact. These projections meet the EU Treaty reference value for general government gross debt (60 per cent of GDP) by a considerable margin. The Treaty deficit in 2006-07 was 2.6 per cent of GDP. The deficit rises to 2.9 per cent of GDP in 2007-08 and then falls in each year of the forecast.

4.10 The rise in borrowing compared with Budget 2007 projections is concentrated in 2007-08 and 2008-09, driven in part by recent financial market disruption and the consequent impact on the economy. Other factors which reduce receipts in 2007-08 compared to the Budget are a fall in North Sea revenues, as a result of lower-than-

expected gas prices, and a series of one-off corporation tax repayments. In 2008-09 receipts are also lower due to reduced oil production forecasts.

4.11 With output close to or at trend throughout the projection period, the profile of cyclically-adjusted borrowing is very similar to that of the headline measure. Both measures are expected to rise in 2007-08 before falling in every year of the projection period. Cyclically-adjusted borrowing is slightly higher than the main aggregate in 2007-08 because the economy appears to be slightly above trend in this year.

4.12 With net debt forecast to remain below 39 per cent, falling to 38.6 per cent by the end of the projection period, and general government gross debt forecast not to exceed 45.3 per cent throughout the forecast period, the Government is demonstrating its continued commitment to long-term sustainability and meets the EU Treaty reference value for general government gross debt by a considerable margin. This is also consistent with the increased focus on sustainability in the reforms to the Stability and Growth Pact, agreed in March 2005.

4.13 The UK's low debt levels and sustainable fiscal position provide the Government with the flexibility to invest in its public services (see Chapter 6 for further details). The fiscal framework has protected an historically unprecedented increase in public sector net investment, while net debt has been maintained at a low and sustainable level. This is consistent with both the Integrated Guidelines and the UK's Lisbon National Reform Programme.

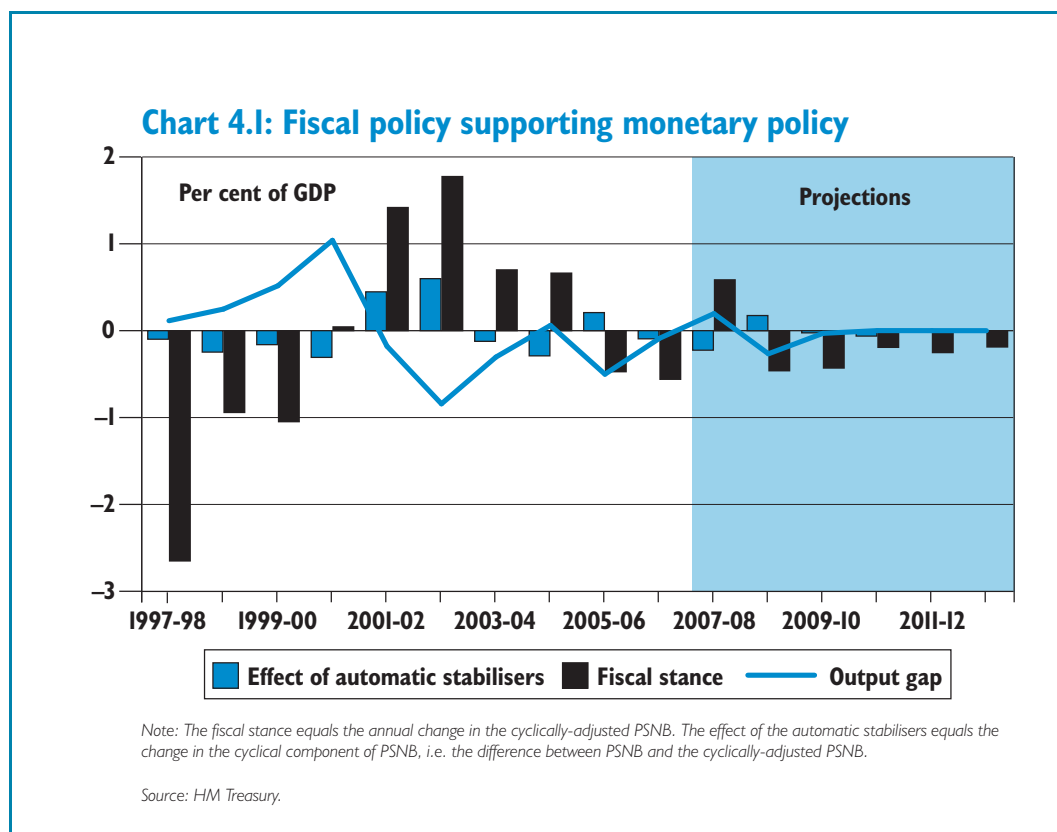
Automatic stabilisers

4.14 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. These can be broken down into changes due to the effects of the automatic stabilisers and those due to the change in the fiscal stance, as illustrated in Chart 4.1.

4.15 During the late 1990s, the fiscal stance and the automatic stabilisers tightened at a time when the economy was above trend. As the economy moved below trend in 2001, the automatic stabilisers and the fiscal stance supported the economy. With the output gap closing and the economy appearing to have passed through trend in the final quarter of 2006, the fiscal stance was tighter in 2005-06 and 2006-07 and further tightening of the fiscal stance is forecast over the projection period, except in 2007-08. These projections show the public finances accommodating the impact of financial market disruption with borrowing increasing in 2007-08 and with modest discretionary fiscal loosening in 2007-08 and 2008-09 helping to smooth the path of the economy. From 2008-09 borrowing falls year on year, supported by discretionary fiscal tightening from 2009-10, the impact of which builds towards the end of the projection period.

Cyclically adjusted aggregates

4.16 Cyclical adjustment cannot take account of non-cyclical temporary shocks to the public finances, nor cyclical shocks with different impacts than those experienced in the past. Therefore to the extent that cyclical adjustment is not taking account of the impact of temporary financial market disruption, structural PSNB may be lower than Pre-Budget Report projections suggest.



Current and capital budgets 4.17 Table 4.2 provides more detail on the projections for the current and capital budgets for the public sector.

Table 4.2: Current and capital budgets

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

¹ Net of asset sales; for a breakdown see Table 17 in Pre-Budget Report and Comprehensive Spending Review 2007: the economy and public finances - supplementary charts and tables.

² General government net borrowing on a Maastricht basis.

³ General government gross debt on a Maastricht basis.

ECONOMIC ASSUMPTIONS FOR THE FISCAL PROJECTIONS

4.18 The Treasury's neutral estimate of the economy's trend rate of output growth remains at 2¾ per cent a year to the end of the projection period, the same assumption that underpinned the previous two economic forecasts.¹⁴

The cautious approach

4.19 The fiscal projections assume that the economy follows the path described in Chapter 3. In the interests of caution, these projections are based on the assumption that trend output growth will be ¼ percentage point lower than the Government's neutral view.

4.20 The main domestic economic assumptions are summarised in Table 4.3.

Table 4.3: Economic assumptions for the public finance projections

	Percentage changes on previous year						
	Outturn	Estimate	Projections				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Output (GDP)	3	3	2	2¾	2½	2½	2½
Prices							
CPI	2½	2¼	2	2	2	2	2
GDP deflator	2¾	3¼	2¾	2¾	2¾	2¾	2¾
RPI ¹ (September)	3½	4	2¾	2¾	2¾	2¾	2¾
Rossi ² (September)	3	2¼	2½	2¼	2¼	2¼	2¼
Money GDP ³ (£ billion)	1,323	1,404	1,471	1,550	1,630	1,714	1,802

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

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

³ Not seasonally adjusted.

4.21 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 4.1. None of these assumptions were due for review in the Pre-Budget Report.

¹⁴ For a full discussion of the most recent review of the Treasury's trend growth projections, see *Trend growth: new evidence and prospects*, HM Treasury, December 2006.

Box 4.1: Key assumptions audited by the NAO^a

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

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

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

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

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

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

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

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

Forecast differences and risks

4.22 The fiscal balances represent the difference between two large aggregates of expenditure and receipts, and forecasts are inevitably subject to wide margins of uncertainty. Over the past ten years, the average absolute difference between year-ahead forecasts of net borrowing and subsequent outturns has been around 1 per cent of GDP. This difference tends to grow as the forecast horizon lengthens and uncertainties increase accordingly. A full account of differences between the projections made in Budget 2005 and Budget 2006, and the subsequent outturns is provided in the 2007 *End of year fiscal report*, published alongside the 2007 Pre-Budget Report.

Box 4.2: Forecasting

The table below provides a summary comparison of the year-ahead projections for main fiscal aggregates in Budget 2005 and Budget 2006 compared with the latest outturn information. More information is set out in the 2007 *End of year fiscal report*.

	Per cent of GDP					
	2005-06			2006-07		
	Budget 2005 Forecast	Outturn	Difference	Budget 2006 Forecast	Outturn	Difference
Surplus on current budget	-0.5	-1.1	-0.7	-0.5	-0.4	0.2
<i>Memo: average absolute difference, current budget, since 1998-99</i>			0.8			0.8
Cyclically-adjusted surplus on current budget	-0.3	-0.9	-0.6	0.4	-0.2	-0.6
Public sector net borrowing	2.6	3.0	0.4	2.7	2.3	-0.4
<i>Memo: average absolute difference, net borrowing, since 1970-71</i>			1.1			1.1
Cyclically-adjusted public sector net borrowing	2.4	2.8	0.4	1.8	2.2	0.4
Public sector net debt	35.6	36.1	0.5	36.7	36.7	-0.1

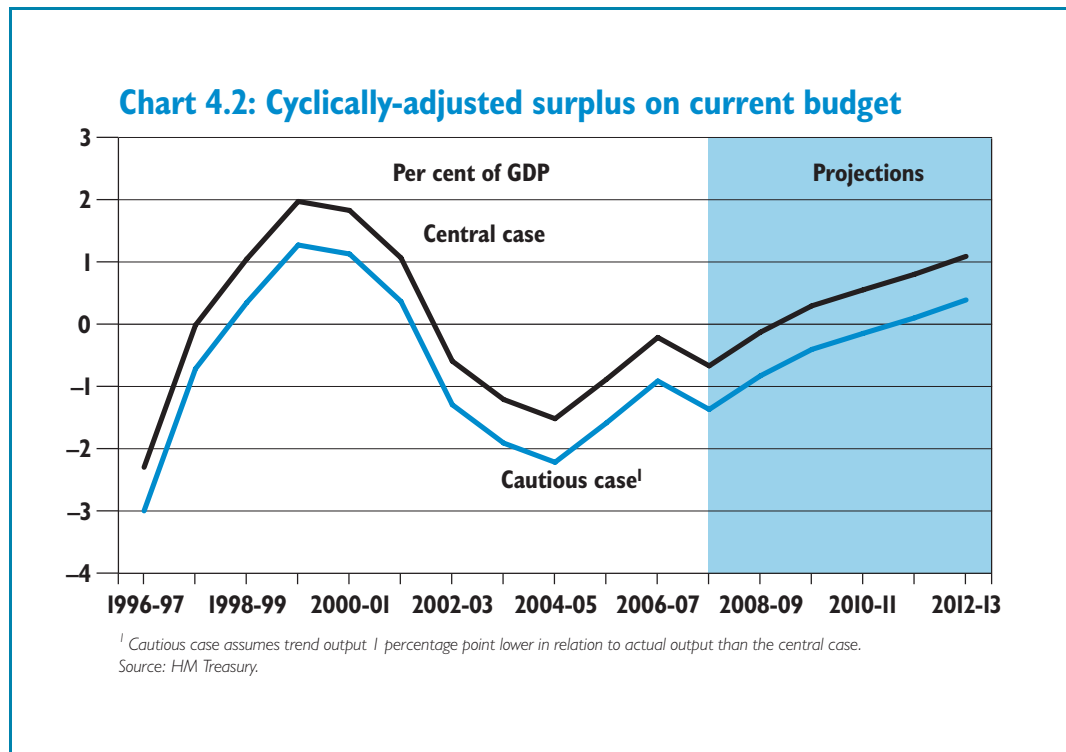
Note: figures may not sum due to rounding.

