

3. An audit of the public finances

As last year, the public finances seem healthier than the government forecast. IFS / Goldman Sachs expect public sector net borrowing (PSNB)¹ to record a surplus of £15.9 billion in 2000–01, virtually unchanged from 1999–2000. This is £10 billion better than the March 2000 Budget forecast and £5.8 billion better than the November 2000 Pre-Budget Report forecast. The better-than-expected performance in the public finances reflects a combination of greater buoyancy in tax receipts and an undershoot in public spending. We consider the reasons for these in Sections 3.2 and 3.3.

The government's fiscal rules continue to be met with ease. The 'golden rule' requires the government to run a surplus on current budget over the economic cycle; in 2000–01, we expect a surplus of 2.2% of GDP. The 'sustainable investment rule' requires a stabilisation in the ratio of public sector net debt to GDP below 40%; in 2000–01, we expect a net debt ratio of 31.7%.

The Pre-Budget Report announced measures that increase government borrowing by £2.6 billion in 2001–02, rising to £3.9 billion in 2002–03. The Chancellor also announced a range of measures for consultation, mainly benefiting motorists, that if implemented will raise borrowing by an additional £1.7 billion in 2001–02, rising to £2.2 billion in 2002–03. In our baseline forecast, we assume that these will be implemented. For our medium-term forecasts, we have adopted the Treasury's cautious assumption of trend GDP growth of 2¼% a year. Even so, we expect the surplus on current budget in the medium term to run about 0.5% of GDP above the path in the 2000 Budget and Pre-Budget Report. The Chancellor could announce additional discretionary measures costing £3–4 billion by 2002–03 to bring the public finances broadly onto the path envisaged in the 2000 Budget and Pre-Budget Report. If trend GDP growth turns out stronger, as we expect, the Chancellor will have further room for manoeuvre in future years.

As the end of the parliament approaches, it seems appropriate to consider how the public finances have evolved relative to the projections set out in the Conservatives' last Budget, in November 1996. We consider this in Section 3.6. Our main findings are the following:

- Tax receipts in 2000–01 are likely to be £24 billion higher than projected in the November 1996 Budget. Higher-than-expected inflation explains £7 billion of this increase; hence, in real terms, taxes are £17 billion (1.8% of GDP) higher than the November 1996 forecast.
- Up until 1999–2000, all of the additional real increase in taxes was used to reduce public borrowing. Public spending in the first three years of the parliament was actually lower in real terms than the Conservatives' plans.

¹ All references in the text to public sector net borrowing and the surplus on current budget exclude the windfall tax and associated spending.

- By reducing public borrowing, the government has made significant savings on debt interest payments. In addition, falls in unemployment have reduced cyclical social security spending. Discretionary public spending has risen, on average, by 2.0% a year in real terms during the past four years. This is still slightly less than the annual increase in discretionary public spending by the Major Government.
- The government plans further significant increases in public spending in 2001–02 and beyond. If this parliament were to run for a full five-year term and the spending plans were delivered, real discretionary public spending would increase by an average of 2.9% a year – a meaningful increase both on the 1.4% a year recorded during the Conservative period of office from 1979 to 1997 and on the 2.2% achieved during John Major’s period as Prime Minister.

3.1 The government’s fiscal rules

Since coming to office in May 1997, the government has adhered to two fiscal ‘rules’, both of which are assessed over the economic cycle:²

- The ‘golden rule’ requires the public sector to borrow only to invest; current spending must be financed from tax receipts. To achieve this, there must be a surplus on current budget over the economic cycle.
- The ‘sustainable investment rule’ requires net public sector debt to be kept stable as a share of GDP, which the government has judged should be no more than 40%. This imposes a limit on public sector net borrowing which, for any given surplus on current budget, places a constraint on public investment. On the government’s existing plans for public investment, the sustainable investment rule is automatically satisfied if the golden rule is met.

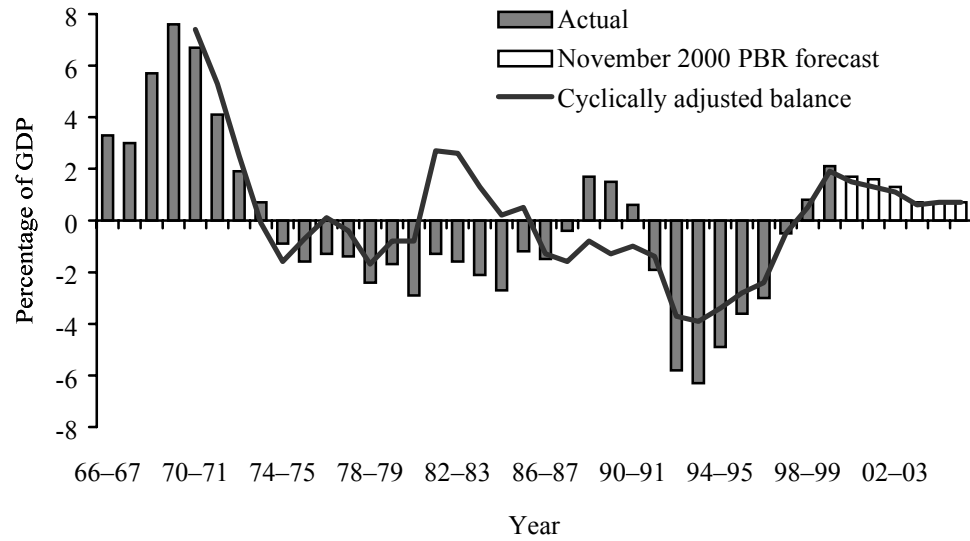
These rules were first adopted to enhance the credibility of fiscal policy. They ensure that the public finances are kept on a sustainable footing, although they could be breached for some time without the public finances becoming unsustainable.³ In fact, the golden rule implies levels of borrowing that are historically very low. It is not the case that meeting the golden rule is necessarily optimal, particularly given the difficulties of determining precisely what constitutes current spending and investment. The government has argued that these rules promote intergenerational equity since each generation pays for its own current spending without imposing an unfair burden on future generations. But this is not guaranteed.⁴

² A more detailed description of these, and other measures of public borrowing, can be found in HM Treasury, *Analysing UK Fiscal Policy*, HM Treasury, London, 1999.

³ For a discussion of the two fiscal rules, see, for example, C. Emmerson and C. Frayne, *The Government’s Fiscal Rules*, Briefing Note, IFS, London, forthcoming.

⁴ Current spending may benefit taxpayers differentially depending on their age. Alternatively, an unanticipated increase in life expectancy may result in individuals receiving a greater pension than expected when making National Insurance contributions. For a more in-depth

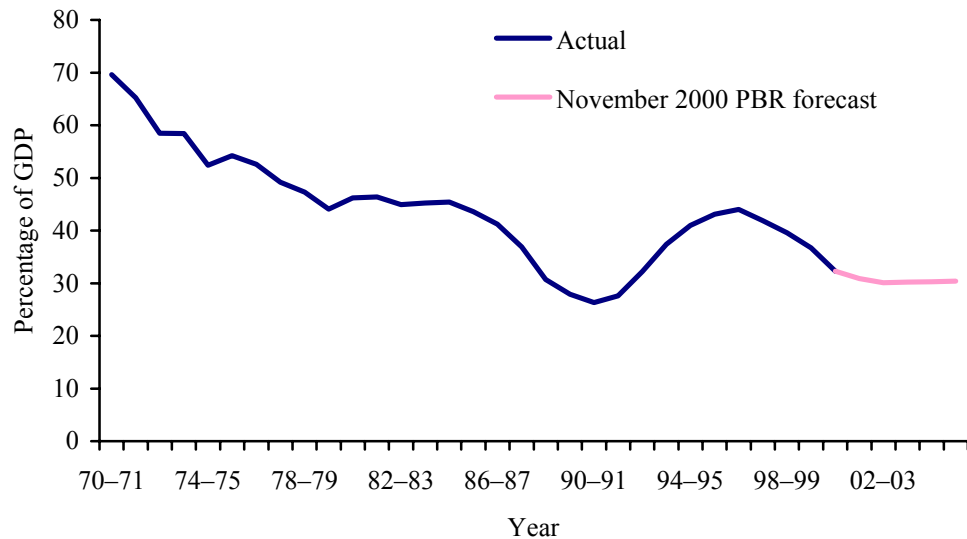
Figure 3.1. Meeting the golden rule? Current budget balances as a percentage of GDP



Notes: Measures exclude the windfall tax and associated spending. For more details on the cyclically adjusted current budget surplus, see HM Treasury, *Fiscal Policy: Public Finances and the Cycle*, HM Treasury, London, 1999.

Source: HM Treasury, *Public Finances Databank*, 24 November 2000, HM Treasury, London, 2000.

Figure 3.2. Ups and downs in debt: net public sector debt as a percentage of GDP



Source: HM Treasury, *Public Finances Databank*, 24 November 2000, HM Treasury, London, 2000.

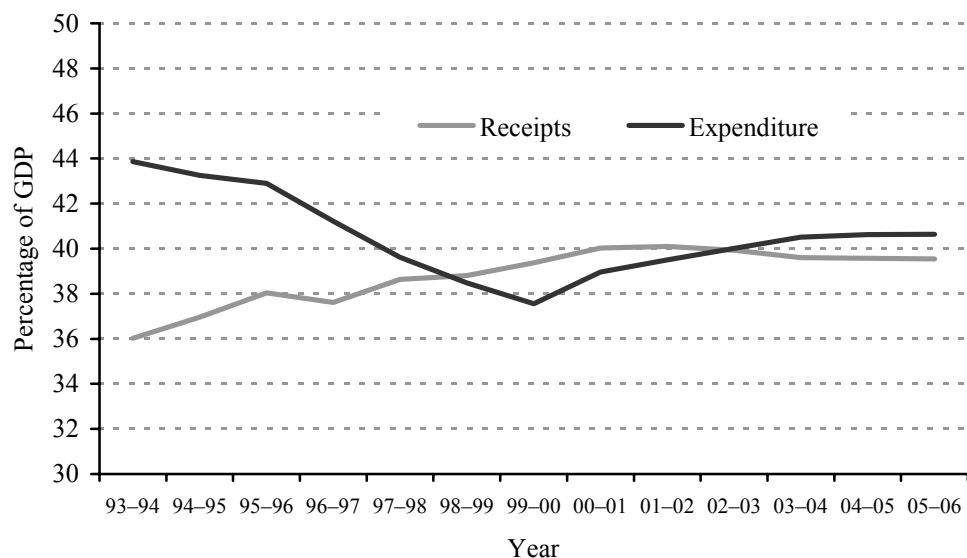
discussion, see J. Banks, R. Disney and Z. Smith, 'What can we learn from generational accounts in the UK?', *Economic Journal*, vol. 110, issue 467, pp. 575-97, 2000.

Previous governments have managed fiscal policy in different ways, but it is still of interest to see how past out-turns compare with the current rules. Figure 3.1 shows the current budget balance as a share of GDP from 1966–67 to the end of the present forecast period. The Treasury’s estimate of the cyclically adjusted current budget balance is shown from 1970 onwards. In the late 1960s and early 1970s, the golden rule was met comfortably. During this period, public sector net borrowing was not particularly low but public investment was high. As Figure 3.2 shows, the sustainable investment rule was not met: net public sector debt was running above 40% of GDP.

