

# B Fiscal forecast revisions

## Introduction

- B.1 Much of the material we present in each *Economic and fiscal outlook (EFO)* discusses how and why our forecasts have changed since the previous *EFO*. In this annex, we:
- describe the **approach we take to breaking down changes in our fiscal forecast** between classification changes, the results of our own forecast judgements and the consequences of decisions taken by the Government (from paragraph B.3);
  - review the **average size and direction of our underlying fiscal forecast revisions** since 2010, and explore the main drivers of those changes and their composition (from paragraph B.16); and
  - summarise **how the Government has responded** when we have presented different changes in the underlying fiscal forecast that forms the basis of decisions taken at each Budget and Autumn Statement (from paragraph B.29).
- B.2 The analysis presented in this annex draws on a new database that we have compiled, which decomposes all our fiscal forecast revisions since 2010. We will update it after each forecast and it will be available on our website.

## Decomposing changes between forecasts

- B.3 The starting point for this annex is the diagnostic tables that we have included in each of our *EFOs* since November 2010. These decompose changes in receipts, spending and borrowing forecasts since the previous *EFO*. The tables are built from individual forecasts: the sources of changes to public sector net borrowing (PSNB) are derived from the receipts and spending tables, which are in turn compiled from the individual receipts and spending lines that make up each total. Where changes to an individual receipt or spending line are large or unusual, we present a dedicated table for that item. These ‘forecast diagnostics’ form an integral part of the scrutiny process that we undertake when producing each fiscal forecast – they often provide the initial signal that there is an issue in a forecast model or that a forecast judgement needs to be reviewed.

## Methodology

- B.4 To construct the new database, we have aggregated the information contained in the diagnostic tables from past forecasts into three categories:

- **classification changes:** these are typically the result of decisions taken by the Office for National Statistics (ONS) since the previous forecast;
- **underlying forecast changes:** these are the result of our own judgements about how our forecasts should change in light of new information since the previous forecast; and
- **policy changes:** the results of Government decisions that are announced in each Budget and Autumn Statement, or in the period since the previous fiscal event.

### Classification changes

- B.5** When discussing forecast changes, we try to isolate the effect of classification changes and significant one-off factors in order to present a 'like-for-like' picture of how the public finances have evolved. This is usually the first step in the process – for example, our November 2015 *EFO* focused on underlying forecast changes since the previous forecast in July, after first stripping out the effect of a reclassification of housing associations from the private to the public sector. In our new database, we have removed the effects of major classification changes and other one-offs (for example, the changing treatment of the Asset Purchase Facility) from each forecast-to-forecast change. But we have not attempted to restate all our previous forecasts on the basis of current definitions and classifications, which would be a much bigger task.
- B.6** Table B.1 details the classification and other one-off effects that have been accounted for explicitly in this analysis. The biggest items relate to transfers from the Royal Mail Pension Plan and Asset Purchase Facility in 2012, the major overhaul of economy and public finances data in 2014 (which affected both receipts and spending, but with only a small net effect on PSNB) and the reclassification of housing associations to the public sector last year. More detail on each can be found in the relevant *EFO*. It should be noted that while this analysis captures all the material classification changes and one-offs, we have not identified all the smaller changes that have taken place over the past six years. The effect of these changes will therefore be included in the underlying forecast changes.<sup>1</sup>

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<sup>1</sup> We have focused on headline measures of the deficit as defined by the ONS. From November 2010 to March 2014, this was 'public sector net borrowing excluding financial interventions'. From December 2014 onwards, it has been 'public sector net borrowing excluding public sector banks'. Between March 2013 and March 2014, our *Economic and fiscal outlooks* focused on an 'underlying' measure of PSNB that removed the effect of APF and Royal Mail transactions that were particularly large and uneven from year to year. The treatment of these changed following the ONS 2014 review of the public sector finances statistics and the introduction of the 2010 European System of Accounts. In this annex and the database on our website all changes are shown on the basis of the headline PSNB measures.

Table B.1: Classification changes and one-offs factored into the revisions analysis

Fiscal event	Headline PSNB effect over the last five years of the forecast (£ billion)	Headline average PSNB effect (per cent of GDP)	Classification effects and one-off adjustments
November 2011	5.0	0.1	3G spectrum auction proceeds classification change.
March 2012	-28.0	-0.3	Royal Mail Pension Plan transferred to the public sector (ESA95 treatment).
December 2012	-52.2	-0.6	Reclassification of B&B and NRAM into the public sector and transfers from the APF to the Exchequer.
December 2013	0.0	0.0	Changes to ROCs methodology affecting receipts and spending.
December 2014	-2.1	0.0	ESA10 and PSF review classification changes.
March 2015	6.6	0.1	Multilateral development bank subscriptions added to spending, plus various other changes.
July 2015	0.0	0.0	Tax litigation provision switched from receipts to negative spending.
November 2015	10.6	0.1	Reclassification of housing associations into the public sector and other small changes.

### Underlying forecast changes

- B.7** When producing our forecasts, we start by producing a ‘pre-measures’ forecast, to which the effects of the Government’s policy decisions are added. In compiling the database the process was reversed, so that after accounting for the effects classification and policy changes, we are left with the underlying forecast change. These are the changes that reflect our own forecast judgements. They include the effects of changes in outturn data, revisions to our economy forecast, and judgements about how the public finances will perform in a given state of the economy, which we typically refer to as fiscal modelling changes.
- B.8** Underlying forecast changes also include the effects of any revisions to the amount policy measures announced at previous fiscal events are expected to cost or yield. So, for example, the shortfall in receipts from the Swiss capital tax announced in Autumn Statement 2012 contributes to downward revisions to underlying receipts in subsequent forecasts while the lower-than-expected cost of the marriage tax allowance announced in Autumn Statement 2013 and amended in Budget 2014 has contributed positively to receipts in this forecast.

### Policy changes

- B.9** In order to isolate the effect of Government decisions on our forecast, we need first to define a ‘decision’. In some cases this is simple, but in others there are different options. In this annex, we define ‘policy changes’ as:
- **scorecard measures:** changes to receipts and annually managed expenditure (AME) that result from policy measures presented on the Treasury’s ‘scorecard’ table of policy decisions. We reproduce the scorecard in Annex A of each *EFO*;

- **non-scorecard measures:** changes to receipts and AME spending that we have identified as policy changes in an *EFO* despite the Treasury choosing not to present them on the scorecard. The Treasury sometimes tries to justify this because the policy measure raises or reduces spending and receipts in equal measure, and therefore has no net effect on PSNB. One example is when additions to council tax were announced in November 2015 to finance higher local authority spending on social care;
- **changes to departmental expenditure limits (DELs):** these include all changes that do not reflect our own judgements about underspending against plans or neutral switches of spending between DEL and AME within total managed expenditure (TME). As discussed below, this definition is consistent with how we now present DEL changes, but differs from the presentation in our earlier forecasts; and
- **the indirect effects of Government decisions:** for example, how changes in departmental spending affect our assumptions about workforce growth and so net public service pensions spending. We have identified these explicitly since March 2015, but have not gone back to estimate such effects in previous forecasts.

**B.10** Within TME, DEL spending is the element over which the Government has the greatest discretion. It is typically set out in multi-year spending plans – as in last November’s Spending Review, which set plans up to 2019-20 and in some cases 2020-21. So one would expect most changes in DELs to be the result of Government decisions.