4.23 The 2007 *End of year fiscal report* examines fiscal trends in recent years and forecast performance, measured in terms of accuracy and caution. The key findings of this assessment are:

- the year-ahead net borrowing forecast has on average been cautious since the introduction of the new macroeconomic framework in 1997;
- since the introduction of the new macroeconomic framework two-year ahead net borrowing forecasts have performed similarly well in terms of caution as they did in the period before 1997-98; and
- the overall accuracy of one-year ahead and two-year ahead PSNB forecasts has remained broadly unchanged compared with the period before 1997-98.

4.24 In addition to basing the public finance forecasts on cautious assumptions, including one of lower trend growth, it is also sensible to test the robustness of these projections. The projections are 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.

This addresses an important source of potential error, from misjudging the position of the economy in relation to the trend level of output. Chart 4.2 illustrates the projections for this cautious case and shows that the cyclically-adjusted balance will be in surplus at the end of the projection period.



4.25 Treasury forecasts for GDP growth since 1997 have, on average, outperformed the independent consensus. They 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).

Risks 4.26 The disruption in global financial markets has meant economic prospects have become more uncertain. It presents clear risks to the economic forecast, though these are judged to be broadly balanced. Considerable uncertainty surrounds the timing and extent to which the disruption might affect the wider economy, and the longer it persists, the greater the risk of it detracting from growth. However, the UK economy has proved resilient to a number of shocks over the past decade, demonstrating the success of the Government's macroeconomic framework and the promotion of open and flexible labour, product and capital markets. As such, growth could also slow by less than expected.

Box 4.3: The impact of the financial sector on the economy and public finances

As outlined in more detail in Chapter 3, financial market disruption has had an impact on UK and global financial markets. Such events have the potential to impact on the wider economy through the price and availability of credit for companies and individuals, which could dampen private consumption and investment growth. It is not yet clear what the extent or duration of any impact might be. For the purposes of the economic forecast, it has been assumed that there will be some feed-through to tighter credit conditions and to household and company spending in the short term.

The performance of the financial sector also impacts on the public finances, most directly through financial company corporation tax and income tax and NICs on bonuses, where receipts from the sector are significant. While the effect on the public finances of current global financial market disruption is uncertain, the projections for the public finances allow for an impact on receipts from corporation tax and income tax and NICs, along with other factors.

The financial sector is not only important in terms of its impact on the wider economy, but also as a successful industry, one in which Britain is a global leader. Financial companies' share of UK GDP and of overall corporate profits has been on an upward trend for over two decades. The sector has successfully weathered major financial disruption in the past, such as the Russian debt default and Long Term Capital Management (LTCM) related disruption of 1998 and the global stock market falls in 2001.

The innovation and responsiveness of the City, against the backdrop of a stable UK economy, puts it in a strong position to adapt to global changes. The UK not only has a comparative advantage in financial services, but also in the wider business services sectors, including areas such as computer and information services and other business services.^a

^a *Productivity in the UK 6: Evidence and Progress*, HM Treasury, 2003.

GENERAL GOVERNMENT FINANCES

4.27 Table 4.4 gives a breakdown of general government finances.

Table 4.4: General government transactions by economic category

	£ billion				
	Outturn 2006-07	Estimate 2007-08	2008-09	Projections 2009-10	2010-11
Current receipts					
Taxes on income and wealth	194.2	205.5	217.3	232.8	248.6
Taxes on production and imports	169.9	179.7	189.6	199.1	208.1
Other current taxes	30.3	31.9	33.6	35.4	37.3
Taxes on capital	3.6	3.9	3.3	3.3	3.3
Compulsory social contributions	90.9	95.8	101.7	108.2	114.3
Gross operating surplus	12.6	14.0	14.8	15.7	16.6
Rent and other current transfers	1.8	2.1	2.1	2.3	2.5
Interest and dividends from private sector and abroad	5.6	6.8	6.5	6.4	6.5
Interest and dividends from public sector	1.5	2.3	1.6	1.1	1.1
Total current receipts	510.4	542.0	570.5	604.3	638.3
Current expenditure					
Current expenditure on goods and services	287.1	306.3	320.7	335.5	352.4
Subsidies	8.7	9.3	10.0	10.4	10.1
Net social benefits	148.4	157.1	165.9	172.8	179.2
Net current grants abroad	-0.1	0.2	-0.5	-0.5	-0.1
Other current grants	34.0	37.0	38.7	40.3	42.1
Interest and dividends paid	28.1	30.7	29.8	31.8	33.5
AME margin	0.0	0.1	0.9	1.8	2.7
Total current expenditure	506.1	540.7	565.6	592.1	619.9
Depreciation	12.6	14.0	14.8	15.7	16.6
Surplus on current budget	-8.4	-12.8	-9.8	-3.5	1.8
Capital expenditure					
Gross domestic fixed capital formation	23.7	27.1	30.6	32.2	35.0
Less depreciation	-12.6	-14.0	-14.8	-15.7	-16.6
Increase in inventories	0.0	0.0	0.0	0.0	0.0
Capital grants (net) within public sector	1.4	0.6	0.5	0.5	0.5
Capital grants to private sector	14.8	15.1	16.1	17.2	17.8
Capital grants from private sector	-1.4	-1.1	-1.2	-1.3	-1.1
AME margin	0.0	0.9	0.1	0.2	0.3
Net investment	25.8	28.6	31.3	33.1	35.8
Net borrowing¹	34.2	41.4	41.1	36.6	34.0
of which:					
Central government net borrowing	32.5	38.6	37.5	32.2	29.8
Local authority net borrowing	1.7	2.7	3.6	4.4	4.3
Gross debt (Maastricht basis)					
Central government	511.7	553.8	595.5	634.5	671.9
Local government	62.7	62.0	63.0	64.6	66.2

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

4.28 The Eurostat definition of total revenues and expenditure used in Table 2 of the *Guidelines on the format and content of Stability and Convergence Programmes*¹⁵ differs from that used in the public finance projections outlined in this Convergence Programme. Both the UK projections and Eurostat classifications are ESA95 compatible. The differing total revenue and expenditure data is due to differing treatments of ESA95 components. For example, public sector pension contributions are included as receipts in the Eurostat definition, but are subtracted from net social benefits in the UK projections definition. Both classifications produce the same figures for the Treaty deficit, and for all other fiscal aggregates.

¹⁵ Available at http://www.europa.eu.int/comm/index_en.htm

DISCRETIONARY POLICY CHANGES IN THE PRE-BUDGET REPORT

4.29 In considering the impact of additional discretionary policy changes on the fiscal position, the Government has taken into account the following factors:

- the importance of ensuring the strict fiscal rules are met over the cycle;
- its broader, medium-term objectives for fiscal policy, including the need to ensure sound public finances and that spending and taxation impact fairly both within and between generations; and
- the need to ensure that fiscal policy supports monetary policy.

4.30 Consistent with the requirements of the *Code for fiscal stability*, the updated projections take into account the fiscal effects of all decisions announced in the Pre-Budget Report or since Budget 2007. This includes:

- an addition of £2 billion to total public sector net investment, in 2010-11, to take forward vital capital investment in public services;
- ensuring that all married couples and civil partners automatically benefit from double the standard inheritance tax allowance;
- reforming capital gains tax by introducing a single rate of 18 per cent, ensuring a more sustainable system that is straightforward and internationally competitive; and
- action to protect tax revenues and further modernise the tax system, including a number of measures to tackle tax avoidance.

DEVELOPMENTS ON THE REVENUE SIDE

4.31 The latest projections for general government receipts, contained in the 2007 Pre-Budget Report, are shown in Table 4.4.

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

Table 4.5: Public sector net borrowing compared with Budget 2007

	Outturn ¹	Estimate ²	Projections			
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Budget 2007 (£ billion)	35.0	33.7	30	28	26	24
Changes since Budget 2007						
Total economic and other forecasting effects	-3.9	4.0	6½	4	1½	3
Total before discretionary measures	31.0	37.6	36	32	27	27
Discretionary measures	0	0.4	½	-1	½	-1½
2007 Pre-Budget Report	31.0	38.0	36	31	28	25

Note: Figures 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.

Income tax and national insurance contributions

4.33 Cash receipts of income tax and national insurance contributions (NICs) in 2007-08 are expected to be £1.4 billion below their Budget 2007 projection, from a combination of the impact of the recent financial market disruption and higher than expected income tax repayments.

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

Non-North Sea corporation tax

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

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

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

North Sea revenues

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

operating and capital expenditure of North Sea firms and the continued appreciation of sterling against the dollar.

VAT 4.39 Cash receipts of VAT in 2007-08 are expected to be £1.4 billion above the Budget 2007 forecast, helped by the continuing success of the Government's strategy for tackling Missing Trader Intra-Community (MTIC) fraud and a stronger-than-expected rise in nominal consumer spending in the first half of 2007. Consumer spending accounts for around two-thirds of the VAT base and the stronger growth reflected both higher inflation and real spending growth, above the Budget 2007 forecast range.

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

DEVELOPMENTS ON THE EXPENDITURE SIDE

4.41 The spending projections cover the whole of the public sector, using the National Accounts aggregate Total Managed Expenditure (TME). For fiscal aggregates purposes, TME is split into National Accounts components covering public sector current expenditure, public sector net investment and depreciation. For budgeting and other purposes, TME is split into DEL (firm three-year limits for departments' programme expenditure) and AME (expenditure that is not easily subject to firm multi-year limits). Departments have separate resource budgets for current expenditure and capital budgets for investment.