During the second half of the 1970s, there were small deficits on the cyclically adjusted current budget, implying that the golden rule was narrowly missed. While there were current budget deficits during the first half of the 1980s, the cyclically adjusted series shows that, once allowance is made for the state of the economic cycle over this period, the golden rule was in fact met. The opposite is true of the last two years of the 1980s where, despite current budget surpluses, there were deficits on the cyclically adjusted measure. The net debt ratio fell steadily, reaching a low of 26.6% of GDP in 1990–91. During the first half of the 1990s, the golden rule was missed decisively: the cyclically adjusted deficit on current budget averaged 2.7% of GDP between 1990–91 and 1994–95. The net debt ratio rose steadily to a high of 44.0% in 1996–97.

There has been an improvement in the current budget every year since 1993–94. The surplus reached 2.1% of GDP in 1999–2000, larger than that achieved at the height of the economic boom in 1988–89. The forecasts in the government’s November 2000 Pre-Budget Report (PBR) show a gradual decline in the surplus to 0.7% of GDP in 2005–06, implying that the golden rule will continue to be met comfortably. The public sector net debt ratio is forecast to stabilise at just over 30% of GDP.

Figure 3.3. From deficit to surplus followed by a return to deficit? Public sector receipts and spending as a percentage of GDP



Note: Measures exclude the windfall tax and associated spending.

Source: HM Treasury, *Public Finances Databank*, 24 November 2000.

The shares of tax receipts and total public spending in national income from 1993–94 to 2005–06 are shown in Figure 3.3. The difference in the two series is equal to public sector net borrowing. PSNB (excluding the windfall tax and associated spending) has moved from a deficit of 7.8% of GDP in 1993–94 to a surplus of 1.8% of GDP in 1999–2000. This was achieved by a 3.3 percentage point rise in the share of taxes in GDP and a 6.3 percentage point fall in the share of public spending in GDP.

The PBR projected the elimination of the overall budget surplus by 2002–03 and PSNB of 1.1% of GDP in 2005–06. This is due primarily to the increases in public spending announced in the March 2000 Budget and allocated in the July 2000 Spending Review. Taxes are projected to decline slightly as a share of GDP.

3.2 Issues in planning government revenues

Tax revenues as a share of GDP have increased during this parliament, from 37.6% of GDP in 1996–97 to 40.0% in 2000–01 on the government's latest estimates.⁵ This increase is equivalent to around £23 billion in current prices. There are various reasons why the ratio of taxes to national income can change, the most important of which are economic growth and discretionary tax changes. We discuss each in turn.

Economic growth

A given tax system will tend to produce tax revenues that are higher as a share of GDP during periods when the economy is running above trend output and lower when the economy is operating below trend. This is due to, for example, changes in levels of employment and profits affecting income tax and corporation tax receipts. In addition to this cyclical effect, there is, over time, a tendency for taxes to increase as a share of GDP as the economy grows. This phenomenon is known as fiscal drag and is partly a product of the progressivity of the tax system. Income tax allowances are normally raised in line with retail price inflation, while earnings tend to grow in real terms. As a result, more income is taxed at each rate of income tax. The government will also tend to receive more revenue in social security taxes. The Treasury has estimated that, in the absence of offsetting measures, the ratio of taxes to GDP will rise by 0.23 percentage points a year when the economy is growing at close to a trend rate.⁶

Discretionary government tax measures

The proportion of national income taken in taxation is affected by discretionary changes in taxation. These can be implemented in several ways:

1. *Changes in tax rates:* For example, as a result of the duty escalators, the rates of taxation on petrol and tobacco have risen substantially since 1993.

⁵ Figures for public sector current receipts as a share of GDP from HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000.

⁶ HM Treasury, *Fiscal Policy: Public Finances and the Cycle*, HM Treasury, London, 1999.

Working in the other direction, the basic rate of income tax has fallen from 25p in 1995–96 to its current level of 22p.

2. *Changing the tax base:* Recent examples include the phasing-out of tax relief on profit-related pay announced in the November 1996 Budget and the abolition of the payment of dividend tax credits to pension funds announced in the July 1997 Budget. These are estimated to have raised income tax receipts by £1.7 billion and £5.4 billion a year respectively.

Table 3.1. Change in tax revenues in the previous parliament and the current parliament resulting from Budget announcements (£ billion)

Announcement	Last parliament to 1996–97	Current parliament to 2001–02
	Effect over and above any effect on previous parliament	
<i>Conservative Budgets from 1987–92 parliament affecting revenues</i>		
Spring 1991 Budget	2.3	n/a
Spring 1992 Budget	–4.0	n/a
Budget measures from 1987–92 parliament affecting revenues	–1.8	n/a
<i>Conservative Budgets after the 1992 election</i>		
Spring 1993 Budget	16.9	3.6
Autumn 1993 Budget	7.9	3.9
Autumn 1994 Budget	–0.9	0.4
Autumn 1995 Budget	–4.3	–1.3
Autumn 1996 Budget	n/a	0.8
Total Conservative Budgets during 1992–97 parliament	19.6	7.4
<i>Labour Budgets after the 1997 election</i>		
Summer 1997 Budget	n/a	5.6
Spring 1998 Budget	n/a	3.8
Spring 1999 Budget	n/a	–2.5
Autumn 1999 Pre-Budget Report	n/a	–4.0
Spring 2000 Budget	n/a	–0.6
Autumn 2000 Pre-Budget Report ^a	n/a	–0.6
Total Labour Budgets during current parliament	n/a	1.7
Total effect of Budget changes on taxes over parliament	17.9	9.0
Actual change in revenues over parliament	–11.7	24.8

^a November 2000 Pre-Budget Report only includes those measures introduced without further consultation.

Notes: Increases are over and above the effect that any measure may have had on revenues in the preceding parliament. Measures announced in the March 2001 Budget may affect the figures for this parliament. Figures stated are for the effect on revenues in 1996–97 and 2001–02 respectively. All figures have been updated to 2001–02 prices using nominal GDP growth. Reductions to the generosity of mortgage interest relief that occurred in the Budgets in Spring 1993, Autumn 1993, Summer 1997 and Spring 1999 are not included since the relief counts as government expenditure rather than tax forgone in the National Accounts. The Spring 1993 numbers include the effect of a 3% fuel escalator on annual revenues in both parliaments, while the Autumn 1993 figures include the effect of increasing this fuel escalator to 5% and introducing a tobacco escalator at 3%. The Summer 1997 numbers include the effect of increasing these escalators to 6% and 5% respectively. Both escalators were subsequently abolished in the November 1999 PBR. Thus the –£4 billion effect of the PBR includes the fiscal implications of removing the automatic tobacco and fuel escalators in 2000–01 and 2001–02. Any further changes in excise duties are treated as one-off changes in the year they occurred. For more details, see Appendix A.

Sources: HM Treasury, *Financial Statement and Budget Report*, various years; authors' calculations.

3. *Introducing new taxes:* For example, insurance premium tax and air passenger duty were introduced in the November 1993 Budget. In the March 1999 Budget, the Chancellor announced the introduction of the climate change levy from April 2001.

Government revenues in both the previous and the current parliament have changed partly as a result of Budget announcements. The effect that Budget announcements have had is shown in Table 3.1. For announcements made in previous parliaments, the table shows the effect that each Budget had on tax revenues in that parliament, and any additional effect that it had on subsequent parliaments. Budget measures announced during the 1992 to 1997 parliament meant that revenues by the end of that parliament were £19.6 billion higher in 1996–97, and an additional £7.4 billion higher in 2001–02, than they would have been in the absence of any Budget announcements. Most of this increase came from the measures announced in the Spring and Autumn 1993 Budgets.⁷ The Autumn 1993 Budget, for example, increased tax revenues by £7.9 billion in 1996–97 and an additional £3.9 billion by 2001–02.⁸ Despite these increases, actual government revenues fell by 1.2 percentage points of GDP in the last parliament, which is equivalent to £11.7 billion. This was due to other factors, such as economic growth, affecting revenues.

Measures announced in the 1992 to 1997 parliament increased revenues in 2001–02 by an additional £7.4 billion. This was largely the result of the automatic escalators on fuel and tobacco duties, which were assumed in the last Budget of the previous parliament to remain in place for the whole of the current parliament. Budget announcements since 1997 have increased this figure by £1.7 billion to £9.0 billion.⁹ Overall, tax revenues, in the absence of any further announcements, will have increased over this parliament by 2.5 percentage points of GDP, which is equivalent to £24.8 billion.

While the effect of Budget announcements in the current parliament on government revenues may seem surprisingly small, it is largely a reflection of the abolition of the automatic fuel and tobacco escalators in the November 1999 Pre-Budget Report. The current government could, if it had wanted to, have reversed or offset any of the previous Budget announcements. It could also have made discretionary policy announcements so that the ratio of tax to national income did not rise.

Although tax revenues will have increased by £1.7 billion due to announcements made in the current parliament, taxes were first increased and then reduced. The effect on revenues in 2000–01, one year earlier than that shown in the table, is to increase revenues by £5.8 billion. This will, on current policies, fall to £1.7 billion in 2001–02, as shown in Table 3.1. This is due to factors such as the introduction of the children's tax credit and the removal of

⁷ Measures announced in these Budgets included the introduction of VAT on fuel, higher employee National Insurance contributions, a freezing of income tax allowances and a reduction in the generosity of the married couple's allowance. These Budgets also introduced the fuel and tobacco escalators, which committed the government to increasing excise duties on fuel and tobacco in real terms by 5% and 3% respectively each year.

⁸ All figures uprated to 2001–02 prices using nominal GDP growth.

⁹ Numbers do not sum to total due to rounding.

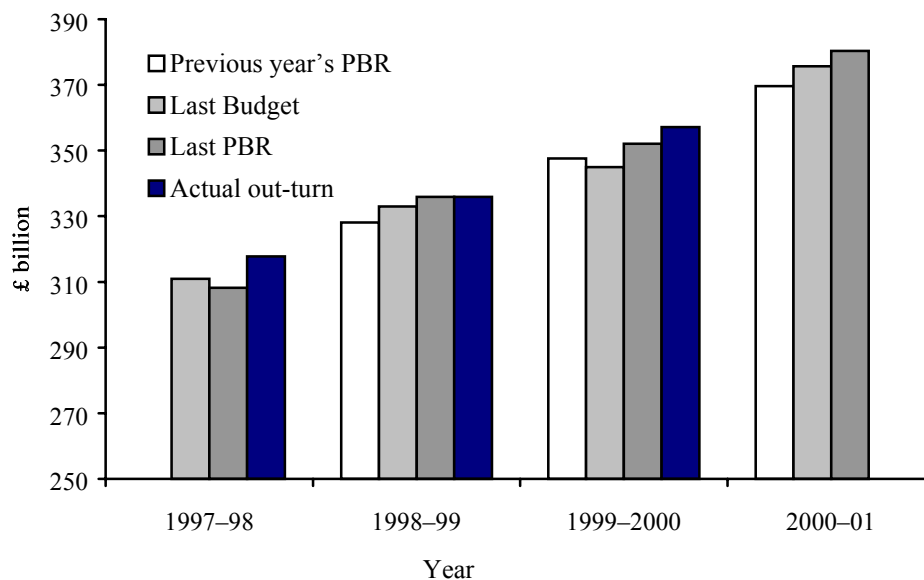
the automatic fuel and tobacco escalator for an additional year. If the March 2001 Budget implements in full the measures under consultation from the Pre-Budget Report, such as the reduction in duty on ultra-low sulphur petrol and diesel, then announcements made in this parliament will have made no effect on revenues in 2001–02.