**B.11** During the last Parliament, the Coalition Government initially set DEL plans to 2014-15 and then extended them to 2015-16. But by the final forecast of the Coalition’s term, the forecast period extended to 2019-20, so DELs in four of the five years of the forecast were set by Government assumption rather than detailed plans. The Coalition deployed an increasingly complicated assumption – first described as a ‘spending assumption’, then as a ‘fiscal assumption expressed in terms of TME’ – from which the future path of Resource DEL (RDEL) was inferred.<sup>2</sup> A separate – and also complicated – rule determined Capital DEL (CDEL) spending.

**B.12** In our *EFOs*, we described the roundabout way in which the Government changed its spending assumption to set the overall level of TME, and what that implied for RDEL after subtracting our forecast for AME spending and the CDEL spending determined by the Government’s rule. It meant, for example, that if applying our new GDP deflator forecast to the previous formulation of the spending rule changed the level of implied RDEL spending, we described that as a forecast change. While that was a true reflection of the process, it ignored the fact that all the information was available to the Government when setting the rules, so in effect the rules were just a presentational device for telling us what it assumed it would wish to spend on DELs beyond the years covered by detailed plans.

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<sup>2</sup> In March 2015 we published a compendium of the spending assumptions that had been used between 2011 and 2015, which is available on our website.

B.13 Since July 2015, we have adopted a more transparent approach of showing all changes in DELs in our forecast as the result of Government policy decisions, except where they are the consequence of our own judgements about the extent to which departments will underspend the limits set for them by the Treasury. In the database produced for this annex, we have derived DEL policy changes in all forecasts on this basis: removing from total DEL changes any movements in our underspend assumptions and any switches with AME spending.

### Measuring changes over a multi-year forecast period

B.14 Before turning to the analysis, we need to make one more decision: how to express overall changes in our forecast over a multi-year period. Should we average the changes across years? Sum them? Express them as a percentage of spending or receipts, or of national income? Since the factors driving those changes may vary from year to year, a single metric may not always be the most appropriate. In the database and this annex, we have focused on two:

- the **change as a percentage of GDP** over the forecast period. This is our preferred metric as it corrects for the upward trend in cash revisions over time and through each forecast period that results from nominal GDP growth. To abstract from changes in nominal GDP between forecasts – and the fact that the receipts forecast tends to move with GDP – this is calculated by summing total cash changes then expressing that total as a percentage of total GDP produced over the forecast period. It is not equivalent to averaging the changes in receipts and spending as a share of GDP; and
- the **cumulative cash revision** over the forecast period. This is perhaps the simplest metric and can be useful when revisions are uneven across years, meaning that an average or the final year of the forecast can be misinterpreted or may not be representative. But it does have the drawback of generating numbers that appear large when not placed in the context of the UK's £2 trillion economy or the Government's £<sup>3</sup>/<sub>4</sub> trillion annual spending. That was apparent in the discussion of the £27 billion cumulative downward revision to our PSNB forecast last November, which as this annex shows was in fact one of the smaller revisions we have made.

B.15 For both metrics, we focus on changes over the 5-year forecast period, excluding any revisions to the current year forecast. As our *Forecast evaluation reports* have shown, revisions to current year forecasts can also be material, but they are less comparable across all our forecasts. When producing a forecast alongside an Autumn Statement, we typically have information about seven or eight months of the fiscal year. At Budget time, we have ten months of official data and some administrative data for the eleventh month of the year.

## Summary of underlying fiscal forecast revisions since 2010

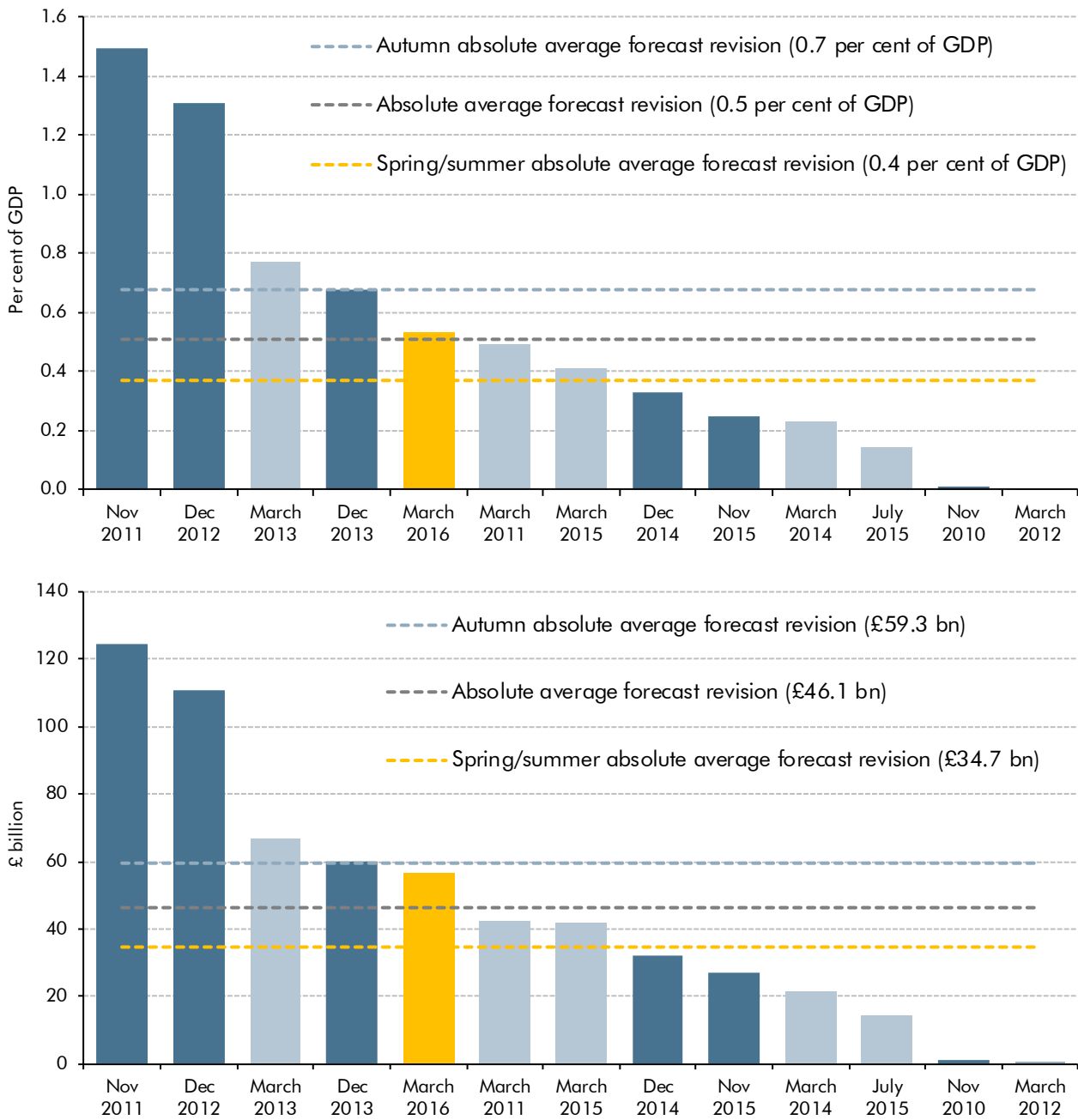
B.16 We have published 15 forecasts since the OBR was established in June 2010, including the interim OBR's pre- and post-Budget forecasts in June 2010 itself. In this section, we analyse the underlying fiscal forecast revisions in the 13 forecasts published since that final June 2010 forecast, including our latest forecast described in this *EFO*. We start by looking at the average size of revisions, abstracting from their direction. We turn to that question next, before considering how they relate to changes in our economy forecast.