4.42 Expenditure items that are large, potentially volatile and demand-led – such as social security benefits and debt interest payments – are collectively known as Annually Managed Expenditure (AME). These items are subject to tough scrutiny twice a year as part of the Budget and Pre-Budget Report process to ensure that volatility in AME does not threaten fiscal stability. The Government recognises the uncertainties in planning public expenditure, it allows for this through the DEL reserve and AME margin and remains vigilant to pressures and risks. Taken together, DEL and AME add up to Total Managed Expenditure (TME), the broadest measure of total public expenditure.

Spending plans for the CSR07 period

4.43 The challenges of the decade ahead require a balance to be struck between delivering further investment in public services to equip the country for change, while entrenching the macroeconomic stability that is essential in the increasingly competitive global economy. Budget 2007 set out the overall spending envelope for the CSR07 period, locking in the historic increases in investment since 1997 while allowing total public spending to increase by an average of 2 per cent per year in real terms. Having assessed the future investment needs of the country, the continued strength of the UK's public finances with net debt remaining below 39 per cent throughout the forecast period, enables the Government to announce an addition of £2 billion to total public sector net investment in 2010-11, to take forward vital capital investment in public infrastructure. With this addition, total public spending over the CSR07 period will rise from £589 billion in 2007-08 to £678 billion in 2010-11, an average increase of 2.1 per cent a year in real terms, with:

- current spending increasing by an average of 1.9 per cent per year in real terms; and
- net investment rising to 2¼ per cent of GDP.

Table 4.6: CSR07 spending envelopes

	£ billion			
	Estimate	Spending Plans		
	2007-08	2008-09	2009-10	2010-11
Total Managed Expenditure				
Budget 2007	586.6	615	644	674
Effect of neutral classification and depreciation changes to TME ¹	2.1	2.0	2.2	2.5
Discretionary policy additions ²	0.4	0.0	0.0	2.0
CSR 07	589.2	617.4	646.6	678.3
of which public sector current expenditure	541.2	566.0	592.5	620.3
of which public sector net investment	29.7	32.3	33.9	36.7
of which depreciation	18.3	19.1	20.2	21.2

¹ Includes changes to take account of the inclusion by the Office of National Statistics of imputed subsidies from Local Authorities to the Housing Revenue Account within public spending and changes to depreciation that reduce TME but leave net investment and current spending unaffected.

² Includes additional public sector net investment in 2010-11 and addition to the Special Reserve in 2007-08.

4.44 Within these overall envelopes, the 2007 CSR sets out the forecast for Annually Managed Expenditure (AME), consistent with the economic assumptions and policy decisions included in this report, and fixes firm departmental spending plans for the years 2008-09, 2009-10 and 2010-11. Table 4.7 sets out real growth over the CSR07 period in AME and Departmental Expenditure Limits (DEL) both of which grow at 2.1 per cent per year on average.

4.45 TME in all years is higher than at Budget 2007 because of a fiscally-neutral classification change for the public sector as a whole. In June 2007, the ONS changed its treatment of local authorities' Housing Revenue Accounts. In the National Accounts, these are regarded as 'quasi-corporations' and are included in the public corporations sub-sector. The effect of the change was to increase current expenditure of local authorities and receipts of public corporations by equal amounts in each year. This change added £1.6 billion to receipts and expenditure in 2006-07.

Table 4.7: CSR07 DEL envelope

	£ billion				Annual
	Estimate	Spending Plans			Average Real
	2007-08	2008-09	2009-10	2010-11	Growth
Departmental Expenditure Limits	344.6	361.1	377.5	396.9	2.1%
Annually Managed Expenditure	244.6	256.4	269.2	281.4	2.1%
Total Managed Expenditure	589.2	617.4	646.6	678.3	2.1%

Central government spending in 2006-07

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

4.47 Debt interest payments for the year to date are 19 per cent higher than the same period last year, largely because of the impact of higher RPI inflation on the accruing uplift of index-linked gilts payments. Although debt interest payments are expected to grow more strongly than in the Budget 2007 forecast, this growth is not expected to

continue because the pattern of RPI increases as they affect the uplift in 2007-08 differs from that which affected 2006-07.

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

4.49 Table 4.8 shows the allocation of Total Managed Expenditure and Table 4.9 shows Departmental Expenditure Limits, both resource and capital budgets.

Table 4.8: Total Managed Expenditure 2006-07 to 2010-11

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

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

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

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

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

⁴ This expenditure is mainly financed by council tax revenues.

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

Table 4.9: Departmental Expenditure Limits - resource and capital budgets

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

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

SUSTAINABILITY FOR THE LONG TERM

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

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

5.3 Since 2002, the Government has published the Long-term public finance report on an annual basis,¹⁶ with the intention of providing a comprehensive analysis of long-term socio-economic and demographic developments, and their likely impact on the public finances. The focus of the report is on long-term demographic trends such as the ageing of the population or changes to the overall population size over the coming decades and as such it relies on the latest available population projections for its analysis.

**New
population
projections**

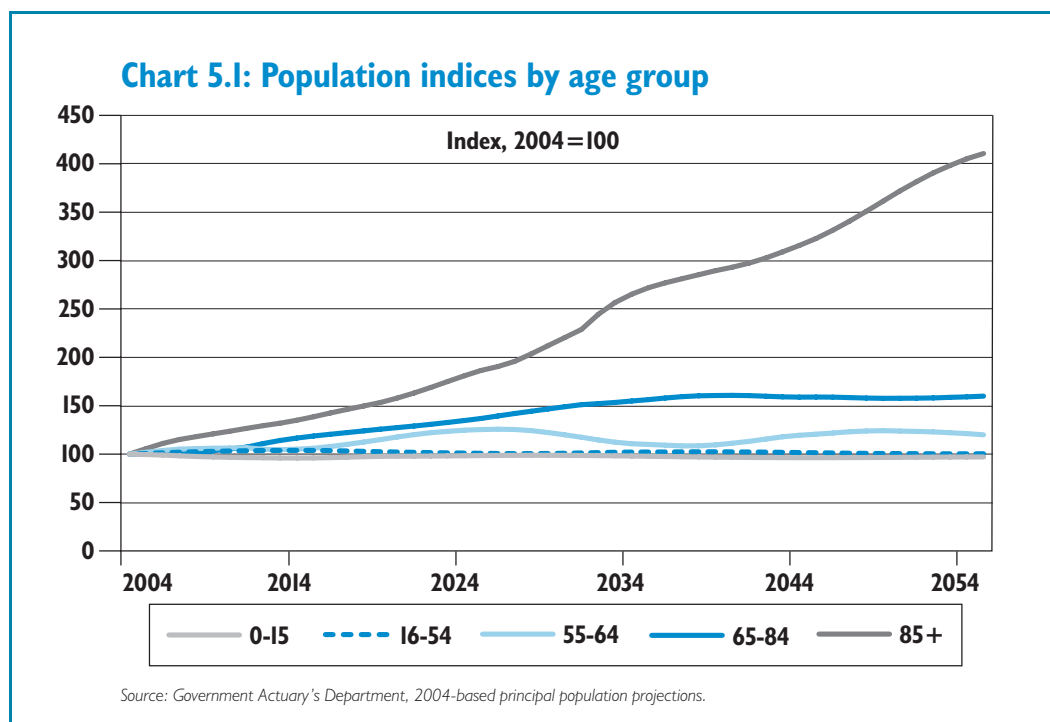
5.4 Up to 2005, the Government Actuary's Department (GAD) was the producer of the official population projections for the UK. This responsibility moved to the Office for National Statistics (ONS) in January 2006. The ONS published a new set of population projections on 23 October 2007. These projections were based on the mid-year population estimate for 2006, which the ONS published on 22 August 2007, and on a new set of assumptions regarding the key three vital statistics, i.e. fertility, net migration and longevity. These projections were therefore published too late to be included in an assessment of long-term sustainability at the time of the October 2007 Pre-Budget Report. The next Long-term public finance report will be published at a later date to ensure it incorporates the most up-to-date data.¹⁷

**Long-term
socio-
economic and
other trends**

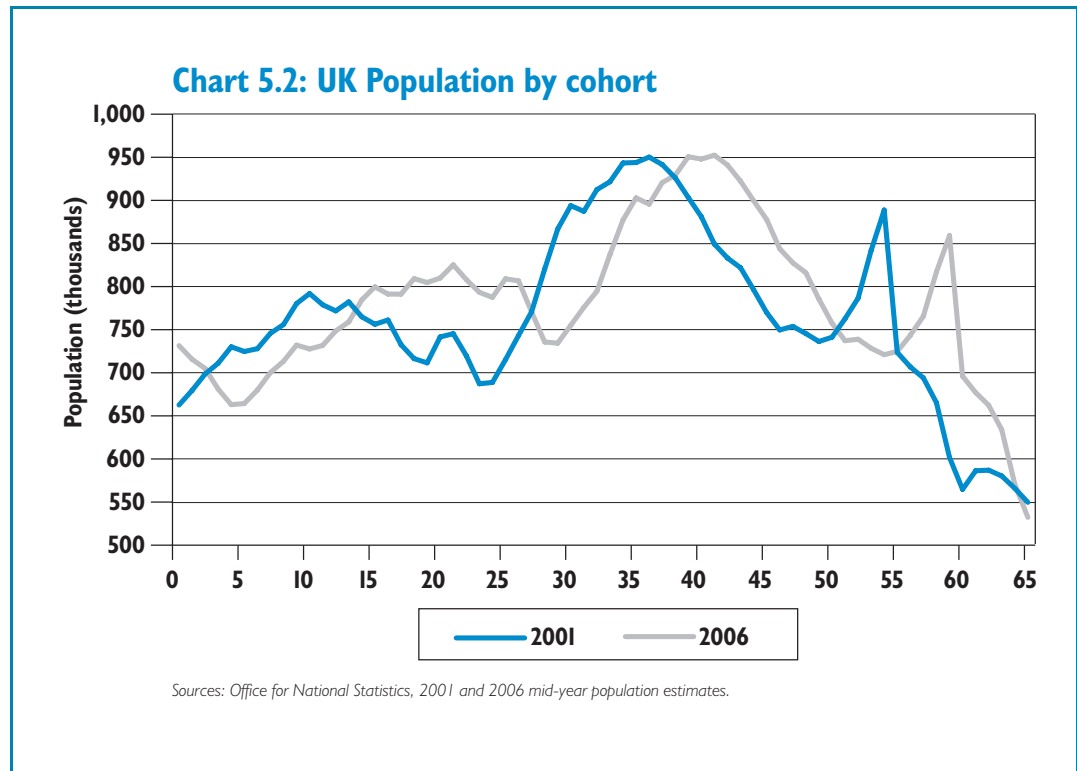
5.5 The Government is committed to updating and regularly reporting on its assessment of long-term fiscal sustainability, based on the most up to date information, so that the Government can make the right strategic policy decisions to address the long-term socio-economic challenges that it will face in the coming decades. For example, the structure of the UK population is projected to change dramatically over the coming decades, with only a fraction of these changes taking place over the next decade. This is illustrated by Chart 5.1: while the number of people aged 85 years and over is projected to quadruple over the next 50 years, using GAD's 2004-based projections, the projected increase over the next decade will be much more modest. Similarly, the UK's total population is projected to increase from around 60 million at present to 63½ million by 2017 but to reach near 70 million by mid-century. The projected increase over the long term is likely to create its own opportunities and challenges, which the UK will have to deal with in the decades ahead.