It is also not known what would have happened had the Conservatives been re-elected in 1997. For example, the fuel and tobacco escalators could have been abolished or reduced earlier, or other taxes could have been reduced. Regardless, lower levels of taxes would not be possible without lower levels of public spending or higher levels of public borrowing.

Previous errors in forecasts of government receipts

Any estimate of future government receipts depends on the expected path of the economy and its relationship with tax revenues as well as on the net impact of previous Budget announcements. Figure 3.4 compares Treasury forecasts for current receipts with the eventual out-turn, adjusting for subsequent Budget measures. In recent years, the Treasury has consistently underestimated tax revenues. For example, the out-turn for public sector current receipts in 1998–99 was £335.9 billion; it was forecast at £328.1 billion in the November 1997 PBR and £333.0 billion in the March 1998 Budget.

Figure 3.4. An ever-improving situation? Out-turns for government receipts compared with previous Treasury forecasts



Notes: Forecasts from each Pre-Budget Report and Budget are adjusted to take account of subsequent changes to the tax system that affect future receipts. The first PBR was in November 1997, so there is no previous year's PBR corresponding to 1997–98.

Sources: HM Treasury, *Pre-Budget Report*, various years; HM Treasury, *Financial Statement and Budget Report*, various years.

This is no surprise since Treasury forecasts are currently, by design, more likely to underestimate than overestimate government receipts. They build in a deliberate degree of caution. Revenue projections are based on an underlying rate of real GDP growth of 2¼% a year, even though the Treasury believes that the economy's long-run sustainable growth rate is 2½% a year or possibly higher.¹⁰ Furthermore, the Treasury employs cautious assumptions about oil prices, equity prices, the level of smuggling, unemployment and the ratio of VAT revenue to consumer expenditure.¹¹ This caution is evident in recent Treasury forecasts since they show no rise in the share of government revenues in GDP over the medium term.

There is ample justification for adopting a cautious approach to forecasting government revenues. The average absolute error in forecasting public sector net borrowing one year in advance is £10 billion even if growth in the economy is correctly forecast. Looking four years ahead, the average error is £27 billion.¹² Errors of this magnitude are easily sufficient for the government to fail to meet its golden rule.

How important is fiscal drag?

The Treasury's caution in projecting future tax receipts is striking, given that the reforms made to income tax and employee National Insurance may have actually increased fiscal drag. This is because any given increase in earnings should now lead to a larger increase in tax receipts than previously, since a larger proportion of income is now taxed at a higher marginal rate.¹³ Using the IFS tax and benefit model, TAXBEN, it is possible to estimate the change in income tax and employee National Insurance revenues resulting from a 1% across-the-board increase in earnings under both the April 1997 and the April 2001 tax structures. These elasticities are shown in Table 3.2 and they imply a

Table 3.2. Increase in income tax and National Insurance receipts from a 1% increase in earnings, under two regimes

	April 1997	April 2001
Income tax	1.29	1.31
Employee National Insurance contributions	0.82	0.92

Source: IFS tax and benefit model, TAXBEN, using data from the Family Resources Survey, 1996–97.

¹⁰ For more details, see HM Treasury, *Trend Growth: Prospects and Implications for Policy*, HM Treasury, London, 1999.

¹¹ The forecast for the rate of unemployment is only cautious when this rate is expected to fall by independent forecasters. For more details, see National Audit Office, *Audit of Assumptions for the 2000 Pre-Budget Report*, Hc959, Stationery Office, London, 2000.

¹² Average error corresponds to the average absolute error over the period 1985–86 to 1997–98; see HM Treasury, *Pre-Budget Report, November 1998*, Cm. 4076, 1998, Table B13 for more details.

¹³ The 10% tax band is narrower than the 20% band that it replaced and personal allowances have fallen relative to average earnings. The entry fee for employee National Insurance contributions has been abolished. There have been above-inflation increases in both the lower earnings limit and the upper earnings limit, on earnings between which employee National Insurance contributions are made.

slightly stronger increase in tax revenues now for any increase in earnings than when Labour came to office. Changes to employer National Insurance work in the same direction.¹⁴ Reforms to corporation tax may have gone the other way, although it not clear that these have had any effect at all.

3.3 Issues in planning government spending

Public expenditure has fallen as a share of GDP over the course of this parliament, from 41.2% in 1996–97 to 37.8% in 1999–2000, the latest year for which we have the out-turn. This is equivalent to a real-terms decrease in spending of just £1.4 billion or 0.4%. Spending in the current year (2000–01) is projected to increase to 39.2% of GDP. If spending hits this target, it will have risen over the first four years of this parliament by £21.9 billion in real terms, or 6.3%.¹⁵

As in our discussion of planning government revenues, economic growth and discretionary expenditure changes have played an important role in the fall in public spending as a share of national income. An additional factor has been the consistent underspending by government departments.

Economic growth

Public spending is much less cyclical than tax revenues. There is a tendency for its share of GDP to fall during upswings and rise during downswings, in part reflecting the counter-cyclical nature of unemployment-related social security benefits.¹⁶ Other social security benefits will also tend to fall as a share of GDP as the economy grows, since benefits are uprated in line with price inflation rather than in line with earnings.¹⁷ Spending on government debt interest payments also tends to fall as the economy grows. The decline in debt interest payments and cyclical social security benefits during this parliament is shown in Figure 3.5. These items are currently around 10.5% of total public spending, but this proportion is decreasing as spending on these items continues to fall.

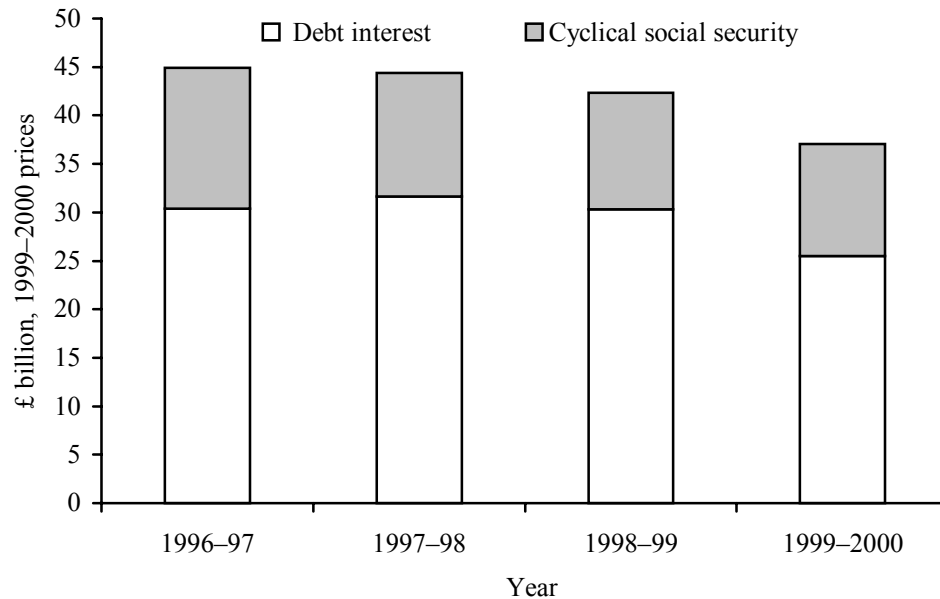
¹⁴ This is because the reforms to employer National Insurance have increased the progressivity of the system by increasing the tax rate on earnings above the lower earnings limit from between 3% and 10% in 1997–98 to 11.9% in 2001–02. For more details, see L. Chennells, A. Dilnot and N. Roback, *A Survey of the UK Tax System*, Briefing Note no. 9, IFS, London (<http://www.ifs.org.uk/taxsystem/taxsurvey.pdf>).

¹⁵ Figures are for total managed expenditure as set out in HM Treasury, *Pre-Budget Report November 2000*, Cm. 4917, HM Treasury, London, 2000.

¹⁶ The government estimates that each 100,000 drop in unemployment cuts public spending by £580 million in 2000–01. Source: Department of Social Security, *Departmental Report: The Government's Expenditure Plans 2000/01 to 2001/02*, Stationery Office, London, 2000.

¹⁷ An exception to this is that the government intends to uprate pensioners' minimum income guarantee in line with earnings every year. See statement by the Chancellor of the Exchequer on the Pre-Budget Report on 8 November 2000 (*Hansard*, column 325).

Figure 3.5. Cyclical spending: cyclical social security spending and debt interest payments, in real terms (1999–2000 prices)



Note: Discretionary increases to unemployment-related benefits (increases in the child premiums to income support) mean that the fall in social security spending shown in this graph understates the fall that has occurred due to falling unemployment.

Source: Department of Social Security, *The Changing Welfare State: The Reform of Social Security*, November 2000. HM Treasury, *Building Long-Term Prosperity for All: Pre-Budget Report November 2000*, Cm. 4917, 2000. HM Treasury, *Prudent for a Purpose: Building Opportunity and Security for All. 2000 Spending Review*, Cm. 4807, 2000.

Although growth in the economy helps to reduce the share of public spending in GDP, there are longer-term upward pressures. Demand for government-provided services, such as education and health, tends to grow at least as quickly as the economy expands. Demands on infrastructure traditionally provided by government, for example roads, tend to increase as the economy grows. Public sector wages, which represent a large proportion of the cost of providing many services, tend to grow in line with private sector wages over time. These increased demands resulting from economic growth do not automatically lead to higher public spending, but will only feed through into increases in public spending by discretionary additions to departmental budgets through the planning regime.

Discretionary spending measures

The first two years of the parliament

One of the key reasons for the fall in public spending as a share of GDP during this parliament was the government's aim to keep to the tight spending plans for 1997–98 and 1998–99 laid down in the November 1996 Budget by the previous Conservative administration. Overall expenditure¹⁸ was £4.0 billion

¹⁸ This refers to the overall public spending aggregate known as total managed expenditure (TME). TME, and its division between annually managed expenditure (AME), which is planned annually, and departmental expenditure limits (DELs), which are planned on a three-

lower in real terms¹⁹ in 1998–99 than in 1996–97, a fall of 1.2% over the two-year period. Although cyclical social security spending fell, discretionary spending also declined. Growth in spending on defence, transport, housing, and trade and industry were all cut in real terms. Spending growth on health and on law and order were low in historical terms and considerably lower than the growth in GDP. Capital spending also fell, despite the government identifying this as one of the key ‘problems with previous approaches to public spending’ and one that it claims to have learnt lessons from since it came to power in 1997.²⁰ The trends in public spending are shown in Table 3.3.