### The average size of fiscal forecast revisions

B.17 The two panels of Chart B.1 present our underlying pre-policy-measures forecast revisions in absolute terms – ignoring whether the revision was up or down. The top panel presents revisions on our preferred metric as a percentage of GDP and the bottom in cumulative cash terms. Past spring and summer budget forecast revisions are shown in light blue, autumn statement revisions in dark blue and the latest forecast in yellow. They show that:

- on average, we have **revised our underlying borrowing forecast** by 0.5 per cent of GDP over the five years of the forecast period at each fiscal event. In cumulative cash terms, the average revision has been £46.1 billion;
- **revisions to Autumn forecasts are typically bigger than those at the time of Budgets.** One reason is that more time has passed since the previous forecast, during which news about the economy and public finances accumulates. The average revision to Autumn forecasts is 0.7 per cent of GDP (or £59.3 billion in cumulative cash terms), compared to 0.4 per cent of GDP (or £34.7 billion) for Budget forecasts;
- **changes in the November 2010 and November 2015 forecasts were small relative to other Autumn forecasts**, partly because both followed a post-election Summer Budget which meant that less time had elapsed since the previous forecast. If we control for that effect by dividing the revisions by the number of months since the previous forecast, Budget and Autumn forecasts both show average revisions per month that has passed of almost £10 billion cumulatively over the forecast period; and
- **the underlying revision in our current forecast is close to the average size** of all past forecasts, although it is the second biggest revision in a Budget forecast.

Chart B.1: Absolute underlying forecast revisions



Source: OBR

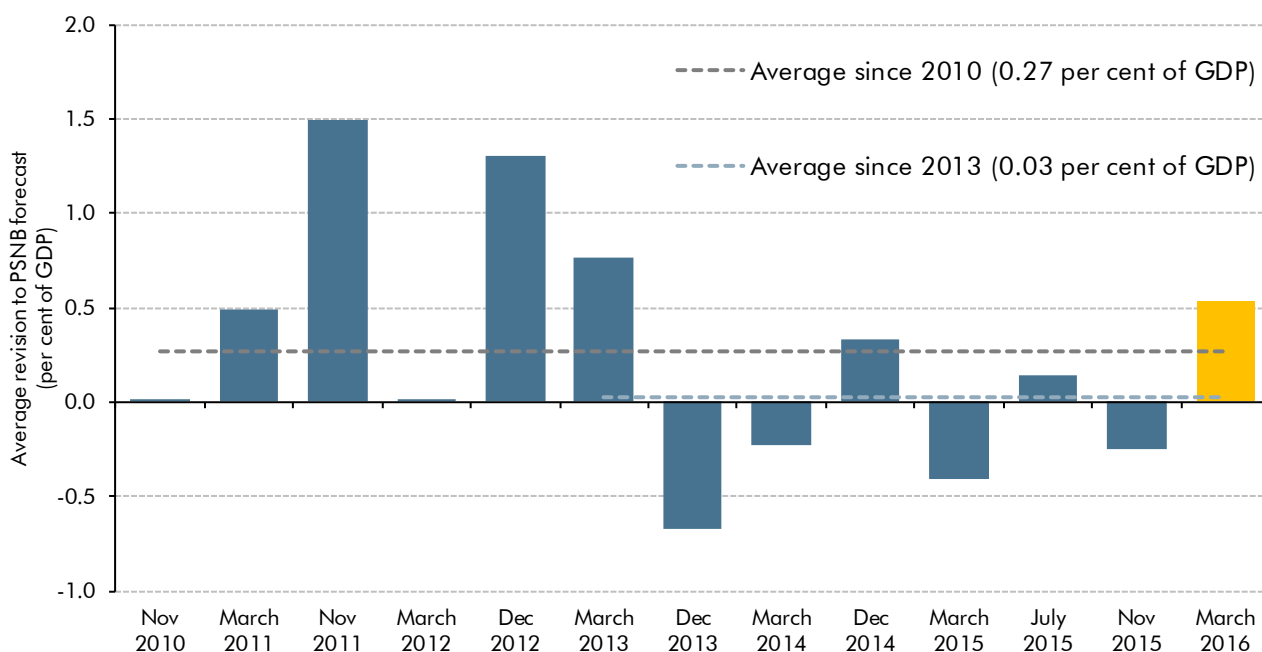
### The direction of underlying fiscal forecast revisions

**B.18** We aim to produce central forecasts, so over the long term we should expect upward revisions about as often as downward revisions, and the scale of those changes should be broadly offsetting. Over the relatively short period covered by Chart B.2:

- we have **revised our borrowing forecast up on average** by 0.3 per cent of GDP (or £23.0 billion in cumulative cash terms) in each forecast since November 2010. Nine forecasts have included upward revisions and four downward revisions;

- **our average upward revision** of 0.6 per cent of GDP (£49.9 billion) has been around 50 per cent **bigger than our average downward revision** of 0.4 per cent of GDP (£37.6 billion); and
- **the biggest upward revisions came in our earlier forecasts**, in particular those published alongside the Autumn Statements in 2011 and 2012. Since 2013, our forecast revisions have averaged close to zero, with upward revisions (including in this forecast) broadly offsetting downward revisions.

Chart B.2: Underlying revisions to borrowing forecasts



Source: OBR

## What drives our fiscal forecast revisions?

**B.19** Having reviewed the average size and direction of our underlying fiscal forecast revisions, we now consider the factors that have led to those revisions. By far the most important driver is changes to our economy forecast. But we also make a number of judgements about how the public finances will evolve for a given state of the economy. Changes in these judgements can sometimes have a material effect on our fiscal forecasts.

### Economy forecast changes

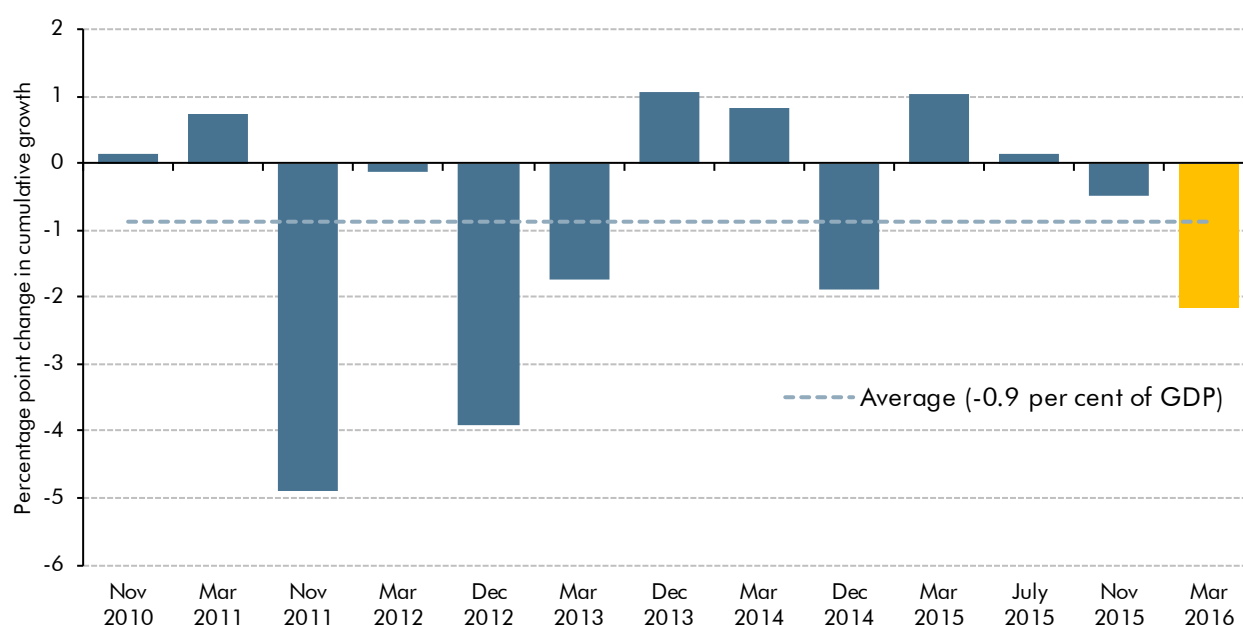
**B.20** Most economic forecasts focus on the outlook for real GDP, but it is nominal GDP that matters most when forecasting the public finances. Forecasts of tax receipts are particularly dependent on the profile and composition of economic activity. On the income side, labour income is generally taxed more heavily than company profits. On the expenditure side, consumer spending is subject to VAT and other indirect taxes while business investment attracts capital allowances that reduce corporation tax receipts in the short term. And while around half of public sector expenditure is set out in multi-year plans, large elements (such