¹⁶ See, for example, the 2006 *Long-term public finance report: an analysis of fiscal sustainability*, HM Treasury, December 2006.

¹⁷ For information on the 2006-based population projections see <http://www.gad.gov.uk/Demography%5FData/Population/>.



5.6 Chart 5.2 shows the age distribution of the UK's population in 2001 and 2006. The two most prominent features for the 2001 distribution are the spike around the 55-year age group and the much larger hump around the 35-year groups. The former represents the immediate post-war baby boom, the latter the more sustained and pronounced second baby boom of the 1960s. By 2006, the large cohorts of the two baby booms had aged by five years, as represented by the shift to the right of the profile over these years. Females of the immediate post-war baby boom are now leaving the labour force and entering state pension age, with males following within the next few years. The cohorts of the second baby boom are currently at their prime in the labour market but will reach state pension age in the late 2020s to the early 2030s.



5.7 The 2006 *Long-term public finance report* provided a detailed analysis on how employment might evolve over the coming decades. Using the cohort method of projecting employment trends and GAD'S 2004-based principal population projections, the 2006 *Long-term public finance report* projected that periods of employment increases were balanced by periods of employment declines.¹⁸ As a result of this, employment changes are projected to have a neutral effect on long-term trend growth, with productivity the main source of real GDP growth.

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

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

¹⁸ See 2006 *Long-term public finance report: an analysis of fiscal sustainability*, HM Treasury, December 2006, pages 23 to 27 for a more detailed discussion of the employment trends projected using the cohort method.

ECONOMIC POLICY COMMITTEE (EPC) PROJECTIONS

5.10 The long-term projections presented in the 2006 *Long-term public finance report* are based on assumptions that differ in a number of ways from the commonly-agreed assumptions used by the Economic Policy Committee (EPC). The key differences in the underlying data used in the two sets of projections are explained in Chapter 5 of the 2006 *Convergence Programme for the United Kingdom*.

5.11 As well as different assumptions, the EPC's budgetary projections also use different modelling and projection methodologies for health, long-term care and education expenditures.¹⁹ For the pension projections, the same methodologies are used for both sets of projections (though using different underlying assumptions).

¹⁹ See *The 2005 projections of age-related expenditure (2004-2050) for the EU-25 Member States: underlying assumptions and projection methodologies*, European Union Economic Policy Committee, November 2005, for a full explanation of the assumptions and methodologies agreed by the EPC.

QUALITY OF PUBLIC FINANCES

6.1 The macroeconomic stability and sound public finances set out in previous chapters provide the platform for delivering the Government's goal of world-class public services, through a combination of sustained investment in key areas alongside reforms to improve the effectiveness, efficiency and responsiveness of public services.

Progress over the last decade

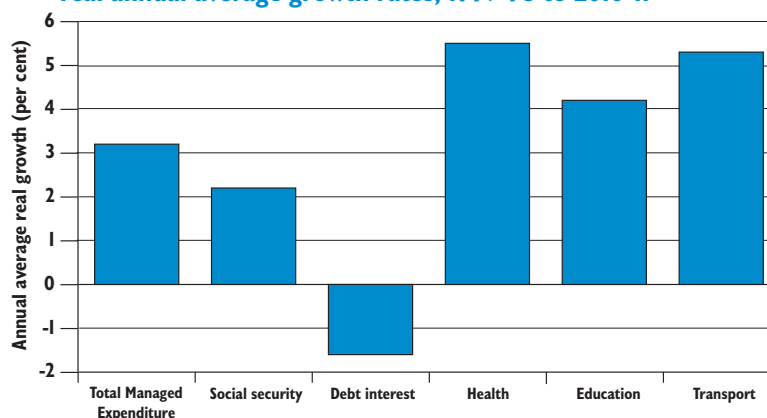
Sustained investment in public services

6.2 Ten years ago the Government began its programme of public service transformation with the launch of the first Comprehensive Spending Review (CSR) – a fundamental and in-depth examination of public spending to re-focus resources on its urgent priorities such as health and education. Building on the platform of stability provided by the new macroeconomic and fiscal frameworks, the 1998 CSR and subsequent Spending Reviews in 2000, 2002 and 2004 delivered sustained increases in spending for key public services, tackling the legacy of decades of under-investment. This year, compared with 1997-98:

- spending on the National Health Service is nearly 90 per cent higher in real terms;
- total spending on education is over 60 per cent higher in real terms, and as a proportion of GDP has risen from 4.5 to 5.5 per cent – from one of the lowest in the industrialised world to among the highest;
- public expenditure on transport is over 60 per cent higher in real terms; and
- spending on the police, criminal justice system and wider public order and safety is over 50 per cent higher in real terms.

6.3 These increases in spending have been made possible by the stable and sustainable economic growth described in previous chapters, with falling debt interest payments and low unemployment releasing resources for key priorities, as illustrated by Chart 6.1.

Chart 6.1: Releasing resources for priorities – real annual average growth rates, 1997-98 to 2010-11



Source: HM Treasury.

Building the framework for delivery

6.4 This additional investment has been matched by a series of steps to reform the public spending and performance management frameworks, driving improvements in outcomes and increasing value for money:

- the 1998 CSR set for the first time fixed, three-year budgets for all departments, separated into resource and capital spending, removing the previous bias against investment and enabling public services to plan for the long term. Departments were given full end-year flexibility to carry forward any underspends from one year to the next to help prevent wasteful end-year surges in spending. The 1998 CSR also saw the introduction of the first systematic, transparent, outcome-focused performance management system for public services, in the form of Public Service Agreements (PSAs);
- the 2000 and 2002 Spending Reviews saw the introduction of Resource Accounting and Budgeting to capture accurately the full cost of running public services and sharpen asset management incentives. They also saw further improvements to the PSA framework and targets, including the introduction of selected value for money targets within PSAs and formal monitoring of PSA delivery; and
- the 2004 Spending Review represented the first systematic attempt to drive operational efficiencies across the public sector through the review led by Sir Peter Gershon, focusing on key processes that are common across government and bringing the performance of all delivery units up to the level of the best.

Improvements in outcomes

6.5 By matching this sustained growth in spending with ambitious reforms to support the efficiency, delivery and accountability of public services, the Government has been able to raise standards and achieve major improvements in outcomes across key services:

- deaths from cancer have fallen by 14 per cent, and from heart disease by 31 per cent. In total, over 200,000 lives have been saved since 1996 as a result of reductions to mortality rates from cancer and circulatory diseases among people aged under 75;
- in education, over 58 per cent of 16 year olds now achieve five or more good GCSEs, up from 45 per cent in 1997, with some of the biggest improvements seen in disadvantaged areas with a history of low achievement;
- the number of offences brought to justice has increased by 40 per cent in the last five years, overall crime has fallen by around a third in the last ten years, the fear of crime has reduced and re-offending rates fell by 6.9 per cent between 1997 and 2004; and
- the transport system is improving, with over 100 road schemes completed, people travelling further by rail than in any year since the 1940s and bus use increasing year on year for the first time in decades.

The next decade

6.6 While much has been achieved in the past decade, the context in which public services operate is changing rapidly, becoming increasingly challenging and complex.

The social, economic and environmental trends affecting the UK are generating new pressures on public services, and these developments together with the achievements of the past ten years are generating rising expectations from the public.

6.7 To ensure that public services are ready to respond to these challenges, over the last two years the Government has been consulting with frontline professionals, outside experts and the public to prepare for a second Comprehensive Spending Review. This lays the foundations for the transformation of the UK's public services over the next ten years through a strategy based on three strands:

- **investing in the UK's future**, focusing sustained additional resources on the key services that are crucial to meet long-term challenges and tackle the barriers to individual fulfilment and economic success; and
- **embedding value for money** in departmental expenditure planning, building on the SR04 efficiency programme with more ambitious reforms to release £30 billion of savings by 2010-11 to reinvest in further improvements in public services; and
- **driving forward the next stage of reform**, including through a new performance management framework which defines the Government's top 30 priorities for the coming period, and empowers the public and frontline professionals to shape the services needed to deliver excellent outcomes and experiences for all.

INVESTING IN THE UK'S FUTURE

The fiscal framework

6.8 The last decade has shown how it is possible to deliver a strong economy and sound public finances at the same time as sustained investment in public services. The Government's fiscal rules have been central to this achievement, and will continue to provide the framework for the CSR07 period, ensuring that the public finances are prudently managed over the economic cycle and that spending and taxation impact fairly between generations – removing the past discrimination against capital spending and ensuring that borrowing for investment is conducted in a sustainable way. This framework has helped protect significant increases in the level of public sector net investment from ½ per cent of GDP in 1997-98 to 2.1 per cent of GDP this year – addressing the backlog of under-investment in public services and putting in place some of the vital infrastructure required to promote the UK's economic growth and productivity.

6.9 The challenges of the decade ahead require a balance to be struck between delivering further investment in public services to equip the country for change, and entrenching the macroeconomic stability that is essential in the increasingly competitive global economy. Chapter 4 sets out the overall spending envelope for the CSR07 period, with:

- current spending increasing by an average of 1.9 per cent per year in real terms; and
- net investment rising to 2¼ per cent of GDP.

Investing in priorities

6.10 Together with the resources released from the Government's ambitious value for money programme for the CSR07 period, described in more detail below, these increases in spending will enable the Government to sustain the pace of improvement

in public services and focus additional resources on its key long-term priorities, including:

- meeting the challenge of globalisation by investing in the human and physical capital that will keep the UK economy competitive over the long term, with additional spending by 2010-11 of £14.5 billion on education, £900 million on science and £3.6 billion on transport;
- making the UK a better place to live by continuing to improve the NHS with further investment of £19 billion by 2010-11 and progressing towards its objective of decent and affordable housing for all, with total spending on new housing of at least £8 billion over the next three years, a 50 per cent increase;
- protecting the nation from external and internal threats, with total spending on counter-terrorism and intelligence rising from £2.5 billion in 2007-08 to £3.5 billion in 2010-11 and continuing the longest period of sustained real increases in defence expenditure in over 25 years; and
- ensuring a lasting cultural and sporting legacy for the nation by investing £3.6 billion in the construction costs of the Olympics over the CSR07 period, with further funding to be confirmed in subsequent spending reviews.

6.11 Table 6.1 shows total allocations made to each department by the 2007 CSR for the years 2008-09, 2009-10 and 2010-11.