Table 3.3. Public spending in the first two years of this parliament compared with the Conservatives’ record: average annual real change in spending

	First two years of Labour: April 1997 to March 1999	Entire Conservative period: April 1979 to March 1997
Total spending	–0.6	1.6
National Health Service	2.2	3.1
Social security	–1.1	3.6
Defence	–2.5	–0.2
Education	1.6	1.5
Law and order	0.8	4.1
Transport	–9.8	0.5
Current spending	–0.4	1.8
Capital spending	–10.3	–5.3

Notes: Current spending includes depreciation. Defence spending is net of receipts from the sale of MOD married quarters. Education spending is net of proceeds from the sale of the student loan book. National Health Service spending is net NHS spending in the UK.

Sources: HM Treasury, *Public Expenditure Statistical Analyses, 1997–98 and 2000–01*; Pre-Budget Report November 2000; ONS Press Release, *Public Sector Accounts: 3rd Quarter 2000*, 21 December 2000.

Spending in 1999–2000 and beyond

After these first two years of tight spending control, the July 1998 Comprehensive Spending Review (CSR) saw a marked change in public spending plans. For the three years starting from 1999–2000, public spending was planned to rise significantly in real terms each year. Overall expenditure was expected to rise between 1998–99 and 1999–2000 by 2.8% in real terms, or £9.5 billion.²¹ Just over one-third of this growth was to be in areas managed

year basis, were first set out in HM Treasury, *Economic and Fiscal Strategy Report 1998*, Cm. 3978, 1998, for spending years going forward from 1999–2000. However, the Treasury also publishes historical series for these aggregates, allowing comparisons to be made prior to the introduction of the new planning regime.

¹⁹ All of the amounts in this section are expressed in real terms, 1999–2000 prices.

²⁰ HM Treasury, *Planning Sustainable Public Spending: Lessons from Previous Policy Experience*, November 2000.

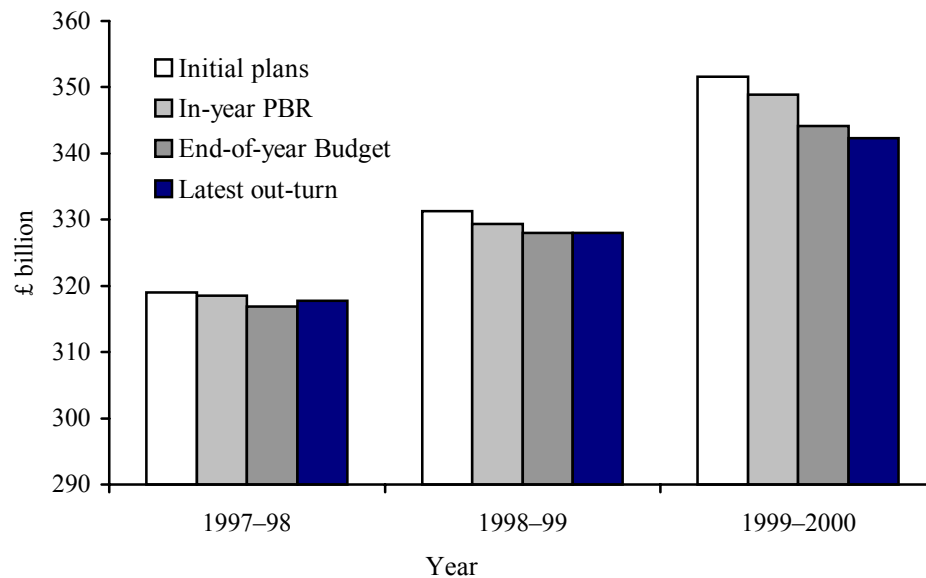
²¹ HM Treasury, *Planning Sustainable Public Spending: Lessons from Previous Policy Experience*, November 2000.

on an annual basis, known as annually managed expenditure (AME), much of this reflecting increased generosity of some social security benefits. Social security spending was expected to grow by around £2.5 billion overall. The remainder of the increase was for government departments as embodied in the plans for departmental expenditure limits (DELs). Total DELs were planned to grow by £6.1 billion or 3.5% in real terms in 1999–2000. Similar increases were planned for DEL spending in 2000–01 and 2001–02. Despite the apparent move to ‘firm three year plans’ for public spending,²² Budget 2000 added to these allocations.

Errors in forecasts: public expenditure underspends

The significant growth in spending envisaged by the first CSR had, up to the end of 1999–2000, failed to materialise. Compared with initial plans, there has been a considerable underspend on cyclical items of expenditure, such as social security spending and debt interest, as well as on discretionary items across many programmes and departments. Throughout this parliament, public spending in each year has turned out lower than initial plans and forecasts.

Figure 3.6. Underspending every year? Government spending compared with initial plans and projections



Notes: These measures have been adjusted to take into account subsequent additions to public expenditure. Spending is measured by general government expenditure (GGE) in 1997–98 and 1998–99, and by total managed expenditure (TME) in 1999–2000. Initial plans for 1997–98 are those set out in the November 1996 Budget. Initial plans for 1998–99 are those set out in the July 1997 Budget. Initial plans for 1999–2000 are those contained in the July 1998 *Economic and Fiscal Strategy Report*.

Sources: ONS Press Release, *Public Sector Accounts: 3rd Quarter 2000*, 21 December 2000; HM Treasury, *Pre-Budget Report*, various years; HM Treasury, *Financial Statement and Budget Report*, various years; HM Treasury, *Stability and Investment for the Long Term: Economic and Fiscal Strategy Report 1998*, Cm. 3978, 1998.

²² See HM Treasury, *Modern Services for Britain: Investing in Reform*, Cm. 4011, 1998.

As Figure 3.6 makes clear, the underspend in 1999–2000 was particularly large: £8.2 billion less was spent than was planned in the CSR. Total managed expenditure (TME) was up only slightly in real terms on the previous year, compared with the 2.8% real-terms increase initially projected. This is despite more than £1 billion worth of discretionary additions, mostly to the social security budget, made in Budget 1999.

Why such a large underspend in 1999–2000?

Table 3.4 shows how overall public expenditure in 1999–2000, as measured by TME and its components, has been revised downwards over time compared with the plans set out in the July 1998 CSR.

Table 3.4. Expenditure plans for 1999–2000: total managed expenditure (TME) and its constituents (£ billion)

	CSR 1998	Budget 1999	Budget 2000	SR 2000	Latest out-turn	Under- spend (on CSR 1998)	Under- spend (on DEL final limits)
TME	351.6	349.2	345.2	340.7	343.4	8.2	–
<i>Of which:</i>							
DEL	179.2	179.2	178.8	176.8	176.8	2.4	4.5
AME	172.4	170.0	166.4	163.9	166.6	5.8	–
<i>Of which:</i>							
Social security benefits	100.5	99.1	97.1	97.0	97.2	3.3	–
Debt interest	27.6	26	25.5	25.5	25.5	2.1	–
<i>Of which:</i>							
Current expenditure	342.9	343.7	339.7	338.1	339.9	3.0	–
Net investment	8.6	5.5	5.5	2.6	3.5	5.1	–

Notes: The division between current and capital expenditure is affected by the adoption of 1995 European System of Accounts (ESA95) in September 1998. This makes an important difference to these measures (see below). DEL and AME are affected by the change to resource accounting from Budget 2000 onwards. However, this makes only a very minor difference to the out-turns for these aggregates in 1999–2000. For more details, see HM Treasury, *Pre-Budget Report November 2000*, Cm. 4917, Table B13. Current expenditure includes depreciation.

Sources: Latest out-turn – ONS Press Release, *Public Sector Accounts: 3rd Quarter 2000*, 21 December 2000; authors' calculations based on HM Treasury, *Pre-Budget Report November 2000*, Cm. 4917, HM Treasury, London, 2000. DEL final limits – HM Treasury, *Public Expenditure Provisional Outturn*, Cm. 4812, HM Treasury, London, 2000. HM Treasury, *Financial Statement and Budget Report*, various years. HM Treasury, *Stability and Investment for the Long Term: Economic and Fiscal Strategy Report 1998*, Cm. 3978, 1998. HM Treasury, *Spending Review 2000*, Cm. 4807, HM Treasury, London, 2000.

The biggest undershoot was in AME – £5.8 billion less than expected. This was due, in part, to unexpected buoyancy in the economy which reduced the need for cyclical spending. Within AME, social security spending was £3.3 billion lower than expected despite an addition of almost £900 million to social security spending in Budget 1999, mostly through discretionary increases in the generosity of pensioners' winter fuel allowances and child

premiums in income support.²³ Central government debt interest payments were £2.1 billion lower than had originally been envisaged. Changes in definitions complicate comparisons among many of the other elements of AME,²⁴ but underspending occurred in net public service pensions (£1 billion), whilst spending by self-financing public corporations ran contrary to this trend, overshooting the amount forecast in Budget 1999 by about £1 billion. Local government self-financed expenditure – for example, that raised by the council tax – also overspent relative to Budget 1999 projections, by £200 million.²⁵

There was also a considerable shortfall in departmental spending. Spending by departments under DEL in 1999–2000 fell short of the original plans set out in the CSR by £2.4 billion. This understates the true level of underspending by departments. Taking into account the extra allocations awarded to departments as a result of accumulated spending entitlements built up from underspends in previous years (amounting to £2.2 billion²⁶), the total DEL underspend in 1999–2000 was £4.5 billion.

Table 3.5 shows that the £4.5 billion DEL underspend was spread widely across departments. The final column of Table 3.5 shows the underspend relative to the size of each department's final budget. Compared with an average underspend of 2.5% across all DELs, the Welfare-to-Work (WTW) programme underspent its budget most significantly, failing to spend more than 50% of the £1.5 billion allocated to it. WTW has now been removed from the DEL planning regime and added to AME, where it will be managed on an annual basis. Notable absences from these large underspends were the Department of Health (DoH) and DETR (local government and regional policy), under which, amongst other things, the majority of spending on schools in England takes place. These budgets take up 22.5% and 18.9% of the total DEL respectively, but their underspends were both less than half of a percentage point of their total budgets.

From Table 3.4, it can be seen that more than half of the total underspend in TME in 1999–2000 arose because of a shortfall in planned net investment. This seems remarkable, given that net investment accounted for just 1% of TME. Table 3.6 sets out the major components of public sector net investment for 1999–2000 and how these have been revised. A major reason for the shortfall was a change in accounting conventions that has boosted estimates of

²³ Since the working families' tax credit and the disabled person's tax credit are counted along with other tax credits as an accounting adjustment in AME rather than in social security spending, the £180 million extra spending on these announced in Budget 1999 for 1999–2000 does not affect the estimates for social security.

²⁴ The shift from cash to resource budgeting in the 2000 Spending Review affects the definitions of some of these aggregates, making comparisons over time difficult.

²⁵ Underspending or overspending in local government self-financed expenditure has no impact on the public finances, since the taxes for this spending are raised locally.

²⁶ This includes £700 million DEL underspend carried forward from 1998–99 and an additional £1.5 billion in allocations resulting from the underspends built up from previous years under the End-Year Flexibility (EYF) scheme.