as social security and debt interest payments) are linked to developments in the economy – notably inflation, market interest rates and the labour market.

**B.21** Chart B.3 shows the revisions to our nominal GDP growth forecasts. In absolute terms, the average revision to cumulative nominal GDP growth over each 5-year forecast horizon has been 1.5 percentage points. We have made downward revisions more often than upward ones, and also by bigger margins, so that the average revision has been down by 0.9 percentage points. It is also apparent that the pattern of upward and downward revisions across forecasts is similar to that of the PSNB forecasts shown in Chart B.2. That relationship is shown more clearly in Chart B.5 below.

Chart B.3: Revisions to nominal GDP forecasts



Source: OBR

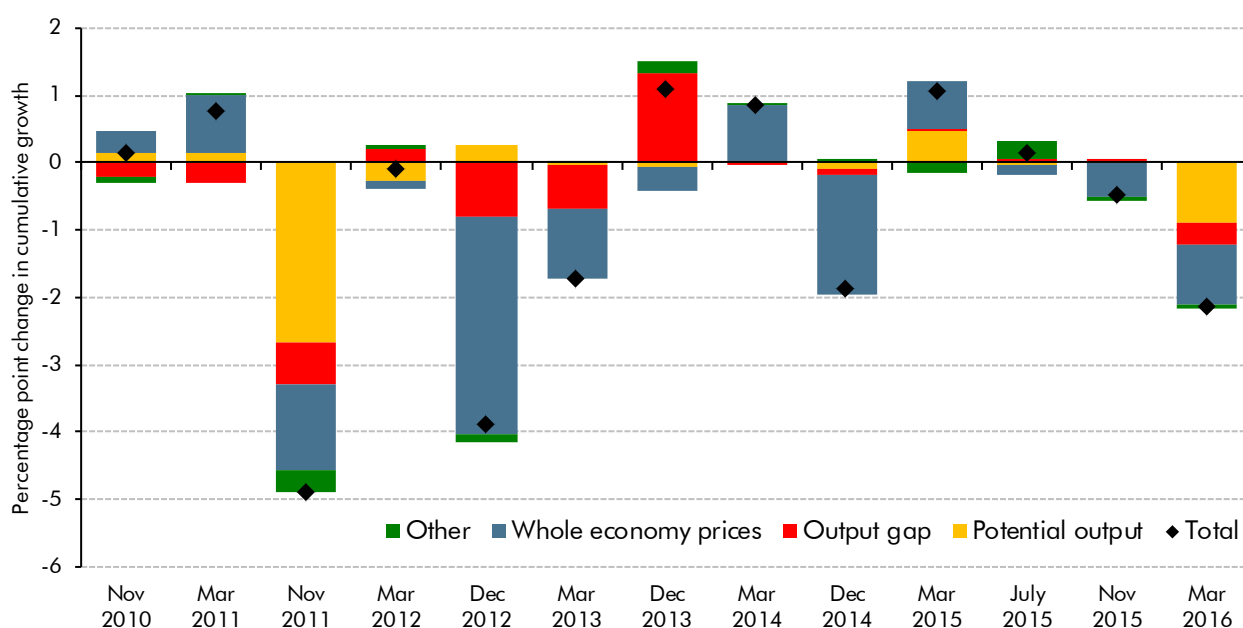
**B.22** Chart B.4 decomposes these revisions into real GDP (which in turn reflects our estimates of the economy's underlying output potential and the amount of spare capacity – the 'output gap' – relative to that potential) and whole economy prices. It shows that:

- revisions to **potential output growth** and the contribution from changes in the **output gap** have generally been small. Both average 0.4 percentage points in absolute terms since November 2010. For potential output in particular, we have tended to make discrete changes when sufficient evidence has built. That includes the big downward revisions to underlying productivity growth in November 2011 and (to a lesser extent) in this forecast, and the migration-driven upward revision in March 2015. Revisions to the output gap profile were most important between December 2012 and December 2013, when we initially assumed that a large negative output gap would persist at the end of the forecast period, then revised that judgement away in December 2013;
- revisions to **whole economy prices**, as measured by GDP deflator growth, have been a bigger source of revision to our nominal GDP growth forecasts, averaging 0.9

percentage points in absolute terms. Some of these revisions have followed changes to our forecast assumptions and methods, including the big downward revisions in December 2012 (a re-evaluation of our medium-term assumptions for the GDP deflator) and December 2014 (changes to how we forecast the government consumption deflator as well as a revision to our CPI inflation forecast); and

- **other factors** in this chart relate to oil production – since we estimate potential output on a non-oil basis – and the treatment of the ‘basic price adjustment’ and ‘statistical discrepancy’ in each forecast.