Table 6.1: Comprehensive Spending Review total DEL settlements

	£ billion				Per cent
	Baseline ¹ 2007-08	2008-09	Plans 2009-10	2010-11	Average annual real growth ²
Resource and net capital DEL					
Children, Schools and Families	50.1	52.9	55.6	59.5	3.1
Health	91.8	97.9	104.4	111.4	3.9
<i>of which: NHS England</i>	90.4	96.4	102.9	109.8	4.0
Transport	12.6	13.4	13.8	14.5	2.1
Innovation, Universities and Skills	18.0	18.7	19.7	20.8	2.2
CLG Communities	10.3	11.3	11.8	12.1	2.9
CLG Local Government ³	23.9	24.8	25.7	26.5	0.9
Home Office	9.2	9.8	9.9	10.3	1.1
Justice	9.5	9.6	9.7	9.7	-1.7
Law Officers' Departments	0.7	0.7	0.7	0.7	-3.2
Defence	32.6	34.1	35.4	36.9	1.5
Foreign and Commonwealth Office	1.6	1.7	1.7	1.7	-0.1
International Development	5.4	5.8	6.8	7.9	11.0
Business, Enterprise and Regulatory Reform	3.4	3.4	3.4	3.4	-2.6
Environment, Food and Rural Affairs	3.5	3.7	3.8	4.0	1.4
Culture, Media and Sport	1.7	2.6	2.0	2.2	6.6
Work and Pensions	7.7	7.5	7.3	7.0	-5.6
Scotland	26.1	27.2	28.4	29.8	1.8
Wales	13.6	14.3	15.0	15.8	2.4
Northern Ireland Executive	8.4	8.8	9.2	9.6	1.7
Northern Ireland Office	1.2	1.2	1.2	1.2	-1.9
Chancellor's Departments	4.9	4.8	4.7	4.6	-4.9
Cabinet Office	1.9	2.2	2.4	2.5	7.2
Independent Bodies ⁴	0.8	0.8	0.9	1.0	4.9
Modernisation Funding	-	0.5	0.4	0.1	
Reserve	2.5	3.2	3.5	3.8	-
Total DEL	344.6	361.1	377.5	396.9	2.1

¹ Baselines exclude one-off and time limited expenditure² Average annual real growth rates are calculated off a 2007-08 baseline³ Resource growth for local Government is 1.0%⁴ Independent bodies within Departmental Expenditure Limits that are not settled as part of the Comprehensive Spending Review. Includes the Statistics board, House of Commons, House of Lords, National Audit Office and the Office of the Parliamentary Commissioner.

Improving transparency and accountability

6.12 As announced in *The Governance of Britain* Green Paper, the Government intends to strengthen Parliament's ability to hold Ministers to account for public spending by ensuring that it reports to Parliament in a more consistent fashion, in line with the fiscal rules, on departmental budgets set in Spending Reviews, in annual Estimates and in resource accounts. The Government will be consulting Parliament and others with an interest on how best to take forward this reform, with the aim of introducing changes before the end of the CSR07 period.

6.13 Budget 2007 announced that from 2008-09 the annual accounts of government departments and other public sector bodies would be prepared using International Financial Reporting Standards (IFRS), adapted as necessary for the public sector. The Government is developing an IFRS-based Financial Reporting Manual for the public sector and considering how best to manage the transition. Where necessary, IFRS standards may be adapted for the public sector to support the Government's wider aim

of improving transparency from the fiscal rules through budgets, Estimates and accounts.

EMBEDDING VALUE FOR MONEY

SR04 Efficiency Programme

6.14 The Government recognises that additional resources alone are not enough to secure excellent and modern public services. Increased investment must be matched by an unwavering commitment to maximise the value of every pound of taxpayers' money. Sir Peter Gershon's Independent Review of Public Sector Efficiency in 2004 marked a major step forward in embedding value for money into the planning and delivery of public services. In line with his recommendations, and as part of the 2004 Spending Review, the Government set an aim to achieve annual efficiency gains of £21.5 billion by 2007-08, alongside significant reductions and relocations in the civil service and public sector workforce. The programme remains on track to deliver these goals, with departments and local authorities reporting at the end of June 2007:

- annual efficiency gains of over £20 billion, meaning that the Government has achieved the high-level ambition set out by the Gershon review, and is on track to deliver the goal of £21.5 billion by the end of March 2008, as agreed by departments at the 2004 Spending Review;
- gross reductions of over 79,000 civil service and administrative and support-related military posts towards the target of 84,150, with over 13,000 of these reallocated to frontline roles; and
- continued progress against the ambitions of the Lyons Review, with 13,300 public sector posts relocated away from London and the South East since the programme began.

6.15 As the National Audit Office noted earlier this year, the programme is having a clear positive impact on the efficiency of public services, with many examples of improvements in the way public services are being delivered, including:

- the Ministry of Defence has rolled out a single personnel management system for all three armed services, improving services to staff – for example by reducing the time taken for service personnel allowances to arrive in bank accounts from six weeks to six days – and saving over £45 million a year;
- better management of patient admissions has reduced the average length of hospital stay, cutting costs by over £500 million a year and freeing up over 1 million bed days to treat more patients, more quickly; and
- the Department for Transport has achieved over £60 million of efficiency gains by switching services to online channels, such as the booking of driving tests, with the convenience of being available 24 hours a day.

Value for money in the 2007 CSR

6.16 Building on the achievements of the SR04 efficiency programme, the Government has developed a more ambitious and far-reaching value for money programme for the CSR07 period – releasing the resources needed to sustain the pace of public service improvement and meet the global challenges of the decade ahead. As part of this programme the Government has:

- deepened the government-wide efficiency programme in the operational areas established by the Gershon Review, harnessing the benefits of greater collaboration across organisations and engaging with frontline professionals to identify opportunities for service improvements;
- conducted a series of zero-based reviews of departments' baseline expenditure, taking a radical look at the way that government spends money on policies and programmes ten years on from the first CSR;
- provided over £1 billion in modernisation funding to help departments meet the up-front costs associated with the implementation of their value for money programme;
- integrated pay and workforce planning more closely into departments CSR07 preparations, to ensure that pay spending represents value for money for taxpayers and supports macroeconomic stability; and
- improving the management of the public sector asset base to underpin service delivery, taking forward the recommendations of the Lyons Review of Asset Management.

6.17 Each department has bought the elements together into a coherent and comprehensive strategy for improving services and driving value for money gains over the full range of their activities in the CSR07 period, enabling the Government to commit to:

- **at least 3 per cent value for money savings per year over the CSR period across central and local government**, all net of implementation costs, cash-releasing and totalling over £30 billion of annual savings by 2010-11, thereby maximising the resources available to improve frontline services and fund new priorities;
- **5 per cent annual real reductions in administration budgets across departments**, as a successor to the SR04 workforce reduction target and thereby ensuring significant additional resources are redirected to public service delivery; and
- **the release of £30 billion from fixed asset disposals between 2004-05 and 2010-11** as well as further funds from the sale of financial assets for reinvestment in new infrastructure.

Box 6.1: Examples from the CSR07 value for money programme

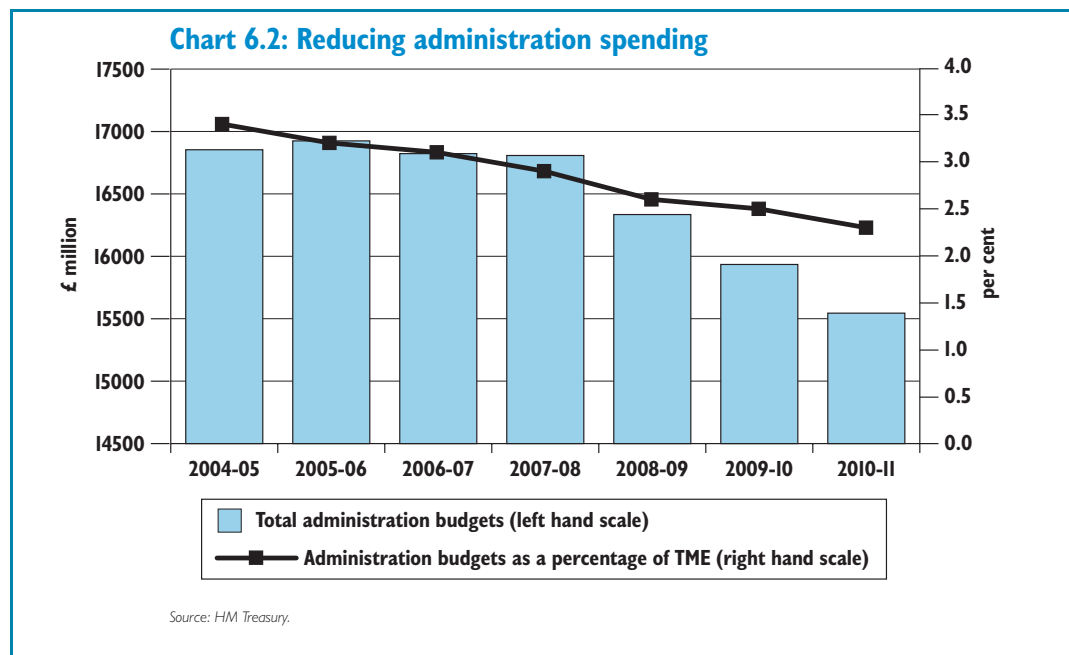
- Alongside increased investment, the National Health Service is delivering savings of at least £8.2 billion a year by 2010-11, including up to £500 million from improving community-based services so that people with long-term conditions can receive greater support in the community; £1.5 billion by reducing variations in productivity across the NHS through the use of new technologies and sharing best practice; and £1 billion from improved procurement practices.
- HM Court Service's Business Strategy aims to generate savings of around £100 million by 2010-11 through reforms aimed at placing the public at the centre of court operations, with services designed around their needs. HMCS aims to build on existing success in managing court caseloads by enabling better case progression through improved technology, introducing simpler, more proportionate procedures for the simplest cases and diverting cases that should not come to court to other methods of resolution.
- HM revenue and Customs will generate total savings of £673 million by March 2011 through a programme of modernisation and reform across the department. £125 million of these savings will be achieved by investing in a modern, high capacity IT infrastructure to support higher take-up of online services, more efficient processing and communication of information and better risk-based compliance checks. In addition, the department will extend the use of lean processing techniques to make more efficient use of resources and undertake a major consolidation and transformation of HMRC's estate to release £280 million annual savings by 2010-11.
- The Foreign and Commonwealth Office has developed plans to save at least £22 million a year by 2010-11 by sharing services with other public bodies at home and overseas, including increased co-location with the Department for International Development.