Table 3.5. Departmental spending in 1999–2000: underspend relative to final DELs

	Underspend (£ billion)	Underspend as a % of total underspend (%)	Underspend as a % of final DEL (%)
Education and Employment	0.83	18.4	5.2
Welfare to Work	0.76	17.0	50.7
DETR – main programmes	0.53	11.8	5.1
Scotland	0.44	9.8	3.1
Trade and Industry	0.40	8.9	12.0
Defence	0.32	7.1	1.4
Health	0.18	4.0	0.4
DETR – local government and regional policy	0.02	0.5	0.1
Other	1.01	22.5	2.7
Total	4.49	100	2.5

Note: The total underspend given here of £4.5 billion is that set out in July 2000 in the Public Expenditure Provisional Out-turn, which estimated the provisional outturn for total DEL spending in 1999–2000 to be £176.9 billion, compared with final DELs of £181.4 billion. The November 2000 Pre-Budget Report showed a provisional out-turn for DEL spending of £176.8 billion, £100 million below the July provisional out-turn. The breakdown of this further £100 million underspend has not been accounted for here.

Source: HM Treasury, *Public Expenditure 1999–2000 Provisional Outturn July 2000*, Cm. 4812, HM Treasury, London, 2000.

Table 3.6. Public sector net investment in 1999–2000 and its components

	CSR 98	Budget 99	Budget 00	PBR 2000	Latest out-turn
Central government spending and local authority support in DEL	10.7	12.3	12.0	9.9	–
Locally financed expenditure	0.7	0.6	0.8	0.9	–
National Lottery	2.0	2.2	1.5	1.4	–
Public corporations	5.0	4.3	4.7	4.5	–
Other capital spending in AME	1.2	0.7	0.5	0.9	–
Allocation of reserve and AME margin	0.2	0.1	0.0	0.0	–
Public sector gross investment	19.8	20.3	19.6	17.6	18.2
<i>less</i> Depreciation	–11.2	–14.8	–14.1	–14.4	–14.6
Public sector net investment	8.6	5.5	5.5	3.2	3.5

Note: Current expenditure includes depreciation.

Source: Latest out-turn – ONS Press Release, *Public Sector Accounts: 3rd Quarter 2000*, 21 December 2000. HM Treasury, *Pre-Budget Report*; HM Treasury, *Financial Statement and Budget Report*, various years; HM Treasury, *Stability and Investment for the Long Term: Economic and Fiscal Strategy Report 1998*, Cm. 3978, 1998.

depreciation. Differences in the measure of depreciation account for £3.4 billion²⁷ of the £5.1 billion underspend. However, there has also been a

²⁷ Approximately £3 billion of the difference in these depreciation aggregates is the result of definitional changes. In September 1998, the Office for National Statistics moved to the 1995 European System of Accounts (ESA95), which resulted in a number of increases in the official measure of depreciation, most notably due to the addition of depreciation of roads and bridges into the measure.

£1.6 billion²⁸ underspend in public sector gross investment, mainly by central government. Again, it is noteworthy that locally financed expenditure has not been part of the general trend of underspending. Of the central government²⁹ capital underspend that has been carried forward into 2000–01 under the DEL End-Year Flexibility (EYF) scheme, about 75% is accounted for by capital spending that has not been undertaken in the DfEE, DETR (main programmes) and DTI.³⁰

Private sector investment under the Private Finance Initiative (PFI) was also considerably lower in 1999–2000 than initial projections. The estimated outturn for capital spending under PFI in 1999–2000 was £1.6 billion.³¹ This compares with initial projections made in Budget 1998 of £4.2 billion and in Budget 1999 of £3.8 billion.

Current spending also fell short, by £3 billion (see Table 3.4), despite a £3.2 billion increase in depreciation due to the accounting change referred to above. A large proportion of the current underspend was accounted for by social security and debt interest payments. There was also a considerable underspend within DEL current budgets. More than £3 billion of current spending from 1999–2000 DELs has been carried forward as notional spending entitlements into 2000–01. Departments accounting for the largest proportion of this are the DfEE, DETR (main programmes) and Scotland.

How desirable is this large underspend?

To the extent that the underspend is due to an improved economic climate, it is of little concern. A further element is undoubtedly the result of the flexibility that departments are now given to carry forward any unspent DEL allocations in the EYF scheme. This has been designed to avoid wasteful end-of-year spending surges as departments rush to spend their allocations before year-end. Of more concern for the government is that underspends may also have arisen because departments have been unable to spend up to the plans set out for them – for example, because of recruitment problems or problems getting capital projects off the ground. For instance, although the NHS has not been part of the general underspend, vacancy rates amongst nursing staff in NHS Trusts in England are as high as 3.8%.³² There is evidence that recruitment in other key public service areas, such as among teachers and the police, is also considerably below requirement. If this is the case, it raises questions about the ability of the government to achieve its targets for spending rises in certain key areas in the current economic climate.

Another potential worry is that these underspends might build up through time. Not only would this lead to a suboptimal allocation of government

²⁸ Numbers do not sum to total due to rounding.

²⁹ Including local authority support in DEL.

³⁰ Source: HM Treasury, *Public Expenditure 1999–2000 Provisional Outturn July 2000*, Cm. 4812, HM Treasury, London, 2000, Table 7.

³¹ See HM Treasury, *2000 Spending Review: Investing in the Future. Departmental Investment Strategies: A Summary*, Cm. 4916, November 2000, Table 5.3.

³² Department of Health, *Recruitment, Retention and Vacancies Survey, March 2000: vacancies in NHS Trusts in England – 3-month vacancy rates at 31 March 2000*.

resources relative to estimated need (as embodied by the original spending plans), but it could have an undesirable macroeconomic impact if the amounts of expenditure involved were large enough.³³ In recognition of this, the Treasury may, in future, have to take a position on the length of time for which underspend entitlements can be held, or limit in some other way the amount of the underspend that can be brought forward and spent each year. Underspends are not, in fact, allocated directly to departments, but are added to the DEL reserve, to which departments may apply for funds. Although the EYF scheme contains notional spending entitlements in 2000–01 of more than £4.2 billion as a result of DEL underspending in previous years,³⁴ in expectation of continuing underspending in the current year, just £1.75 billion has been added to the DEL reserve for 2000–01, whilst £0.75 billion has been added to the DEL reserve for 2001–02. Departments will have to apply to the reserve in order to take up this money. They may also apply for additional spending corresponding to their EYF entitlements not allowed for in the reserve, although, in the current climate of underspending, it seems unlikely that departments will spend up to their original DEL allocations let alone their full EYF entitlements.

3.4 Borrowing in 2000–01

The combination of higher-than-expected government revenues and lower-than-expected levels of public spending that has occurred in recent years has led to a more favourable out-turn for government borrowing than previously expected. In 1999–2000, the government ran a surplus on PSNB of £16.1 billion (1.8% of GDP), which was far greater than forecasts of a £6.8 billion surplus in the January 2000 Green Budget, a £3.5 billion surplus in the November 1999 PBR and a £3 billion deficit in the March 1999 Budget.³⁵ This was also the case in 1998–99, when the £2.5 billion surplus on PSNB exceeded the surplus predicted in the 1998 PBR by £1.0 billion and the January 1999 IFS / Goldman Sachs forecast by £0.2 billion.

In 2000–01, the public finances have continued to be in a healthier state than expected at the time of the last Budget. Central government revenues in the first nine months of the financial year were 6.2% higher than a year earlier, compared with the March 2000 Budget forecast of 5.3% growth for the year as

³³ An analogy is with a company that allows its employees to carry over their unused annual holiday leave. If this means that employees use their holiday time sensibly rather than all taking unsatisfactory holidays in December, this could be a good idea. However, if all employees built their holidays up over a number of years, it could lead to undesirable outcomes, both in terms of the functioning of the staff if they have not taken sufficient leave each year (this is the suboptimal allocation of resources argument) and in terms of the overall functioning of the company if all staff decided to take their built-up leave at once (this is the macroeconomic effects argument).

³⁴ This amounts to the full DEL underspend less any DEL claims agreed during the course of the year from the reserve that have not been spent, but including any EYF underspends from previous years not taken up. See HM Treasury, *Public Expenditure 1999–2000 Provisional Outturn*, Cm. 4812, July 2000.

³⁵ See Appendix A for more details.

a whole. Over the same period, central government spending has grown by just 5.1%, compared with the March 2000 Budget forecast of 7.1%.³⁶ If these trends in receipts and spending persisted for the remaining months of 2000–01, the central government surplus on PSNB would be £20.1 billion. This is substantially greater than the £10.1 billion forecast in the November 2000 PBR, which was already higher than the £4.1 billion predicted in the March 2000 Budget.

The November 2000 Pre-Budget Report assumed that departments will spend their DEL allocations in the current financial year. Given the underspends in recent years, which were discussed in Section 3.3, and the growth in spending seen so far this year, this seems unlikely. The immediate effect of any underspend is, other things being equal, a reduction in borrowing. In following years, this should be counterbalanced with an equivalent increase in borrowing as departments carry any underspend forward. The only lasting gain to the public finances will be the relatively small reduced debt interest payments and depreciation from the initial underspend.

The Treasury forecast for AME was not revised in the PBR, despite lower-than-expected spending on items such as social security benefits and debt interest payments. As in previous years, these savings were added to the AME margin, or reserve. This is shown in Table 3.7. In both the 1999 and 2000 Budgets, TME was reduced by resetting the AME margin back to £1 billion in the forthcoming financial year and £2 billion for the following year.

Table 3.7. The size of the AME reserve (£ billion)

	1999–00	2000–01	2001–02	2002–03
Comprehensive Spending Review, July 1998	1.0	2.0	3.0	n/a
Pre-Budget Report, November 1998	3.0	4.5	6.0	n/a
Budget, March 1999	1.0	2.0	3.0	n/a
Pre-Budget Report, November 1999	3.5	3.9	6.4	n/a
Budget, March 2000	0	1.0	2.0	n/a
Spending Review 2000, July 2000	n/a	1.5	1.0	2.0
Pre-Budget Report, November 2000	n/a	2.6	2.7	3.6
<i>IFS / Goldman Sachs forecast</i>	n/a	0	1.0	2.0
<i>Reduction in spending arising from unused margin</i>	n/a	2.6	1.7	1.6

Source: Various HM Treasury Pre-Budget Report, Budget and Spending Review documentation.

The IFS / Goldman Sachs forecasts for 2000–01

The IFS / Goldman Sachs forecast assumes that the increase in the AME margin will not be needed, either in 2000–01 or in subsequent years, and hence the margin will be returned to its normal level in the March 2001 Budget. This reduces spending by £2.6 billion in 2000–01. The IFS / Goldman Sachs forecast is for an underspend in DELs relative to plans of £2 billion, of which £1 billion is forecast to be capital expenditure. We assume that departments will be able to carry forward half of this underspend into 2001–02 and half into 2002–03.

³⁶ Latest figures from ONS / HM Treasury Press Release, *Public Sector Finances: December 2000*, 19 January 2001.

On the receipts side, the IFS / Goldman Sachs forecast is for revenues to be £1 billion higher than in the November 2000 PBR and £5.7 billion higher than the March 2000 Budget. This difference is mainly due to greater income tax receipts. Our forecasts imply a deceleration in the growth of receipts from the pace seen so far in 2000–01, mainly due to slower growth in corporation tax receipts. Our projections are shown in Table 3.8, and more details are provided in Table 3.10.