Chart B.4: Sources of revisions to successive nominal GDP forecasts

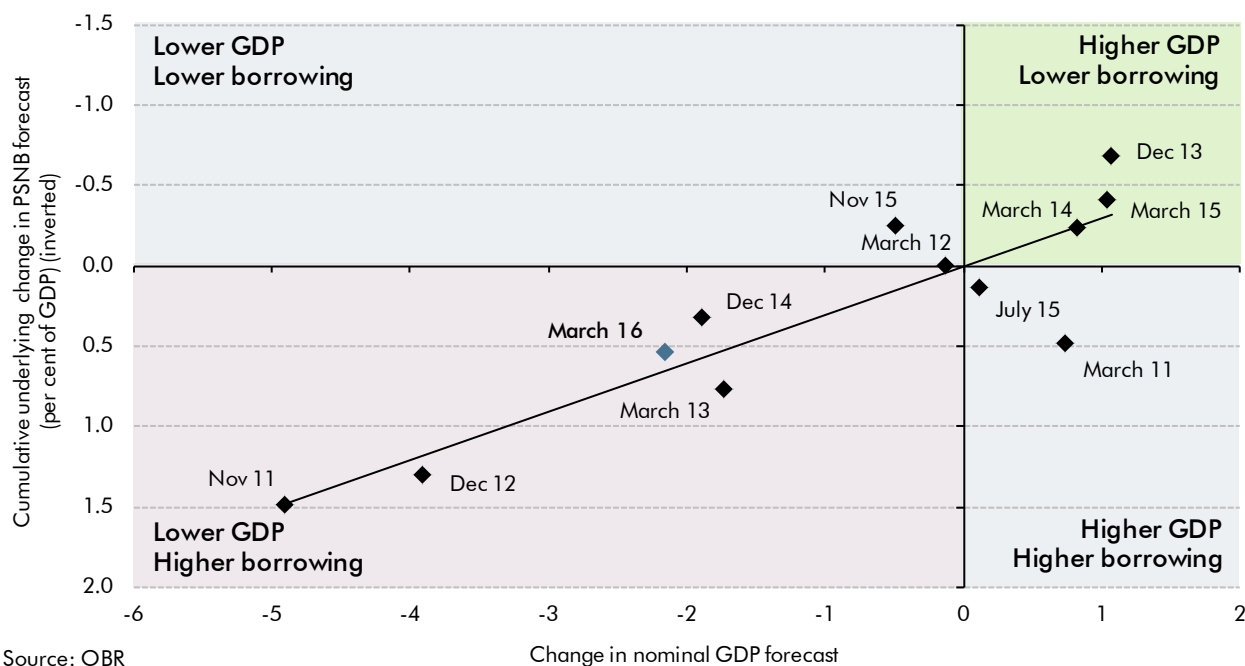


Note: Our November 2011 forecast incorporated the effects of an ONS methodological change to estimating the GDP deflator, which meant that all else equal real GDP growth was 0.2 percentage points higher for a given rate of nominal GDP growth. We have adjusted the decomposition of that forecast revision to show it on a like-for-like basis.

Source: OBR

**B.23** Chart B.5 shows the close correlation between our economy and fiscal forecast revisions. When we revise down prospective GDP growth, we tend to revise up our borrowing forecast, and vice versa. In statistical terms, around 80 per cent of the variation in revisions to our borrowing forecasts is explained by variation in those to our nominal GDP forecasts. That falls to around two-thirds when compared with revisions to our real GDP forecasts, on which most people focus. That said, we have produced three forecasts in which the revisions to borrowing and nominal GDP have moved in the same direction rather than in opposite directions.

Chart B.5: Underlying changes in borrowing and nominal GDP revisions



Source: OBR

### Modelling changes and other forecast judgements

**B.24** While economy forecast judgements are usually the biggest driver of changes in our fiscal forecast, the judgements we make about how receipts and spending will perform in a given state of the economy can also be important. For example, judgements about the distribution of labour income will affect our receipts forecast, since higher earners pay a higher effective tax rate per pound of earnings, while judgements about the performance of ongoing reforms to the welfare system will affect our spending forecast. Changes of this sort are sometimes previewed when we present related analysis in our other documents, in particular the annual *Forecast evaluation report (FER)* and *Welfare trends report (WTR)*.

**B.25** Modelling changes and other forecast judgements can lead us to raise or lower our borrowing forecasts. Some of the bigger changes that increased borrowing include:

- in December 2014, we revised our forecasts for the **PAYE and NICs effective tax rates** down, lowering receipts by £17.0 billion over the forecast period. That reflected weaker-than-expected receipts in 2014-15 (implying a lower effective tax rate for a given amount of labour income) as well as the incorporation of analysis from our October 2014 *FER*, which highlighted that employment driven income growth (which is less tax rich) had been a source of forecast error in previous years;
- also in December 2014, we revised up our forecast for spending on **disability benefits**. That followed analysis presented in our October 2014 *WTR* of how the reforms replacing disability living allowance with the new personal independence payment had continued to disappoint against the savings factored into our forecast. That increased spending by £3.7 billion over the forecast period. We revised disability benefits spending up again in November 2015, adding a further £7.0 billion over the forecast

period, and have done so once more in this forecast, increasing spending by £5.4 billion over the forecast period. The effect of these revisions on successive forecasts are shown in Chart 4.10 in Chapter 4;

- in a similar vein, expected savings associated with reforms to **incapacity benefits** also fell short of initial forecasts. We revised up spending on incapacity benefits by £8.0 billion over the forecast period in December 2013. In March 2014, it was revised up again, by a smaller £2.6 billion over the forecast period. Then in December 2014, we revised our forecast up once more, increasing spending by £3.1 billion over the forecast period;
- in July 2015, we changed the methodology we use to forecast **net spending on public sector pensions**. Previously, for years beyond the existing Spending Review period, we had assumed no change in the workforce since no plans had existed. We felt that it would be more consistent with the rest of our forecast if we linked workforce assumptions in the public sector pensions forecast to the general government employment path derived from departmental spending totals and public sector pay policy. Since that implied falling workforce numbers and lower contributions to pensions schemes, it pushed net spending up by £11.1 billion; and
- in December 2014, we revised our assumption for the underlying downward trend in tobacco clearances from 2 per cent to 4 per cent a year, reflecting weakness in tobacco receipts and the effects of the EU tobacco products directive. This change reduced **tobacco duty receipts** by £4 billion over the forecast.

**B.26** Some of the bigger changes that reduced borrowing include:

- in December 2012, we introduced an assumption of **underspending against DELs**. That followed analysis presented in our October 2012 *FER*, which showed that a significant source of error in our previous spending forecasts had been to underestimate the extent of underspending against plans. The underspending assumptions only applied to years in which plans had been set (up to 2014-15, the end of the 2010 Spending Review period). Over the 2012-13 to 2014-15 period, the new assumptions reduced borrowing by £12.7 billion;
- also in December 2012, we revised up the extent of expected **net additions to local authorities' current reserves**, which our 2012 *FER* analysis identified as another significant source of error in our spending forecasts. We had previously expected tighter budgets to prompt local authorities to draw on their reserves, but in fact the uncertainty over future budget cuts appeared to have prompted additions to reserves. That change reduced borrowing by £6.2 billion over the forecast period;
- in preparing our October 2015 *FER*, we discovered an error in our historic VAT forecasts relating to **VAT deductions to the government sector**, which meant that previous *EFOs* had been over-forecasting those deductions. We corrected this error in our November 2015 forecast, which boosted VAT receipts and therefore reduced

borrowing by £11.1 billion over the forecast period. We have retained this corrected forecast methodology in our latest forecast; and