**Monitoring
CSR07 savings**

6.18 The SR04 efficiency programme has demonstrated the importance of public accountability as a powerful driver for improved value for money. By the end of the year, departments will publish value for money Delivery Agreements setting out how they will achieve their proposed savings, and departments will monitor and report on progress throughout the CSR07 period. Reflecting the higher level of ambition in the CSR07 programme, the new monitoring and reporting framework will put more emphasis on mainstreaming value for money into core departmental business, including through stronger integration with the PSA framework. Greater accountability will therefore be devolved to departments, with common requirements for reporting progress to the public to ensure rigour and consistency. The Government also expects that the National Audit Office will play an important role in reviewing reported savings, providing Parliament and the public with a further level of assurance.

**Administration
budgets**

6.19 By harnessing the potential of new technologies and increasing efficiency in the running of departmental business, the Government will be able to make further progress in reducing the proportion of taxpayers' money that is spent on administrative functions within departments and the core civil service. Having frozen administration budgets in nominal terms over the 2004 Spending Review period to ensure that all additional expenditure went directly to frontline services, the Government will go further over the CSR07 period with 5 per cent annual real reductions in administration budgets across all departments, releasing over £1.2 billion by 2010-11 for investment in priority areas and reducing the running costs of central government to a record low as a percentage of public spending.



Pay and workforce planning

6.20 The Government's commitment to high quality public services can only be realised through the skills and dedication of public sector workers. Over the last ten years the Government has therefore sought to increase the number of frontline professionals, with 36,000 more doctors than in 1997, 79,000 more nurses, 35,000 more teachers and 102,000 more teaching assistants. Training has been improved and pay increased significantly to reflect the crucial contribution of public service professionals to the country. The competitiveness of the public sector reward package, which includes valuable pension benefits, is demonstrated by healthy levels of recruitment and retention.

6.21 Over the CSR07 period, the Government is committed to continuing to support public sector professionals in their efforts to deliver the best possible public services, with departments taking forward their workforce planning for the CSR07 period consistent with the following objectives:

- maintaining macroeconomic stability in order to promote growth and employment, with public sector pay settlements consistent with the achievement of the Government's inflation target of 2 per cent, as set out in more detail in Chapter 2;
- ensuring total pay bills represent value for money and are affordable within departments' overall expenditure plans, taking into account other spending that is key to service improvements and the ability of staff to do a good job, such as equipment and new technologies; and
- maintaining the necessary levels of recruitment and retention needed to support service delivery, taking into account the wider labour market conditions relevant to the public sector.

Improving asset management

6.22 Public investment in infrastructure is crucial both to underpin the delivery of high quality public services and to help increase the flexibility and productivity of the wider economy. In order to take full advantage of the sustained investment over the past decade, the 2007 CSR will introduce a more strategic approach to the management of public assets, driving better value for money and supporting improvements in frontline services. Each department is therefore developing an asset management strategy, to be published by the end of the year, which will ensure that:

- assets are adequately maintained and efficiently utilised to deliver high performing public services;
- future investment decisions are based on a more complete assessment of the condition and performance of the existing asset base; and
- there are plans in place for the disposal of surplus assets no longer required for service delivery.

6.23 A key tool for helping to improve asset management practice is the updated National Asset Register, which was published in January 2007. The Register provides information on the assets held by over 370 different government bodies, constituting the most comprehensive list of central government assets and maintaining the UK's position at the forefront of international best practice in public sector asset management.

6.24 The Government remains ahead of schedule to deliver its ambition to dispose of £30 billion of surplus fixed assets between 2004-05 and 2010-11, having already sold £18.3 billion for reinvestment in new equipment and infrastructure by March 2007. In addition, the Government is taking forward the sale of its financial assets, such as student loans, where private ownership delivers better value for money. Planned asset sales for the forthcoming period include:

- the Ministry of Defence is in the process of selling Chelsea Barracks, the proceeds from which will be reinvested to improve Armed Forces accommodation;
- the Department for Transport plans to dispose of land and buildings held by the Highways Agency, Channel Tunnel Rail Link and the British Railways Board (Residuary) Ltd;
- the Ministry of Justice is developing plans to rationalise land and buildings held by Her Majesty's Court Service, with the proceeds recycled into its courts modernisation programme; and
- over the CSR07 period the Department of Health will release over £500 million for reinvestment in the NHS through the disposal of surplus property.

Private Finance Initiative

6.25 The Private Finance Initiative (PFI) plays a small but important role in the Government's investment in public services. Approximately 600 PFI projects have been signed, with a total capital value of £56.9 billion, and public authorities report a high level of user satisfaction. Over £10 billion worth of projects have been signed in the last 18 months.

6.26 PFI projects worth a total of £22.2 billion are expected to reach financial close before April 2011. The Government believes PFI should continue to form a significant part of its strategy for delivering high quality public services, alongside a broader range of traditional and alternative procurement models depending on the circumstances. For the CSR07 period the Government has allocated a total PFI Credit envelope of £10.9 billion. Consistent with this allocation, the Government will continue to pursue PFI projects where they demonstrate value for money, alongside conventional capital programmes.

DRIVING FORWARD THE NEXT STAGE OF REFORM

6.27 Over the last decade far-reaching social, economic and technological changes have transformed the environment in which public services operate. An ageing population, changing patterns of work and family life, globalisation, technological innovations such as the internet and other developments are creating new and rising demands on a range of public services including childcare, education and training, and health and social care.

6.28 There have also been substantial changes in public attitudes and expectations. As real incomes have grown – the benefit of a strong and stable economy – so too have people’s expectations of public services. Across the economy standards of service have improved enormously, the result of rising disposable incomes and intensifying competition for businesses. Opening hours fit around the needs of the customer, new methods of payment and delivery have been created, and a much greater focus is placed on high quality customer service.

6.29 People are therefore now accustomed to much greater choice and control over their lives. Higher educational levels mean they are better equipped to exercise this choice, less likely to accept advice without question and less likely to allow others to make choices on their behalf. With the advent of the internet and other new media, people now have immediate and unfettered access to information on virtually any topic that interests them. The old divides between producers and users, experts and amateurs, are being broken down and blurred. Public services need to be ready to respond to these trends.

6.30 Alongside these responsibilities for government, citizens will also need to take on a more active and responsible role themselves in order to fulfil their aspirations and meet the challenges of the decade ahead. For example, in order to tackle climate change, regulation and investment by the Government will be crucial, but not sufficient unless individuals also act with greater environmental and social responsibility in the way they use resources. Likewise, public investment in education and training will not be enough to meet the challenges of an increasingly competitive global economy unless individuals also take responsibility for upgrading their own skills and seeking out new career opportunities. Collaborative action is a key theme for the Government’s policy and reform agenda over the CSR07 period.

Principles for the next stage of reform

6.31 In order to create the conditions in which better public service outcomes are forged in partnership with citizens, the Government is building a new model of public service delivery for the next decade based on three key principles:

- **setting a clear focus on ambitious priorities**, consulting with the public and professionals to define the key goals for the next ten years in order to respond to the challenges facing the UK, and ensuring the resources and policies are in place to deliver these ambitions;

- **putting users at the heart of services**, through new channels of engagement that help the public shape services; new mechanisms to deliver accountability, including greater use of real-time data; new opportunities for people to exercise choice in how to access and tailor their services, coupled with clear responsibilities for all; and
- **freeing up the frontline to drive public service improvements**, placing greater trust in those delivering services to respond to the priorities of individual areas, communities and citizens.

The new performance management framework

6.32 Since their introduction in the 1998 CSR, Public Service Agreements (PSAs) have played a vital role in ensuring that the sustained increases in resources have been translated into higher standards across public services and led to major improvements in outcomes. But the challenges of the next decade are different, and so following extensive consultation with the public and frontline professionals over the last two years the Government has decided to make a decisive shift in the way it sets its priorities and drives performance. **The 2007 CSR therefore announces a new performance management framework based on a stronger relationship with public sector professionals, with a streamlined set of 30 new PSAs setting the Government's priority outcomes for the CSR07 period.** Box 6.2 describes the key elements of the new framework.

Box 6.2: The new performance management framework

The new performance management framework consists of the following elements:

- a streamlined set of 30 new Public Service Agreements (PSAs), which articulate the Government's highest priority outcomes for the CSR07 period and span departmental boundaries, setting out a shared vision and leading collaboration at all levels in the delivery system;
- a single Delivery Agreement for each PSA, developed in consultation with frontline workers and the public, and published to strengthen accountability and ownership across organisational boundaries;
- new Cabinet Committees announced in July which will play a key role in driving performance on cross-government PSAs by regularly monitoring progress and holding departments and programmes to account. The Government is also examining the scope for building PSAs explicitly into the performance management framework for the civil service – ensuring a relentless focus on PSA delivery in Whitehall;
- a small basket of national, outcome-focused indicators to support each PSA, ensuring robust and transparent performance measurement alongside genuine rationalisation, with a significant reduction in the overall number of priority indicators attached to PSAs;
- targets used where appropriate to deliver improved performance and accountability; with nationally set targets reserved for a small subset of PSA indicators that require firm central direction, and far greater space for increased local target setting;
- a more comprehensive approach to performance monitoring, with each department publishing a set of Departmental Strategic Objectives (DSOs) for the CSR07 period, alongside the smaller, prioritised set of PSAs. This will for the first time bring all performance monitoring into a single framework, covering both the Government's highest priorities (PSAs) and the wider span of departmental business; and
- across the whole framework, a premium on the use of high quality, timely data while freeing up the frontline professionals by reducing low value data burdens.

6.33 The new framework creates the conditions for public services to work collaboratively in delivering excellent outcomes and excellent experiences for all. By prioritising a radically reduced set of PSA indicators and rationalising the use of targets attached to PSAs, the new framework will allow more space to deliver innovative and flexible services, with a greater role for local communities to focus action on their priorities. The changes represent a new balance of accountability where central co-ordination works in synergy with greater direct accountability to service users and local communities; citizens' personal experiences of services will increasingly shape design, delivery and measurement of success; and staff in the public sector will be empowered – respecting their skills and professionalism – to respond to citizens' needs.

6.34 Alongside reforms to the national framework, the Government has agreed a single, aligned framework for the performance management of outcomes delivered by local government working alone or in partnership, with a much smaller and more focused set of 198 performance indicators, down from an estimated 1,200. The new set of indicators have been published by the Secretary of State for Communities and Local Government, and includes all relevant PSA and DSO outcomes, replacing the range of current issue-specific performance indicator sets and reducing the reporting burden for

local authorities. Local authorities and their partners will shortly begin negotiating new Local Area Agreements, with designated local improvement targets for up to 351 of the indicators from the national set. The Government will not mandate targets for any Local Area Agreement, so even where targets are set out for PSAs at national level, local areas will have the flexibility to respond to these national ambitions in the most appropriate way, in negotiation with regional Government Offices.