Table 3.8. Comparison of Green Budget and HM Treasury forecasts for government borrowing, 2000–01 (£ billion)

	Budget, Mar. 00	Pre- Budget Report, Nov. 00	Green Budget, Jan. 01	Differences in Green Budget forecast relative to:	
				Budget	PBR
Current receipts	375.6	380.3	381.3	5.7	1.0
Total managed expenditure	370.9	371.6	367.1	-3.8	-4.5
<i>Of which:</i>					
Departmental expenditure limits	193.7	195.2	193.2	-0.5	-2.0
Annually managed expenditure	177.2	176.4	173.9	-3.3	-2.5
Public sector net borrowing ^a	-6.0	-10.1	-15.9	-10.0	-5.8
Net investment	8.2	7.0	6.0	-2.2	-1.0
Surplus on current budget ^a	14.0	16.6	21.1	7.1	4.5
Net public sector debt (% of GDP)	35.1%	32.3%	31.7%	-3.4 ppts	-0.6 ppt

^a Excludes windfall tax and associated spending.

Note: ppt = percentage point.

Sources: Treasury forecasts – HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000; HM Treasury, *Financial Statement and Budget Report, March 2000*, Hc346, 2000.

The IFS / Goldman Sachs forecast is for PSNB, excluding the windfall tax and associated spending, to record a surplus of £15.9 billion (1.7% of GDP), only slightly below the £16.1 billion (1.8% of GDP) surplus in 1999–2000. This compares with forecasts of £10.1 billion in the PBR and £6.0 billion in the March 2000 Budget. We expect the surplus on current budget to be £21.1 billion (2.2% of GDP), compared with forecasts of £16.6 billion and £14.0 billion in the PBR and March 2000 Budget respectively.

The fiscal stance in 2000–01

In the March 2000 Budget, the Chancellor predicted a cyclically adjusted budget surplus of 0.5% of GDP. This estimate was raised to 0.8% of GDP in the PBR. On IFS / Goldman Sachs forecasts, the eventual out-turn could be as high as 1.2% of GDP, little changed from 1999–2000. The measures announced in the PBR will help to offset part of this unexpected fiscal tightening. The Chancellor will need to decide in the 2001 Budget how much more, if any, of this tightening should be offset in 2001–02 and future years.

3.5 Borrowing in 2001–02

Reflecting the better-than-expected trend in the public finances since the last Budget, the PBR contained a number of measures, shown in the top half of Table 3.9, that increase government borrowing by £2.6 billion in 2001–02, rising to £3.9 billion in 2002–03. These brought the Treasury's medium-term

projections for PSNB back to a similar level to those in the March 2000 Budget. Pensioners gained most from the PBR. The Chancellor announced an above-inflation increase in the basic state pension in April 2001 and April 2002 and large increases in the minimum income guarantee to which the poorest pensioners are entitled. Motorists also gained from the PBR announcement that there will be a nominal freeze in petrol duties in April 2001, which costs the exchequer £0.6 billion a year.

Table 3.9. Effect of measures announced in the Pre-Budget Report on the exchequer (£ billion)

	2001–02	2002–03
Measures implemented without further consultation		
Pensioners' package	-1.8	-2.5
Disability and carers' package	-0.2	-0.2
One-year nominal freeze for all fuel duties	-0.6	-0.6
Urban regeneration package	-0.2	-0.2
Unapproved share options	0.2	-0.2
Other measures	-0.1	-0.2
<i>Total measures implemented without further consultation</i>	-2.6	-3.9
Measures under consultation		
Reduce duty on ultra-low sulphur petrol by 2p	-0.4	-0.4
Reduce duty on ultra-low sulphur diesel by 3p	-0.6	-0.6
Extension of the small-car threshold on VED to 1,500cc	-0.3	-0.3
50% cut in VED for lorries and abolition of VED on tractors	-0.3	-0.3
Fund to encourage cleaner lorries	-0.1	n/a
Further one-year nominal freeze in fuel duty	n/a	-0.6
<i>Total measures under consultation</i>	-1.7	-2.2
TOTAL MEASURES	-4.3	-6.1

Note: Measures under consultation are assumed to have the same effect in 2002–03 as in 2001–02. If anything, this is likely to underestimate slightly the true cost of introducing these measures in full.

Sources: HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000, Table B4 (p. 170); HM Treasury / DETR Press Release 1, *A Fair Deal for Transport and the Environment*, 8 November 2000; authors' calculations.

The PBR also contained a range of measures that are currently subject to consultation. These are not included in the Treasury's public finance forecasts, and, if implemented, they will cost the exchequer an additional £1.7 billion in 2001–02, rising to £2.2 billion in 2002–03. These are shown in the bottom half of Table 3.9. The proposed measures include a reduction in fuel duty on ultra-low sulphur petrol, an extension of the small-car threshold for vehicle excise duty (VED) to 1,500cc and a 50% reduction in VED for lorries.³⁷ The IFS / Goldman Sachs forecast assumes that all of these measures will be implemented in full.

³⁷ See Chapter 5 for a discussion of these proposals.

Table 3.10. Comparison of Green Budget and HM Treasury forecasts for government borrowing, 2000–01 and 2001–02 (£ billion)

	2000–01		2001–02	
	<i>PBR</i> Nov. 2000	<i>Gr. Budget</i> Jan. 2001	<i>PBR</i> Nov. 2000	<i>Gr. Budget</i> Jan. 2001
<i>Inland Revenue</i>				
Income tax ^a	98.9	100.0	102.6	105.1
Corporation tax ^b	32.2	32.2	38.7	37.5
Petroleum revenue tax	2.0	2.0	2.0	2.0
Capital gains tax	3.0	3.0	2.7	2.7
Inheritance tax	2.3	2.3	2.4	2.4
Stamp duties	8.3	8.3	8.1	8.1
Total Inland Revenue (net of tax credits)	146.7	147.8	156.6	157.8
<i>Customs and Excise</i>				
Value added tax (VAT)	59.2	59.2	61.5	62.1
Fuel duties	23.2	23.5	23.6	22.6
Tobacco duties	7.4	7.4	7.6	8.0
Spirit duties	1.8	1.8	1.8	1.8
Wine duties	1.7	1.7	1.8	1.8
Beer and cider duties	3.0	3.0	3.2	3.2
Betting and gaming duties	1.5	1.5	1.5	1.5
Air passenger duty	1.0	1.0	1.0	1.0
Insurance premium tax	1.7	1.7	1.9	1.9
Landfill tax	0.5	0.5	0.5	0.5
Climate change levy	n/a	n/a	0.8	0.8
Customs duties and levies	2.1	2.1	2.2	2.2
Total Customs and Excise	103.0	103.4	107.4	107.4
Vehicle excise duties	4.9	4.5	5.1	4.5
Oil royalties	0.6	0.6	0.6	0.6
Business rates ^c	17.0	17.0	17.7	17.7
Social security contributions	59.8	59.8	62.3	61.6
Council tax	13.9	13.9	14.7	14.7
Other taxes and royalties ^d	8.8	8.8	9.0	9.0
Total taxes and social security contribns^e	354.7	355.7	373.3	373.3
Accruals adjustments on taxes	2.9	2.9	0.9	0.9
less Own resources contribution to EU	-6.6	-6.6	-5.4	-5.4
less PC corporation tax payments	-0.4	-0.4	-0.4	-0.4
Tax credits ^f	4.9	4.9	5.5	5.5
Interest and dividends	5.2	5.2	5.0	5.0
Other receipts	19.6	19.6	20.5	20.5
Current receipts	380.3	381.3	399.4	399.4
Current spending	364.6	361.1	384.2	382.5
Windfall tax and associated current sp. ^g	0.9	0.8	0.8	0.8
Current balance^h	16.6	21.1	16.0	17.7
Net investment	7.0	6.0	10.7	11.2
Windfall tax and associated capital sp. ^g	0.5	0.9	0.7	0.7
Public sector net borrowing^h	-10.1	-15.9	-6.0	-7.2

^a These figures are net of the children's tax credit and the working families' tax credit.

^b Includes advance corporation tax (net of repayments). Also includes North Sea corporation tax after ACT set-off, and corporation tax on gains. ^c Includes district council rates in Northern Ireland. ^d Includes money paid into the National Lottery Distribution Fund. ^e Includes VAT and 'traditional own resources' contributions to EU budget. Net of tax credits, cash basis.

^f Excludes children's tax credit, which scores as a tax repayment in the National Accounts. For more details, see Appendix B. ^g Removes spending financed by the windfall tax. ^h Excludes spending financed by the windfall tax.

Note: For more details of the IFS / Goldman Sachs forecast in 2000–01, see Table A.3 in Appendix A.

Sources: Treasury forecasts from HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000; this table is equivalent to Table B11 (p. 180). IFS / Goldman Sachs calculations.

The IFS / Goldman Sachs forecasts for 2001–02

A detailed breakdown of the IFS / Goldman Sachs forecasts for 2000–01 and 2001–02 is presented in Table 3.10. For 2001–02, our total receipts forecast coincides with the Treasury's PBR forecast. On the assumption that the PBR consultative measures are implemented, our lower forecasts for road fuel duties and vehicle excise duty are offset by higher forecasts for income tax and VAT receipts than in the PBR.

On the spending side, we forecast £1.7 billion less current spending than the November 2000 Pre-Budget Report, despite the fact that we have carried forward £0.5 billion of current departmental spending from 2000–01. This reflects primarily a reduction in AME margin to £1 billion. We also forecast lower debt interest payments in 2001–02 than the Treasury forecast due to our larger surplus on PSNB in 2000–01. We also expect slightly less spending on cyclical social security due to a lower unemployment forecast than the Treasury. We forecast that capital spending will be £½ billion higher than the Treasury, due to the carry-forward of the capital underspend in 2000–01.

Looking at government borrowing, the IFS / Goldman Sachs forecast for 2001–02 is that there will be a current budget surplus of £17.7 billion (1.8% of GDP), which is £1.7 billion higher than that forecast in the PBR. This is as a result of our lower forecast for current spending. Our forecast for public sector net borrowing in 2001–02 is for a surplus of £7.2 billion (0.7% of GDP). This is £1.2 billion higher than the Treasury's £6.0 billion figure, despite our carrying forward £½ billion of capital spending in 2001–02 from the underspend in the current financial year.

The fiscal stance in 2001–02

Allowing for the measures announced in the PBR, including those under consultation, the cyclically adjusted surplus on PSNB falls, on IFS / Goldman Sachs estimates, to 0.4% of GDP in 2001–02. This is 0.1 of a percentage point of GDP higher than in both the March 2000 Budget and the PBR. We discuss the scope for further fiscal easing in Section 3.8.

3.6 How does the current government differ from previous administrations?

As the end of the parliament approaches, it seems appropriate to consider how the public finances have evolved relative to the projections set out in the Conservatives' last Budget, in November 1996. Of course, this does not necessarily show what the Conservatives would have done had they been re-elected in May 1997, but it represents a useful baseline. Table 3.11 compares the projections for the public finances in the November 1996 Budget with the latest IFS / Goldman Sachs estimates. Public sector receipts were projected to rise from £286 billion in 1996–97 to £357 billion in 2000–01. On our estimates, receipts this year will total £381 billion – an increase of £24 billion relative to the Conservatives' projections.