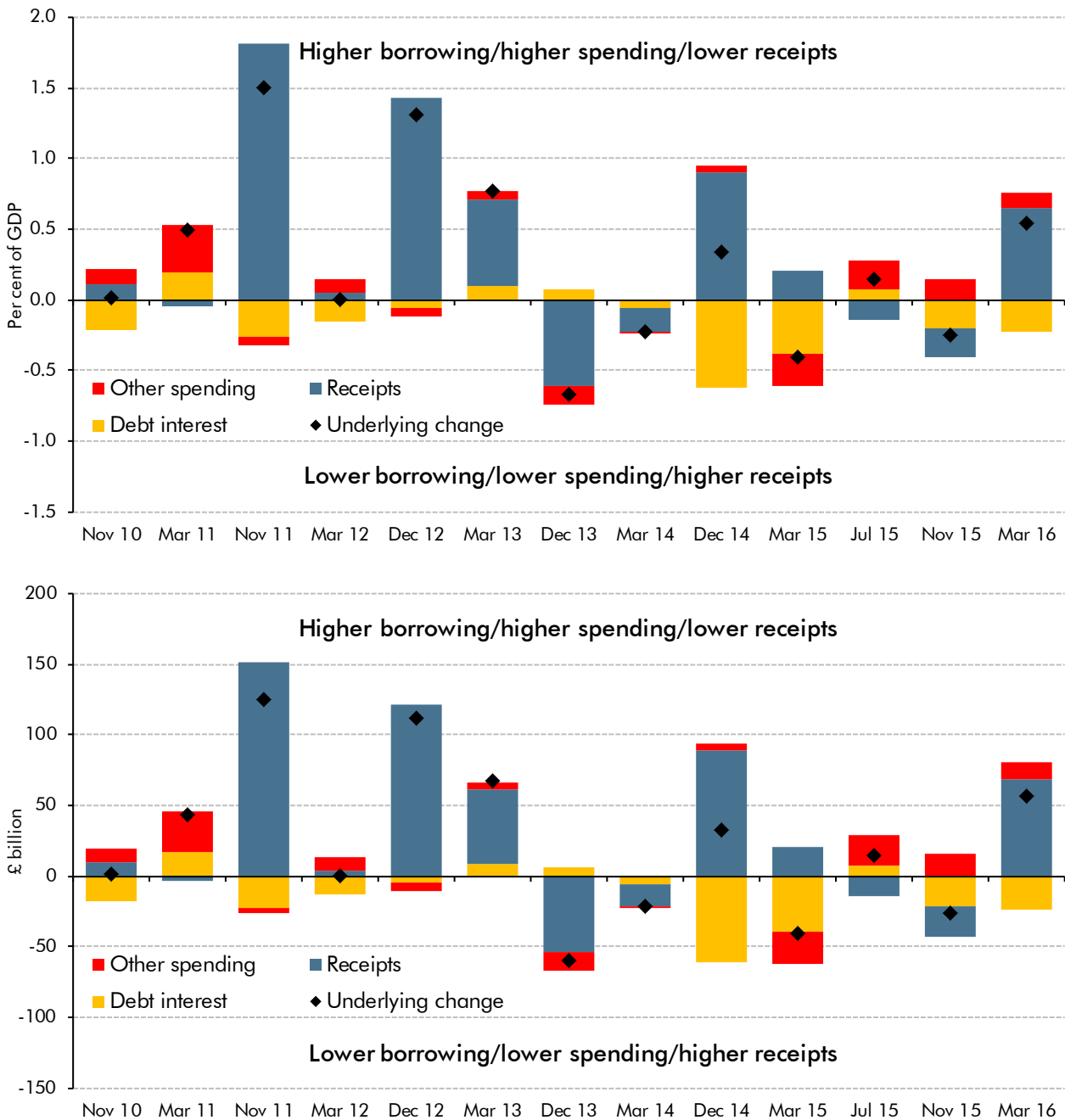
- also in November 2015, we switched our **NICs forecast** to an improved forecasting model. The new model is more transparent, allowing us to scrutinise forecast changes more effectively, and produced a more plausible forecast for the amount of income being taxed above the upper earnings limit. That change boosted NICs receipts and therefore reduced borrowing by £6.6 billion over the forecast. We have continued to use this improved NICs forecast model in our latest forecast.

## The composition of underlying fiscal forecast revisions

**B.27** The two panels of Chart B.6 decompose the underlying changes to successive PSNB forecasts into receipts, debt interest and other spending, on the two metrics used in this annex. The chart shows that:

- **revisions to receipts tend to be bigger than revisions to spending.** In absolute terms, receipts revisions have averaged 0.5 per cent of GDP (£48.1 billion cumulatively), more than twice the average spending revision of 0.2 per cent of GDP (£22.1 billion cumulatively). That is as one might expect, since most receipts are linked to the performance of the economy, whereas around half of public spending (i.e. DELs) is in effect fixed in cash terms. (We would reach a different conclusion if each forecast was specified as a percentage of GDP before decomposing the revisions. With receipts and GDP often moving in step, it is spending that moves most as a share of GDP when we change our GDP forecast, through a denominator effect: if we revise nominal GDP lower, the same spending is a higher percentage of that lower GDP); and
- **revisions to receipts are typically offset to some extent by revisions to debt interest spending.** There have only been three forecasts where changes in receipts and debt interest have contributed in the same direction to the overall revision to borrowing. The most notable of those was our last forecast in November 2015. Again, it should come as no surprise that receipts and debt interest forecast changes tend to offset each other since both are likely to be driven by the same underlying factors. In particular, market expectations of future interest rates, which drive our debt interest forecast, will tend to fall/rise when market participants' expectations of future growth prospects are lowered/raised. If we share that interpretation – as will often be the case – we are likely to revise down/up our nominal GDP growth and receipts forecasts.

Chart B.6: Sources of change in borrowing forecasts



Source: OBR

**B.28** The story of the forecast revisions shown in Chart B.6 can be summarised as:

- in **November 2010**, underlying borrowing was virtually unchanged over the forecast period. Lower spending (on debt interest, social security and public service pensions) was offset by lower receipts. An upward revision to VAT receipts (driven by changes to modelling of the exempt sector and higher household consumption) was more than offset by lower outturn onshore CT, PAYE and NICs receipts;

- in **March 2011**, higher oil prices had a broadly neutral effect on the public finances. Higher revenues from the UK oil and gas sector (which were much higher than they are now) were partly offset by lower fuel duty receipts (as higher oil prices reduced demand for fuel), higher spending on social security and debt interest (as higher inflation fed through to higher indexation) and lower income tax receipts (as higher inflation reduced real earnings growth). Higher inflation from other sources also raised debt interest and welfare spending further. Borrowing was revised up by 0.5 per cent of GDP on average over the forecast period (£42.4 billion cumulatively);
- in **November 2011** we revised down nominal GDP growth significantly. The lower labour income, company profits and household consumption associated with lower GDP explained most of the 1.8 per cent of GDP average downward revision to receipts. Lower debt interest spending (driven by lower gilt rates and lower inflation) provided a partly offsetting 0.3 per cent of GDP reduction in spending. The overall upward revision to PSNB was 1.5 per cent over the forecast period (£124.5 billion cumulatively). This was the largest underlying revision we have made;
- in **March 2012**, underlying borrowing was again virtually unchanged. Lower receipts and higher spending were offset by lower debt interest spending;
- in **December 2012** we once again revised down nominal GDP growth significantly. The weaker economic outlook explained around half the 1.4 per cent of GDP downward revision to tax receipts. Weak outturn income tax and NICs receipts – implying a lower effective tax rate – explained a further quarter of this revision. Spending was revised down by 0.1 per cent of GDP on average over the forecast, with the majority of this change explained by our decision to include estimates of departmental underspends in the forecast. The overall underlying revision to borrowing was 1.3 per cent of GDP on average over the forecast period (£111.0 billion cumulatively);
- in **March 2013**, underlying borrowing was revised up by 0.8 per cent of GDP on average over the forecast period (£66.6 billion cumulatively). Around half reflected weak outturn income tax and NICs receipts, again implying a weaker-than-expected effective tax rate. A further third reflected the weaker economy forecast, in particular lower average earnings growth. The remainder reflected higher debt interest payments (driven by higher interest rates and inflation) and other smaller changes to spending and receipts;
- in **December 2013** we reversed much of the downward revision from the previous forecast as the economy picked up more sharply than expected. Underlying borrowing was revised down by 0.7 per cent of GDP on average over the forecast (£60.2 billion cumulatively). Around two-thirds of this revision reflected higher receipts due to the stronger economy forecast, with the residential property market, consumer spending and company profits all boosting receipts. The remainder was explained by stronger-than-expected outturn receipts and the effect of a lower unemployment forecast on welfare spending;