Reducing data burdens

6.35 The availability of good quality, timely data at all levels is critical to drive strong accountability and improved outcomes in public services. Alongside reforms to the performance management framework, the Government will take steps to ensure that all data it requests from the frontline is proportionate, appropriate and collected efficiently. To reduce unnecessary burdens on the frontline, the Government is announcing a commitment to reduce by 30 per cent by 2010 the total amount of data that central departments and agencies request from the frontline. With work led by the Better Regulation Executive, this commitment will be delivered through departmental simplification plans, which are already being used successfully to reduce administrative burdens on businesses.

Empowering the workforce and public to shape services

6.36 At the heart of the Government's programme of public service reform for the CSR07 period are new plans to ensure the public has a greater say in the design, delivery and governance of their services, giving them more control over and responsibility for their outcomes in health, education and other key areas. This will be accompanied by steps to give frontline professionals greater opportunities and more power to shape service delivery and respond to the needs of the public, including through the reforms to the performance management framework outlined above. Bringing the public and workforce together in this way will help contribute to greater innovation and efficiency, improved outcomes and higher levels of customer satisfaction and staff motivation. This vision will be realised by:

- strengthening people's voice in service provision – for example through the roll-out of Parent Councils in schools and the establishment of local involvement networks allowing clients to express their views on their needs and experiences of health and social care services; and through new participatory budgeting pilots to involve communities directly in decisions over how to prioritise local budgets on the issues that matter most to them;
- driving forward the personalisation of services to ensure they more effectively meet the particular needs and preferences of different individuals. Following the Gilbert Review, schools will extend the provision of personalised learning so that teachers can tailor support to each student's specific learning goals. Individualised budgets for social care will be rolled out, giving people greater ability to shape their own care packages;
- enabling service providers and the public to work collaboratively together to shape positive outcomes – for example by rolling out the Expert Patient Programme across the NHS that enables patients and frontline professionals to work together in improving management of chronic illnesses;
- enhancing the accountability of local services, for example, neighbourhood charters will allow local citizens and service providers to agree on expected

levels of service and provide mechanisms for users to hold service providers to account;

- reaching out to all of society by improving approaches that engage hard-to-reach groups, harnessing third sector expertise where appropriate. The Government will develop a more flexible approach to New Deal, with support tailored to meet the individual needs of long-term benefit claimants, lone parents, and incapacity benefit claimants. The views of local communities will be better represented in the delivery of justice, through Community Legal Advice Centres and Community Justice Centres, delivered in partnership with third sector organisations; and
- working with individuals and businesses to encourage behavioural changes that benefit them and society – for example, the Healthy Schools Programme will be rolled out, encouraging healthy eating and active lifestyles to help reduce childhood obesity. To tackle the problem of climate change, the Government will improve information about the steps individuals can take to reduce their energy consumption, introducing a web-based personal emissions calculator and providing advice on green electricity and gas tariffs.

Transforming service delivery

6.37 The investment and reforms of the last decade have raised standards of delivery across individual public services. The challenge now is for more radical cross-government reform that will be the foundation of personalised public services. This means moving away from the old model of service provision which meets the public's various needs through a number of separate government agencies, each with their own interactions with customers. This compartmentalisation of delivery means that, to date, the Government has struggled to keep pace with the expectations set by the leading edge of the new service economy that has emerged over the last decade, which, by focusing on the totality of the relationship with the customer is able to deliver more immediate and convenient services with less intrusion on their time.

6.38 The Prime Minister has appointed Sir David Varney, former Executive Chairman of HM Revenue and Customs and Chairman of O2, to advise the Government on how to meet this challenge and put in place the vision set out in his report on Service Transformation. The Government recognises that succeeding in this aim, and securing a cross-departmental commitment to build services around the needs of citizens and businesses, will be integral to the achievement of each of the PSA outcomes set in the 2007 CSR. In order to deliver this, **the Government is publishing for the first time a Service Transformation Agreement, which underpins delivery of the whole of the new PSA framework.** The Agreement sets out an ambitious programme of reforms which will be taken forward across government as part of the PSA framework, including:

- piloting a new 'Tell Us Once' service that enables citizens to inform public services just once about changes of circumstances, starting with bereavement;
- rationalising the plethora of government websites by closing down the majority and moving their citizen and business content to the Government's two single access websites, Directgov and Businesslink.gov.uk, thereby giving customers access to the information and services they need with greater speed and ease;

- requiring all publicly funded call-centres to undergo formal published accreditation to ensure faster and better services for citizens and businesses;
- reducing avoidable or duplicated contacts with call centres and local offices;
- empowering individuals to influence their services, with greater opportunities and direct involvement to influence the way they are designed and delivered; and
- improving management of information and identity across the Government's delivery systems to reduce wasted time and inconvenience for citizens, businesses and frontline workers.

6.39 In addition, the Service Transformation Agreement commits all departments to specific plans for transforming the services they provide across all delivery channels, coordinating with other departments where relevant. Examples of the initiatives that are being developed include the Driver and Vehicle Licensing Agency (DVLA) and Department for Work and Pensions (DWP) working to merge the application processes for driving licenses and National Insurance numbers; DWP, HM Revenue and Customs (HMRC) and some local councils developing a single transaction approach for working age benefits, housing benefit and tax credit; and HMRC and the Department for Environment Food and Rural Affairs (Defra) working to develop an International Trade Single Window to enable traders or their agents to submit all regulatory information required in a single message that can then be shared by the relevant government departments. Local government will also play a vital role in delivering this agenda, including on reducing avoidable contact which has been included in the new National Indicator Set.

6.40 The Minister for the Cabinet Office, who chairs the new Cabinet Committee on Public Engagement and Delivery, and the Chief Secretary to the Treasury will hold departments to account for delivery of these commitments as part of the overall performance management framework, and will continue to identify new opportunities for transforming services over the CSR07 period and beyond.

THE FISCAL IMPACT OF BUDGET POLICY DECISIONS

Table A1: Budget 2007 policy decisions

				(+ve is an Exchequer yield)	£ million
	2007-08 indexed	2008-09 indexed	2009-10 indexed	2007-08 non-indexed	
Corporate tax reform					
1 Main rate of Corporation Tax reduced to 28%	-140	-1,385	-2,230		-140
2 General plant and machinery capital allowances at 20%	0	+1,490	+2,270		0
3 Long-life plant and machinery capital allowances at 10%	0	-210	-380		0
4 Integral fixtures capital allowance at 10%	0	+70	+200		0
5 Industrial Buildings Allowance: phased abolition	0	+75	+225		0
6 Small Companies Rate of Corporation Tax phased to 22%	+10	+370	+820		+10
7 One-year extension of 50% First Year Allowances for small enterprises	-35	-250	+80		-35
8 New Annual Investment Allowance at £50,000	0	-30	-920		0
9 R&D tax credit increase to 130%	0	-40	-90		0
10 SME R&D tax credit increase to 175%	0	-30	-60		0
11 Payable Enhanced Capital Allowances	0	-20	-40		0
12 Reform of Venture Capital Schemes	0	+30	+30		0
13 VAT: revalorisation of registration and deregistration thresholds	0	0	0		-5
Personal tax reform					
14 Income Tax: indexation of starting and basic rate limits	0	0	0		-870
15 Remove starting rate of Income Tax on non-savings income	0	+7,320	+8,630		0
16 Increase Age Allowances by £1,180 and raise for 75s and over to £10,000	0	-810	-950		0
17 Increase Child Tax Credit by £150 above indexation	0	-880	-1,020		0
18 Raise the threshold of the Working Tax Credit by £1,200	0	-1,310	-1,310		0
19 Increasing the Tax Credit withdrawal rate by 2 per cent	0	+600	+620		0
20 Income Tax and NICs: phased alignment of higher thresholds	0	+1,110	+1,490		0
21 Income Tax and NICs: raising the higher rate threshold and upper earnings limit	0	0	-250		0
22 Basic rate of Income Tax reduced to 20 pence	0	-8,090	-9,640		0
23 Working Tax Credit continued for 4 weeks after leaving work	-10	-15	-20		-10
Supporting families and communities					
24 Raising the ISA cash limit by £600 and the overall limit by £200	0	-15	-50		0
25 Benefit simplification	0	-5	*		0
26 VAT: reduced rates on products for the elderly	-5	-10	-10		-5
Modernising the tax system					
27 Extension of the dividend tax credit	0	-5	-15		0
28 VAT: reduced rate for smoking cessation products	-10	*	0		-10
29 Energy Products Directive: expiry of derogation	0	+10	+30		0
30 Abolition of Small Consignments' Relief for excise duties	+5	+5	+5		+5
31 Gift aid: increase in benefits	0	-5	-5		0
32 Sale and repurchase agreements: tax treatment	+40	+60	+60		+40
33 VAT: non-business use of assets	+10	+15	+20		+15
34 General insurers' reserves: transitional relief	0	-70	-20		0
Protecting tax revenues					
35 Life insurance companies: financing arrangements	+120	+165	+165		+120
36 Loss-buying	+30	+45	+50		+30
37 VAT: countering missing trader fraud	+50	+45	+35		+50
38 Strengthening the disclosure regime	+15	+30	+30		+15

Table AI: Budget 2007 policy decisions

	(+ve is an Exchequer yield)			£ million
	2007-08 indexed	2008-09 indexed	2009-10 indexed	2007-08 non-indexed
Duties changes				
39 Alcohol duties: revalorise beer, wine and sparkling wine, freeze spirits	-20	-15	-10	+210
40 Tobacco duties: revalorise	0	0	0	+40
41 Gaming duties: changes to duty bands and rates	+30	+35	+35	+35
Property				
42 Rationalisation of empty property relief	0	+950	+900	0
Protecting the environment				
43 Expansion of Enhanced Capital Allowances for water-efficient technologies	*	*	-5	*
Supporting a clean and efficient transport system				
44 VED: enhancing environmental incentives	+125	+220	+280	+230
45 Road fuel duties: increases from 1 October 2007	-380	+490	+660	+480
46 Rebated oils duties: increases from 1 October 2007	+50	+125	+135	+65
47 Biofuels: extension of differential to 2009-10	0	0	+10	0
48 Road fuel gas: continuation of differentials to 2009-10	0	0	+5	0
49 Renewal of reduced pollution certificate scheme for lorries	0	0	-5	0
Protecting the UK's natural resources				
50 Aggregates levy: encouraging the sustainable use of resources	-10	+40	+45	0
Improving waste management				
51 Landfill tax: supporting recycling	0	+175	+325	0
Other policy decisions				
52 Special reserve	-400	0	0	-400
TOTAL POLICY DECISIONS	-525	+280	+125	-130
* Negligible				
MEMO ITEM				
Resetting of the AME margin	-1,000			

Table A.2: Estimated costs for Pre-Budget Report policy decisions and others announced since Budget 2007¹

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

¹ Costings shown relative to an indexed base.² From 2008-09 onwards, included within the Comprehensive Spending Review settlement.³ Negative tax costs. AME spending consequences are included within the Comprehensive Spending Review settlement.⁴ Intention to replace air passenger duty by per plane duty from November 2009.