Table 3.11. Differences in public finances from November 1996 Budget

	1996-97	1997-98	1998-99	1999-00	2000-01
Current receipts	3	14	16	21	24
<i>Of which:</i>					
Real GDP	0	0	-2	-2	0
Inflation	0	2	5	7	7
Budget measures ^a	0	3	4	7	6
Other	3	9	9	9	11
Current expenditure^b	5	2	2	6	19
<i>Of which:</i>					
Inflation	0	3	5	7	7
Current balance	-2	12	14	15	5
Net capital spending	-4	-3	-2	-2	-1
Net borrowing	-2	-15	-17	-17	-5

^a Includes measures included in the Pre-Budget Report and announcements made at other times that directly affect tax revenues.

^b Including depreciation.

Note: Definitional changes arising from the introduction of the European System of Accounts 1995 affect comparisons between the November 1996 Budget and subsequent years. In practice, correct accounting for these measures makes little difference to the interpretation of the numbers. For example, in 1997-98, the different accounting regime would increase the level of taxes planned in the November 1996 Budget by around £1 billion, hence making the increase in taxes under the current government £11 billion in real terms rather than the £12 billion shown by the table. On the spending side, correct treatment of the new accounting system would increase current spending in the November 1996 Budget by £4 billion, hence leading to the conclusion that the current government spent £5 billion less in real terms than what was planned by the Conservatives rather than the £1 billion shown by the table. Capital spending, as planned in the November 1996 Budget, would be reduced by £2 billion, so that the current government actually spent £1 billion less than what was planned by the Conservatives, rather than the £3 billion shown in the table. For more details, see HM Treasury, *Pre-Budget Report: November 1998*, Cm. 4076, HM Treasury, London, 1998.

Sources: HM Treasury, *Financial Statement and Budget Report, November 1996*, HM Treasury, London, 1996; IFS / Goldman Sachs forecasts.

We address two questions. First, why have receipts been so much higher than the Conservatives projected? Second, what has happened to the money?

Why have receipts been greater?

There are many reasons why receipts in 2000-01 might have turned out higher than expected. We have broken down the increase into four components: fiscal drag, inflation, discretionary measures and other forecasting changes.

Fiscal drag

As discussed in Section 3.2, tax receipts tend to grow slightly faster than the growth in GDP. Thus, if the economy has grown faster than projected, tax receipts would also be expected to be higher. The Conservatives assumed a trend growth rate in real GDP of 2½% a year. Allowing for faster growth in the early part of the period to take up the slack in the economy, the November 1996 Budget projected a cumulative 12% increase in real GDP between 1996-97 and 2000-01. The out-turn has been exactly this. Hence none of the extra tax receipts are due to greater fiscal drag associated with faster real GDP growth. The composition of GDP growth and the composition of, for example,

earnings growth will also affect government revenues. To the extent that this growth has been different from the November 1996 projections, any changes will be recorded in the 'other' category.

Inflation

Inflation has been a little higher than projected in the November 1996 Budget, averaging 2.5% a year rather than 2%. This factor accounts for £7 billion of the £24 billion extra receipts.

Budget announcements

There have been substantial changes in taxes announced during this parliament in Budgets and, more recently, in Pre-Budget Reports. On our estimates, the net increase in taxes in 2000–01 has been £6 billion relative to the 1996–97 tax base. As Table 3.1 showed, the net effect of Budget measures since 1996 in 2001–02 will fall to £1.7 billion. This is due to the effect of announcements made but not yet fully in place – for example, the children's tax credit. In addition, the November 1996 Budget assumed that the road fuel escalator would stay in place at least until the end of this parliament. This would have implied a 5% real increase in fuel duties in March 2001, whereas the recent PBR committed the government to a nominal freeze. If the government implements all of the measures for consultation announced in November's Pre-Budget Report, there will have been no change in government revenues resulting from Budget announcements over the five-year parliament.

Other forecasting changes

Tax receipts can be affected by many other factors besides those considered above – for example, oil prices and changes in the composition of GDP. In addition, there are potential forecasting errors on the revenue implications of Budget announcements. These account for the remaining £11 billion of the extra tax receipts in 2000–01.

What has happened to the higher receipts?

Up until 1999–2000, all of the additional real increase in taxes was used to reduce public borrowing. Public sector net borrowing in 1997–98 was £15 billion lower than in the November 1996 Budget projections and was £17 billion lower in each of the following two years.

Table 3.11 shows that public spending in the first three years of the parliament was actually lower than the Conservatives' plans in real terms. For example, in 1999–2000, spending in nominal terms was £6 billion higher than that planned in the November 1996 Budget, but this was more than explained by higher inflation than expected. Once this is taken into account, spending was £1 billion lower in real terms than that set out in the November 1996 Budget.

In the current year, the government has planned a decisive boost to public spending. Allowing for the fact that we expect public spending to undershoot the government's plans by around £4.5 billion this year, it is nevertheless set to increase by almost 5% in real terms. This would be the fastest annual growth rate for eight years. Even so, as shown in Table 3.12, the growth in real public spending will have averaged only 1.2% a year during the first four

years of the Labour Government. This is the same as that seen during Mrs Thatcher's period of office and less than the 1.6% a year delivered during the entire Conservative term of office.

Table 3.12. Changes in taxation and spending, various periods of interest

	Real average annual increase over:				
	Thatcher years	Major years	Tories from 1979 to 1997	Current parliament to:	
				2000–01	2001–02
Total taxes	2.0	1.3	1.8	4.6	4.1
Total government spending	1.2	2.6	1.6	1.2	1.9
<i>Of which:</i>					
Total current spending	1.3	2.9	1.8	1.2	1.6
Total capital spending	-2.9	-9.8	-5.3	3.7	16.1
Discretionary public spending	1.0	2.2	1.4	2.1	2.9
<i>Spending by type</i>					
Education spending	1.2	2.1	1.5	3.6	3.9
NHS spending	3.0	3.3	3.1	4.7	4.9
Social security spending ^a	2.8	5.2	3.6	0.9	1.6
Defence spending ^b	1.0	-2.6	-0.2	-1.7	-1.4

^a Social security spending comprises of total benefit expenditure, social security administration and spending on the working families' tax credit and the disabled person's tax credit.

^b Defence spending excludes receipts from the sale of married quarters in 1996–97.

Note: Spending increases based on IFS / Goldman Sachs estimates. Underspend for 2000–01 could affect the increases in education and NHS spending shown in the table.

Source: HM Treasury, *Pre-Budget Report, November 2000*, HM Treasury, London, 2000; HM Treasury, *Public Finances Databank, 24 November 2000*, HM Treasury, London, 2000; HM Treasury, *Public Expenditure Statistical Analyses 2000–01, April 2000*, Cm. 4601, Stationery Office, London, 2000.

Since 1996–97, spending has grown at a slightly lower rate than during the Conservatives' period of government from 1979 to 1997 and tax receipts have increased more quickly. This has led to a reduction in borrowing and significant savings on debt interest payments. Lower unemployment has reduced cyclical social security spending. The reductions in debt interest payments and cyclical social security spending amount to 4% and 20% a year respectively between 1996–97 and 2000–01. Excluding these items, Table 3.12 also shows that discretionary public spending has risen, on average, by 2.1% a year during the past four years. This is still slightly less than the annual increase in public spending by the Major Government but is 0.7 percentage points a year higher than achieved under the Conservatives. In particular, the average annual increase in education and NHS spending will be higher under the current government than under either Margaret Thatcher or John Major.

The comparisons illustrate why people's perceptions about the state of public services may not have altered much under this government. Discretionary public spending growth has not yet matched the record of the Major Government. A large part of the increase in spending is in capital spending, which may take longer to materialise into benefits felt by the general public. Also, the boost to public spending has come almost entirely in the current year, giving little time for people to notice a difference. The share of public spending in GDP has fallen 1.5 percentage points since the last year of the Conservative Government. Even if we exclude debt interest and cyclical social security spending, the share has fallen by 0.9 percentage points.

If the government were to decide to run for a full five-year term, the picture could look different. The government plans further significant increases in public spending in 2001–02 and beyond. Using IFS / Goldman Sachs forecasts for 2001–02,³⁸ the average annual growth in real public spending over the five years from 1996–97 would be 1.9%; real discretionary public spending would increase by 2.9% a year, comfortably more rapidly than the Conservative's record on public spending.

3.7 Medium-term borrowing forecasts

In projecting the medium-term path for the public finances, we have taken the cautious approach adopted by the Treasury and assumed trend GDP growth of 2¼% a year. These assumptions are shown in Table 3.13 – the only difference from the PBR is that real GDP growth in 2001–02 is likely to be 2½% instead of 2¼%. Like the Treasury, this is not our central expectation for GDP growth. We argued in Chapter 2 that the UK might reasonably be able to grow at an underlying rate of 2¾% a year over the forecast horizon.³⁹ The output gap calculations and cyclically adjusted estimates of borrowing are based on this higher growth assumption.

IFS / Goldman Sachs medium-term forecasts for the public finances are shown in Table 3.14. These forecasts assume that the measures announced in the PBR are implemented in full, including those under consultation. The scope for further discretionary measures in the Budget is considered in Section 3.8. Public spending is slightly lower in 2002–03 and 2003–04 than the Treasury's PBR forecast, reflecting a lower AME margin and lower debt interest payments, but it is back on track in the last two years of the forecast horizon on the assumption that current spending grows at 2.5% a year in real terms and net public investment stabilises at 1¾% of GDP. Receipts are stronger throughout the forecast horizon due to greater fiscal drag than the Treasury assumes.

³⁸ This allows for half of this year's £2 billion likely undershoot in DELs to be carried forward to next year and setting the AME margin back to £1 billion.

³⁹ The UK has grown at an annual rate of 2½% in the post-war period and by almost 3% over the past five years. One of the Treasury's performance targets is 'By 2004, to raise the trend rate of growth from the current estimate of 2.5%' (source: HM Treasury, *Public Service Agreements, July 2000*, Cm. 4808, HM Treasury, London, 2000).

Table 3.13. Comparison of the Treasury's and our main economic assumptions

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Output (GDP, % growth)						
HM Treasury PBR	3	2¼	2¼	2¼	2¼	2¼
IFS / Goldman Sachs	3	2½	2¼	2¼	2¼	2¼
GDP deflator (% growth)						
HM Treasury PBR	2	2½	2½	2½	2½	2½
IFS / Goldman Sachs	2	2½	2½	2½	2½	2½
Money GDP (% growth)						
HM Treasury PBR	5	4¾	4¾	4¾	4¾	4¾
IFS / Goldman Sachs	5	5	4¾	4¾	4¾	4¾
Money GDP (£ billion)						
HM Treasury PBR	950	995	1,042	1,091	1,142	1,196
IFS / Goldman Sachs	948	996	1,043	1,093	1,145	1,199

Note: For more details of the IFS / Goldman Sachs central economic forecast, see Table A.4 in Appendix A.

Sources: Treasury economic forecasts from HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000; this table is similar to Table B3 (p. 169). IFS / Goldman Sachs calculations.