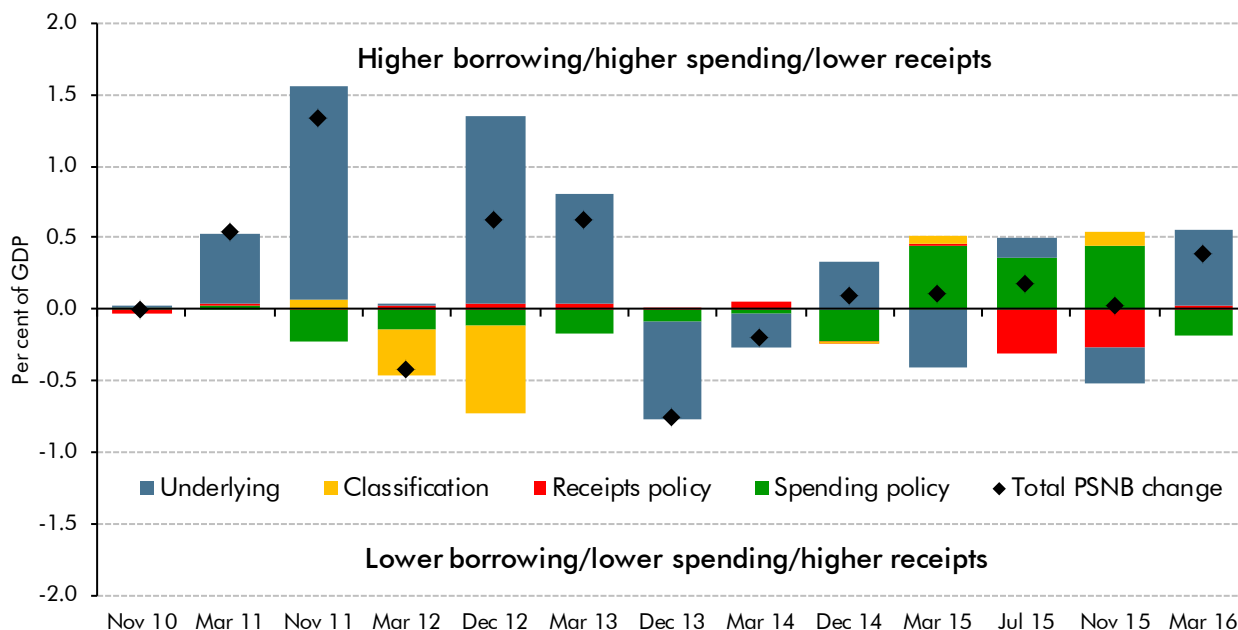
- in **March 2014**, a relatively small cumulative reduction in borrowing of 0.2 per cent of GDP on average (£21.5 billion cumulatively) was mainly driven by lower public corporations' capital expenditure and lower spending on debt interest, as well as higher-than-expected receipts;
- **December 2014** involved a small upward revision of 0.3 per cent of GDP on average (£32.3 billion cumulatively). Even though this was a small overall revision, there were large offsetting changes in the fiscal forecast. A lower outlook for receipts – driven by a weaker nominal GDP forecast and judgements about the effective tax rate on labour income – was partly offset by much lower debt interest payments – driven by lower inflation, gilt rates and modelling changes;
- in **March 2015**, a fall in oil prices – feeding through to a lower inflation forecast – was the main driver of movements in the underlying fiscal forecast. Receipts were revised down by 0.2 per cent of GDP on average, with the largest changes coming from North Sea oil revenues (due to lower oil prices and production). Again, much lower debt interest spending (due to lower RPI inflation and interest rates) and lower welfare spending (due to lower CPI uprating from 2016-17) more than offset this receipts effect and led to an overall downward revision to borrowing of 0.4 per cent of GDP on average (£41.5 billion cumulatively);
- in **July 2015**, a change to how we modelled public service pensions spending was the main factor in the 0.3 per cent of GDP average upward revision to the spending forecast. This was partly offset by an upward revision to receipts, reflecting higher-than-expected outturn tax revenues. Overall, the borrowing forecast was increased by 0.1 per cent of GDP on average (£14.5 billion cumulatively);
- in **November 2015** we revised down many tax bases, including average earnings, consumer spending and equity prices. That was more than offset by changes to the modelling of VAT deductions and a new NICs model, leaving receipts higher by 0.2 per cent of GDP on average. Higher welfare spending (largely reflecting reduced savings from disability benefit reforms) was more than offset by lower debt interest spending (again reflecting a lower path for interest rates). Overall, higher spending was more than offset by higher receipts, leaving the underlying borrowing forecast down 0.2 per cent of GDP on average (£27 billion cumulatively); and
- in **this forecast**, we have revised borrowing up by 0.5 per cent of GDP on average over the forecast period (£56.3 billion cumulatively). The main driver has been the downward revision to our nominal GDP forecast due to lower expected underlying productivity growth. This has fed through to all the main tax bases, leaving the receipts forecast down by 0.7 per cent of GDP on average.



## How did the Government respond?

- B.29** The underlying forecast revisions and classification changes described above have provided the Government with the baseline pre-measures fiscal forecasts against which to take policy decisions. In aggregate, these decisions will reflect its legislated fiscal targets and other fiscal objectives. On some occasions, the Government has chosen to offset the effects of our underlying revisions – e.g. in November 2011, when they would otherwise have led to a target being missed. On others it has chosen to accommodate those changes – e.g. in December 2012, when despite our forecast revisions implying that the debt target was set to be missed, it decided not to offset their effect.
- B.30** More generally, governments might decide that policy should act in the same direction as the underlying revision – e.g. if a cyclical improvement in the underlying forecast was felt to warrant a tighter fiscal policy – or in the opposite direction – e.g. if a structural deterioration in the fiscal position was judged to warrant tighter fiscal policy to restore the structural fiscal position. Table B.2 at the end of this section details the response to our previous underlying forecast revisions. We have grouped the discussion according to the presentation in Chart B.5, which showed how most pre-measures forecasts include lower borrowing when the economy forecast improves and vice versa.
- B.31** Chart B.7 puts these forecast changes and policy responses in context, illustrating the effect of all factors contributing to revisions in our fiscal forecasts. It shows that:
- **when our underlying forecast revisions have worsened the outlook** for the public finances, the Government has tended to respond by using policy to offset part of those changes over the forecast period. When presented with our largest upward revisions to expected borrowing in November 2011 and December 2012, the Coalition decided to add more years to the fiscal consolidation, with the policy tightening assumed to be borne almost entirely by lower departmental spending;
  - **when our underlying forecast revisions have improved the outlook** for the public finances, the Government has responded either by banking the improvement (as in December 2013) or by reducing the squeeze on spending that had been pencilled in at previous fiscal events (as in March and November 2015); and
  - **spending cuts pencilled in during the last Parliament were later reversed.** In the seven forecasts between November 2011 and December 2014, the Coalition’s policy decisions involved cutting spending every time and a net tax giveaway in all but two. At the next three forecasts, the Coalition and then the new Conservative Government reversed much of that planned squeeze on spending in the run-up to setting detailed plans in last November’s Spending Review.