SUPPLEMENTARY INFORMATION

Table B.1: Macroeconomic Prospects¹

	Percentage change on a year earlier unless					
	£bn	otherwise stated				
		Forecast ^{2, 3, 4}				
	2006	2006	2007	2008	2009	2010
Real GDP		2¾	3	2 to 2½	2½ to 3	2½ to 3
Nominal GDP	1 302	5½	6½	5 to 5½	5¼ to 5¾	5¼ to 5¾
Expenditure components of GDP at constant market prices ⁵						
Private consumption expenditure ⁶		2	3	1¾ to 2¼	2¼ to 2¾	2¼ to 2¾
Government consumption expenditure		2	2½	2½	2	2
Gross fixed capital formation ⁷		8¾	5¾	3¼ to 3¾	3¼ to 3¾	3¼ to 3¾
Changes in inventories and net acquisition of valuables ⁸		-¼	0	-¼ to 0	0 to ¼	0
Exports of goods and services ⁹		10¼	-3¼	4½ to 5	4¾ to 5¼	4¾ to 5¼
Imports of goods and services ⁹		9¾	-2	3¾ to 4¼	4 to 4½	4 to 4½
Exports of goods and services (excluding MTIC)		7	3¼	4½ to 5	4¾ to 5¼	4¾ to 5¼
Imports of goods and services (excluding MTIC)		6¾	3¾	3¾ to 4¼	4 to 4½	4 to 4½
Contributions to real GDP growth ^{10, 11} per cent						
Final domestic demand ¹²		3¼	3 to 3½	2¼ to 2½	2¼ to 2¾	2½ to 2¾
Changes in inventories and net acquisition of valuables		-¼	0	0	0	0
Net trade ¹³		-¼	-¼	0	0	0

¹ The forecast is consistent with National Accounts data to the second quarter of 2007, released by the Office for National Statistics on 26 September 2007

² All growth rates in tables throughout this annex are rounded to the nearest 1/4 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 midpoints 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 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 Further detail on the expenditure components of GDP is given in Table A10 of Annex A, Pre-Budget Report 2007

⁶ Household consumption under UK definition. Includes households and non-profit institutions serving households

⁷ Fixed investment under UK definition

⁸ Change in inventories under UK definition. Contribution to GDP growth, percentage points.

⁹ Figures up to and including 2007 are distorted by estimates of MTIC-related activity. Growth rates excluding MTIC are shown in subsequent lines of this table.

¹⁰ Components may not sum to total due to rounding and omissions of private residential investment, transfer costs of land and existing buildings and the statistical discrepancy.

¹¹ Based on central case. For the purpose of public finances projections, forecasts are based on the bottom of the forecast GDP range.

¹² Equals sum of private consumption, business investment and government under UK definition.

¹³ Contribution to GDP, percentage points

Table B.2: Real GDP growth

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Real GDP growth	3	3	2	2¾	2½	2½	2½

Note: GDP growth as used for public finance projections. These figures represent the lower end of the projection range as presented in the Government's economic forecast, adjusted from calendar years to financial years. 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 assumptions of trend growth used as the basis for projecting the public finances.

Table B.3: Change in gross debt ratio

	Per cent of GDP					
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Change in gross debt ratio ¹	0.9	0.4	0.9	0.3	0.2	-0.1

¹ General government gross debt measure on a Maastricht basis.

Table B.4: General government interest and dividends paid

	Per cent of GDP				
	2006-07	2007-08	2008-09	2009-10	2010-11
General government interest and dividends paid	2.1	2.2	2.0	2.1	2.1

Note: GDP growth as used for public finance projections.

Table B.5: General government primary balance

	Per cent of GDP				
	2006-07	2007-08	2008-09	2009-10	2010-11
Primary balance ¹	0.4	0.8	0.8	0.3	0.0

¹ General government net borrowing less interest expenditure.

Table B.6: Stock-flow adjustments

	Per cent of GDP				
	2006-07	2007-08	2008-09	2009-10	2010-11
Stock-flow adjustment ¹	0.7	0.0	0.1	0.3	0.3

¹ Change in gross debt ratio less general government net borrowing.

Table B.7: Cyclical budget components

	Per cent of GDP				
	2006-07	2007-08	2008-09	2009-10	2010-11
Cyclical budgetary component ¹	0.1	-0.1	0.1	0.1	0.0

Note: GDP growth as used for public finance projections.

¹ Treaty deficit less cyclically-adjusted Treaty deficit.

Table B.8: Cyclically-adjusted primary balance

	Per cent of GDP				
	2006-07	2007-08	2008-09	2009-10	2010-11
Cyclically-adjusted primary balance ¹	0.3	0.8	0.7	0.2	0.0

Note: GDP growth as used for public finance projections.

¹ General government net borrowing less interest paid less cyclical budgetary component.

Table B.9: Private consumption deflator

	Level	Percentage change on previous year				
	2006	2006	2007	2008	2009	2010
Private consumption deflator ¹	106¾	2½	2½	2¾	2¾	2¾

¹ Q4

Table B.10: Export deflator (goods and services)

	Percentage change on previous year				
	2006	2007	2008	2009	2010
Export price deflator ¹ (goods and services)	2½	1½	½	1¼	2

¹ Average value indices**Table B.11: Import deflator (goods and services)**

	Percentage change on previous years				
	2006	2007	2008	2009	2010
Import price deflator ¹ (goods and services)	2½	0	½	1½	2¼

¹ Average value indices**Table B.12: Balance on goods and services**

	Per cent of GDP				
	2006	2007	2008	2009	2010
Balance on goods and services	-3¾	-3¼	-3	-3	-3

Table B.13: Balance of primary incomes and transfers

	Per cent of GDP				
	2006	2007	2008	2009	2010
Balance of primary incomes and transfers	½	½	¼	¼	¼

Table B.14: net lending/net borrowing of the private sector

	Per cent of GDP				
	2006	2007	2008	2009	2010
Net lending of the private sector ¹	-¾	¼	-¼	-½	-¾

¹ Mid-points of forecast ranges**Table B.15: Implicit interest rates on debt**

	Per cent of GDP				
	2006-07	2007-08	2008-09	2009-10	2010-11
Implicit interest rate on debt ¹	5.3	5.4	4.8	4.8	4.8

¹ Interest expenditure expressed as per cent of gross debt in previous year**Table B.16: Net borrowing by sub-sector**

	Outturn	Estimate
	2006-07	2007-08
Net Borrowing (£ billion)		
Central Government	32.5	38.6
Local Authority	1.7	2.7
Net Borrowing (% GDP)		
Central Government	2.5	2.7
Local Authority	0.1	0.2

Table B.17: Comparing GDP growth and inflation between the 2005 and 2006 PBR

	Per cent of GDP				
	2006	2007	2008	2009	2010
GDP growth					
PBR 2006	2¾	2¾ to 3¼	2½ to 3	2½ to 3	-
PBR 2007	2¾	3	2 to 2½	2½ to 3	2½ to 3
CPI inflation (Q4) ¹					
PBR 2006	2½	2	2	2	-
PBR 2007	2¾	2	2	2	2

Table B.18: Comparing public sector finances between 2005 and 2006 PBR

	Per cent of GDP					
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Current receipts						
PBR 2006	39.7	40.2	40.4	40.4	40.4	40.4
PBR 2007	39.2	39.2	39.5	39.7	39.9	40.0
Current expenditure						
PBR 2006	38.9	38.9	38.8	38.6	38.4	38.2
PBR 2007	38.3	38.5	38.5	38.2	38.1	37.9
Surplus on current budget						
PBR 2006	-0.6	-0.1	0.3	0.5	0.6	0.8
PBR 2007	-0.4	-0.6	-0.3	0.2	0.6	0.8
Net Investment						
PBR 2006	2.2	2.2	2.2	2.2	2.2	2.2
PBR 2007	2.0	2.1	2.2	2.2	2.3	2.3
Public sector net borrowing (PSNB)						
PBR 2006	2.8	2.3	1.9	1.7	1.5	1.3
PBR 2007	2.3	2.7	2.5	2.0	1.7	1.5
Cyclically-adjusted surplus on current budget						
PBR 2006	-0.4	-0.1	0.3	0.5	0.6	0.8
PBR 2007	-0.2	-0.7	-0.2	0.3	0.6	0.8
Cyclically-adjusted PSNB						
PBR 2006	2.6	2.2	1.9	1.7	1.5	1.3
PBR 2007	2.2	2.8	2.4	1.9	1.7	1.5
Treaty deficit ¹						
PBR 2006	2.7	2.2	1.9	1.7	1.5	1.3
PBR 2007	2.6	2.9	2.8	2.4	2.1	1.8
Treaty debt ratio ²						
PBR 2006	43.7	44.1	44.2	44.2	44.0	43.6
PBR 2007	43.4	43.9	44.8	45.1	45.3	45.2

¹ General government net borrowing on a Maastricht basis² General government gross debt on a Maastricht basis

Table B.19: Comparing public sector finances between the 2005 and 2006 Budgets

	Per cent of GDP				
	2006-07	2007-08	2008-09	2009-10	2010-11
Current receipts					
Budget 2006	40.3	40.9	41.0	41.0	41.0
Budget 2007	39.6	40.1	40.4	40.4	40.4
Current expenditure					
Budget 2006	39.6	39.5	39.2	39.0	38.9
Budget 2007	39.0	39.1	38.9	38.7	38.5
Surplus on current budget					
Budget 2006	-0.6	0.1	0.5	0.7	0.8
Budget 2007	-0.7	-0.3	0.2	0.4	0.6
Net Investment					
Budget 2006	2.2	2.3	2.3	2.3	2.3
Budget 2007	2.0	2.1	2.2	2.2	2.2
Public sector net borrowing (PSNB)					
Budget 2006	2.8	2.2	1.7	1.6	1.5
Budget 2007	2.7	2.4	2.0	1.8	1.6
Cyclically-adjusted surplus on current budget					
Budget 2006	0.4	0.7	0.7	0.7	0.8
Budget 2007	-0.5	-0.3	0.2	0.4	0.6
Cyclically-adjusted PSNB					
Budget 2006	1.9	1.6	1.6	1.6	1.5
Budget 2007	2.5	2.4	2.0	1.8	1.6
Treaty deficit ¹					
Budget 2006	3.0	2.4	1.9	1.7	1.6
Budget 2007	2.8	2.5	2.1	1.9	1.7
Treaty debt ratio ²					
Budget 2006	43.9	44.5	44.5	44.5	44.5
Budget 2007	43.5	44.3	44.4	44.5	44.4

¹ General government net borrowing on a Maastricht basis² General government gross debt on a Maastricht basis

ISBN 978-1-84532-369-1



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