Table 3.14. Medium-term public finances forecasts, based on cautious macroeconomic assumptions (£ billion)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
IFS / Goldman Sachs forecasts						
<i>Current budget</i>						
Current receipts	381.3	399.4	417.4	437.3	458.4	480.9
Current expenditure ^a	361.1	382.5	402.1	422.5	443.8	466.3
Windfall tax & ass. curr. sp. ^b	0.8	0.8	0.7	0	0	0
Surplus on current budget^c	21.1	17.7	15.9	14.8	14.6	14.6
<i>Capital budget</i>						
Net investment	6.0	11.2	15.0	18.2	20.0	22.0
Windfall tax & ass. cap. sp. ^b	0.9	0.7	0.0	0	0	0
Public sector net borrowing^c	-15.9	-7.2	-0.9	3.4	5.4	7.4
HM Treasury forecasts						
<i>Current budget</i>						
Current receipts	380.3	399.4	416	432	452	473
Current expenditure ^a	364.6	384.2	404	425	444	465
Windfall tax & ass. curr. sp. ^b	0.8	0.8	0.7	0	0	0
Surplus on current budget^c	16.6	16	14	8	8	8
<i>Capital budget</i>						
Net investment	7.0	10.7	14.5	18.2	20	22
Windfall tax & ass. cap. sp. ^b	0.9	0.7	0.0	0	0	0
Public sector net borrowing^c	-10.1	-6	1	10	12	13

^a In line with the National Accounts, depreciation has been included as current expenditure.

^b Removes spending financed by the windfall tax.

^c Excludes spending financed by the windfall tax.

Sources: Treasury forecasts from HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000; this table is equivalent to Table B5 (p. 172). IFS / Goldman Sachs calculations.

Fiscal rules met with room to spare

The surplus on current budget stabilises at around £14–15 billion on the IFS / Goldman Sachs medium-term projections, £6–7 billion higher than in the

March 2000 Budget and November 2000 PBR. The average surplus over the period from 1999–2000 to 2005–06 is 1.7% of GDP. Thus the golden rule will be met comfortably. On our cyclically adjusted estimates, shown in Table 3.15, the surplus on current budget is running at 1.2% of GDP at the end of the forecast horizon, 0.5 of a percentage point of GDP above Treasury projections. PSNB also remains historically low. Public sector net debt declines steadily

Table 3.15. Compliance with the fiscal rules: the current balance and net public sector debt ratio as a percentage of GDP

	1999–00	2000–01	2001–02	2002–03	2003–04	2004–05	2005–06
Fiscal balances							
Surplus on current budget ^a	2.1	2.2	1.8	1.5	1.4	1.3	1.2
Average surplus since 1999–2000	2.1	2.2	2.0	1.9	1.8	1.7	1.7
PSNB ^a	-1.8	-1.7	-0.7	-0.1	0.3	0.5	0.6
Public sector net debt	36.8	31.7	29.5	28.0	26.9	26.0	25.3
Cyclically adjusted fiscal balances							
Surplus on current budget ^a	1.9	1.9	1.5	1.3	1.1	1.2	1.2
PSNB ^a	-1.5	-1.4	-0.4	0.2	0.5	0.5	0.6
Output gap ^b	0.3	0.6	0.3	0.4	0.2	0.0	0.0

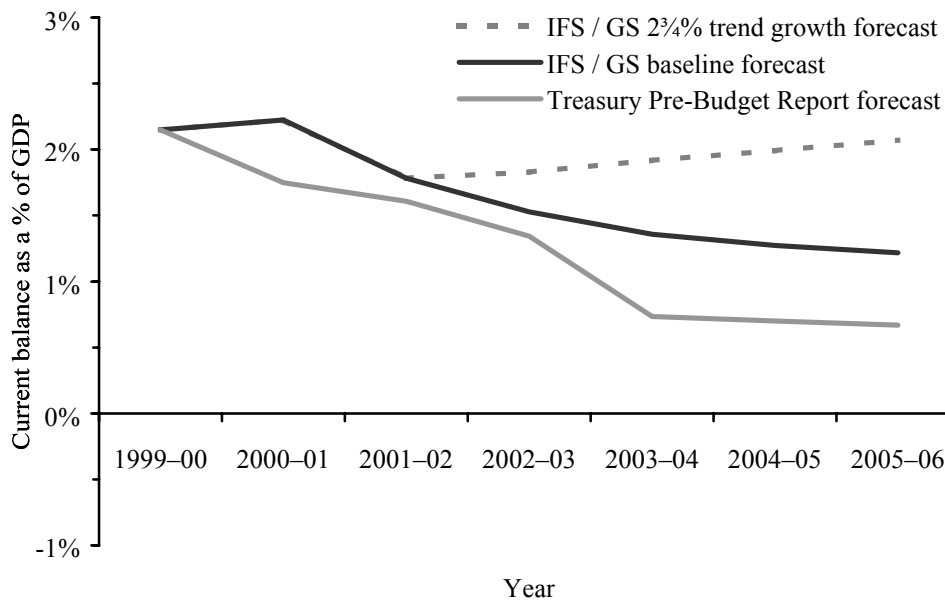
^a Excluding windfall tax and associated spending.

^b The output gap is the difference between the actual level of output in the economy and the trend level of output. Positive numbers for the output gap indicate that output is above trend.

Note: This table is similar to HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000, Table B1 (p. 166). For more information on cyclical adjustments, see HM Treasury, *Fiscal Policy: Public Finances and the Cycle*, 1999.

Source: IFS / Goldman Sachs calculations.

Figure 3.7. Current budget surplus forecasts as a percentage of GDP



Sources: Treasury forecast from HM Treasury, *Pre-Budget Report*, Cm. 4917, November 2000; IFS / Goldman Sachs calculations.

throughout the forecast horizon to almost 25% of GDP in 2005–06, below the previous low recorded in 1990–91.

As noted already, these forecasts are based on a cautious path for real GDP growth. If we adopt the IFS / Goldman Sachs central estimate of 2¾% trend GDP growth, the surplus on current budget continues to rise, to around 2% of GDP by the end of the forecast horizon. This is shown in Figure 3.7.

3.8 The Budget judgement

With the public finances continuing to come in better than expected, the Chancellor is likely to feel that there is scope in the Budget to announce discretionary cuts in taxes or additional increases in spending. The government's approach was set out by Gus O'Donnell, HM Treasury's Director of Macroeconomic Policy and Prospects, in evidence to the House of Commons Treasury Select Committee after the March 2000 Budget.⁴⁰ He stated that 'there is no Government intention to run up surpluses for ever. The intention is to move back towards meeting the Golden Rule with a reasonable margin'. He likened the situation to a golfer who had hit the ball straight down the fairway when an unanticipated wind comes along and blows the ball to the right. The next shot aims back towards target.

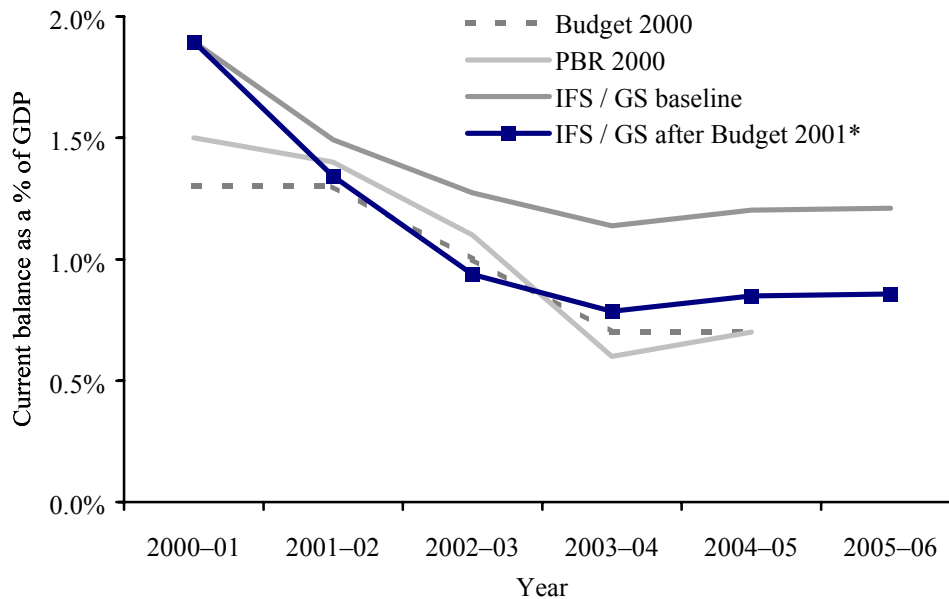
As Figure 3.8 shows, the measures announced in the November 2000 PBR brought the cyclically adjusted surplus on current budget back into line with that planned in the March 2000 Budget. In fact, as Table 3.16 shows, to prevent the surplus on current budget from rising, the Chancellor has already announced, over the past two years, a fiscal loosening amounting to £12 billion in 2001–02 over and above the £9 billion in 2000–01. If the consultative measures announced in the PBR are included, this figure rises to almost £14 billion.

The IFS / Goldman Sachs central forecast already assumes that the Chancellor will cut taxes by £1.7 billion in 2001–02 and £2.2 billion in 2002–03 by implementing in full the measures under consultation from the PBR. Despite this, the cyclically adjusted surplus on current budget is running around 0.5 of a percentage point of GDP above the path in the March 2000 Budget and the PBR.

In the Budget, we expect the Chancellor to announce £3–4 billion of additional discretionary measures by 2002–03. As Figure 3.8 shows, this would bring the cyclically adjusted surplus on current budget broadly in line with that envisaged in the March 2000 Budget. The path of PSNB would also be similar to that planned in the March 2000 Budget. The Chancellor would thus be able to claim that the fiscal stance was at least as tight as intended in last year's Budget.

⁴⁰ House of Commons Treasury Select Committee, *Fifth Report: The 2000 Budget, 13 April 2000 Report, Proceedings, Minutes of Evidence and Appendices*, Hc379, Stationery Office, London, 2000.

Figure 3.8. Cyclically adjusted surplus on current budget as a percentage of GDP



* Assumes a package of tax cuts or spending increases announced in the March 2001 Budget costing £1.5 billion in 2001-02 and £3.5 billion in 2002-03, over and above the cost of the measures under consultation from the November 2000 Pre-Budget Report.

Sources: Treasury forecast from *Pre-Budget Report*, Cm. 4917, November 2000; IFS / Goldman Sachs calculations.

Table 3.16. A comparison of the size of fiscal loosening contained in the Chancellor's recent announcements (£ billion)

	2000-01	2001-02
<i>Measures announced</i>		
March 1999 Budget	-1.4	-3.6
November 1999 Pre-Budget Report	-2.2	-3.5
March 2000 Budget	-4.9	-11.6
November 2000 Pre-Budget Report	-0.7	-2.6
<i>Total measures announced since March 1999 Budget</i>	-9.3	-21.3
Consultation measures, November 2000 Pre-Budget Report	n/a	-1.7
<i>Total including measures under consultation</i>	-9.3	-23.0

Note: November 1999 Pre-Budget Report includes the abolition of the automatic escalators on petrol and tobacco taxes; March 2000 Budget includes the increases in government expenditure announced over and above that implied by the Comprehensive Spending Review. Of the increases in spending announced for 2001-02, £5.9 billion was not actually allocated to departments until the July 2000 Spending Review.

Source: HM Treasury, *Financial Statement and Budget Report*, various years; HM Treasury, *Pre-Budget Report*, various years.

The Chancellor is still likely to have room for manoeuvre in future years if trend GDP growth turns out higher than in the cautious case. For instance, if trend GDP growth turns out to be around 2¾% a year, there may eventually be scope to cut taxes or increase spending by a further £10 billion in today's prices by 2005-06.

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