Chart B.7: Post measures changes in borrowing forecasts

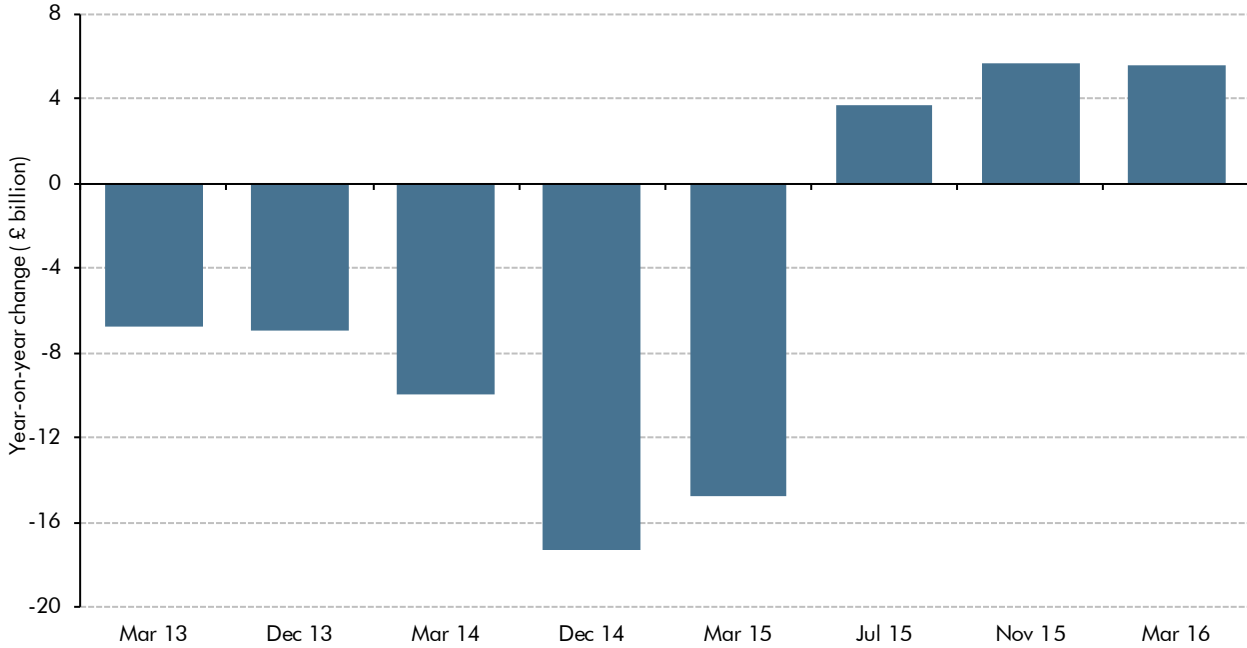


Source: OBR

**B.32** One feature of recent fiscal events that is not captured by Chart B.7 is the way in which the profile of RDEL spending has evolved in response to changes in our underlying fiscal forecast and classification changes. The most striking example came in December 2014, when our fiscal forecast was subject to significant classification changes after the ONS adopted the 2010 European System of Accounts and implemented the conclusions of its Review of the Public Sector Finances statistics. These changes added to receipts and AME spending in roughly equal measure, so were neutral for borrowing. But the Coalition chose to offset the effect of the changes on AME spending by reducing RDEL.

**B.33** That decision was carried out via its ‘fiscal assumption expressed in terms of TME’, so unfortunately it was not presented transparently in our *EFO* at the time. It meant that the year-on-year cut in cash RDEL in 2016-17 went from £10.0 billion in our March 2014 forecast to £17.3 billion in December 2014. Over the next three fiscal events, the Coalition and the new Government more than reversed that change, so that the plans set out in last November’s Spending Review implied that RDEL would rise by £5.7 billion relative to 2015-16 (after allowing for expected underspending). Our latest forecast of RDEL spending in 2016-17 is £321.7 billion, £22.7 billion higher than the figure the Coalition had assumed in Autumn Statement 2014. These changes are shown in Chart B.8.

Chart B.8: Year-on-year change in RDEL in 2016-17 since March 2013



Source: OBR

Table B.2: Underlying forecast changes and Government responses since 2010

<p style="text-align: center;">Lower GDP, lower borrowing</p> <p style="text-align: center;"><b>November 2015</b></p> <p>a) Small downward revision to nominal GDP growth.</p> <p>b) Lower debt interest spending and receipts modelling changes reduce underlying borrowing.</p> <p>c) Looser fiscal policy: Higher departmental spending plans only partly offset by tax rises.</p> <p><b>a) Economy forecast changes</b></p> <p><b>b) Underlying borrowing forecast</b></p> <p><b>c) Government decisions</b></p>	<p style="text-align: center;">Higher GDP, lower borrowing</p> <p style="text-align: center;"><b>December 2013</b></p> <p>a) Stronger outturn growth led to higher near-term GDP forecast.</p> <p>b) Stronger GDP and residential property forecasts boost tax receipts.</p> <p>c) Overall net takeaway driven by assumption-driven cuts to current departmental spending (RDEL).</p> <p style="text-align: center;"><b>March 2015</b></p> <p>a) Lower oil prices and so a lower inflation forecast boost real incomes and consumer spending.</p> <p>b) A lower spending forecast (inflation effects on debt interest and welfare) more than offset a lower receipts forecast.</p> <p>c) Higher DEL spending plans in all years boosts borrowing, much higher in final year keeping TME above post-war low as share of GDP.</p> <p style="text-align: center;"><b>March 2014</b></p> <p>a) Small upward revision to nominal GDP growth.</p> <p>b) Higher GDP boosts receipts forecast, reducing underlying borrowing.</p> <p>c) Broadly neutral policy changes.</p>
<p style="text-align: center;">Lower GDP, higher borrowing</p> <p style="text-align: center;"><b>March 2012</b></p> <p>a) Small reduction in nominal GDP forecast.</p> <p>b) Underlying borrowing broadly unchanged.</p> <p>c) Overall tax cut more than offset by assumption-driven RDEL cuts.</p> <p style="text-align: center;"><b>December 2014</b></p> <p>a) Downward revision to GDP forecast.</p> <p>b) Lower receipts (from lower GDP), partly offset by lower debt interest.</p> <p>c) Assumption-driven RDEL cuts partly offset higher underlying borrowing.</p> <p style="text-align: center;"><b>March 2016</b></p> <p>a) Potential output growth revised down.</p> <p>b) Weaker GDP reduces the receipts forecast significantly, partly offset by lower debt interest spending.</p> <p>c) Spending cuts and tax rises to meet surplus target in 2019-20.</p> <p style="text-align: center;"><b>March 2013</b></p> <p>a) Downward revision to near-term GDP growth forecast.</p> <p>b) Weaker-than-expected taxes on labour income and lower GDP reduce the receipts forecast.</p> <p>c) Assumption-driven RDEL cuts reduce borrowing.</p> <p style="text-align: center;"><b>December 2012</b></p> <p>a) Large reduction in nominal GDP forecast.</p> <p>b) Upward revision to borrowing driven by lower receipts (weaker nominal GDP and weaker-than-expected taxes on labour income).</p> <p>c) Assumption-driven RDEL cuts reduce borrowing.</p> <p style="text-align: center;"><b>November 2011</b></p> <p>a) Large downward revision to potential output and nominal GDP.</p> <p>b) Large economy-driven downward revision to receipts forecast.</p> <p>c) Large assumption-driven RDEL cuts in final two years to meet fiscal mandate for cyclically adjusted current surplus.</p>	<p style="text-align: center;">Higher GDP, higher borrowing</p> <p style="text-align: center;"><b>July 2015</b></p> <p>a) Small upward revision to GDP forecast.</p> <p>b) Receipts boost due to stronger taxes on labour income, more than offset by a higher spending forecast (partly due to a change in public service pensions methodology).</p> <p>c) Tax rises and welfare cuts are more than offset by assumption-driven increase in RDEL ahead of Spending Review. Surplus pushed back a year.</p> <p style="text-align: center;"><b>March 2011</b></p> <p>a) Higher outlook for inflation boosts nominal GDP forecast.</p> <p>b) Higher oil prices and inflation boost spending more than receipts, leaving underlying borrowing higher.</p> <p>c) Government decisions have a small effect on borrowing.</p>