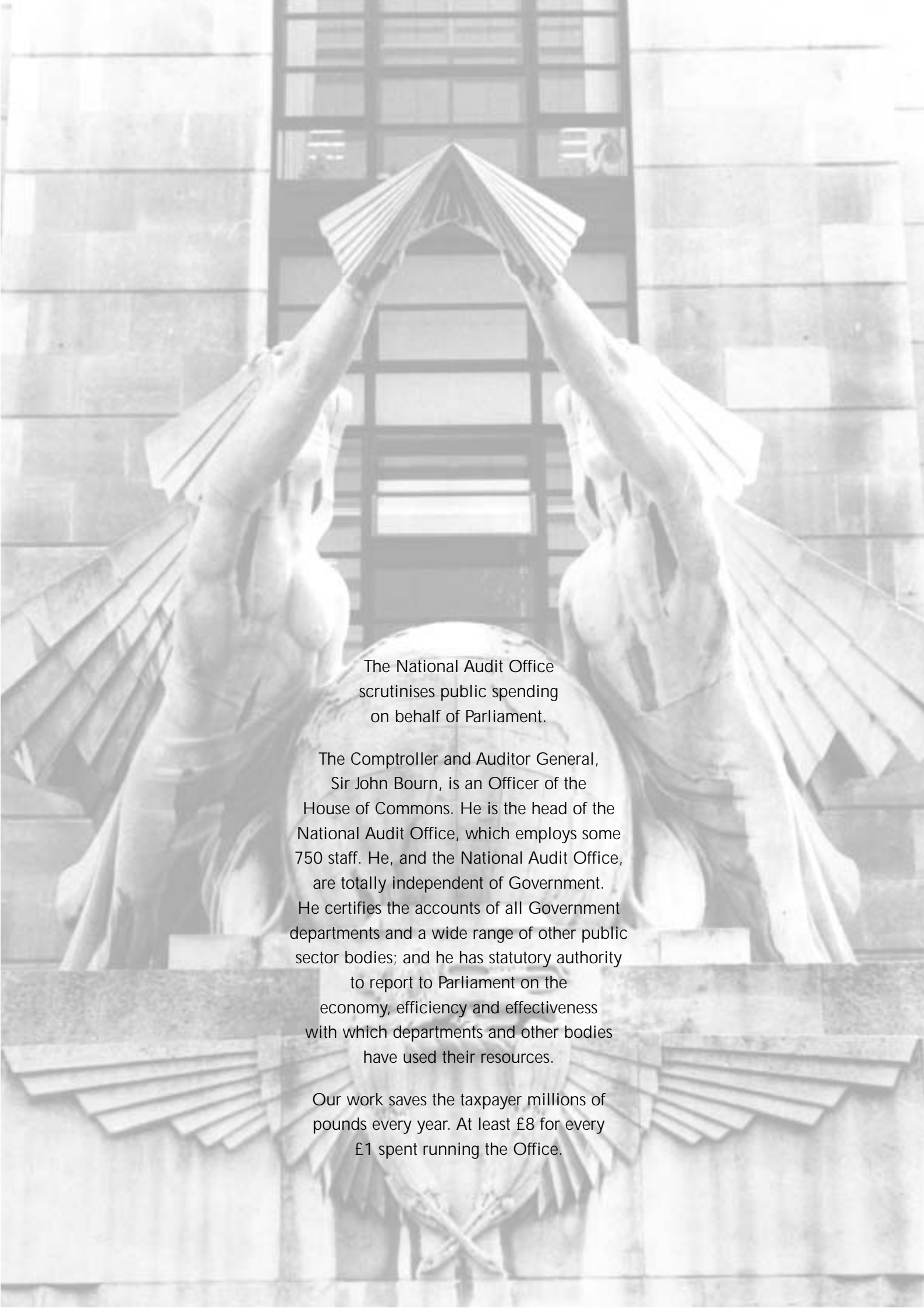


Audit of Assumptions for Budget 2003

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 627 Session 2002-2003: 9 April 2003





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Report

Report by the Comptroller
and Auditor General to the
House of Commons

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Statement of Responsibilities

- 1 Sections 156 and 157 of the Finance Act 1998 provide for me to examine and report on conventions and assumptions underlying the Treasury's fiscal projections that are submitted to me by the Treasury for examination.
- 2 The Chancellor of the Exchequer has asked me to examine a change to the assumption dealing with tobacco revenues:
 - for the purposes of projecting the revenue from duties on tobacco, the underlying market share of smuggled cigarettes will be set at least at the latest published outturn.
- 3 The Chancellor announced in Budget 2003 a compliance and enforcement package for direct tax and national insurance contributions designed to promote compliance and counter tax avoidance and fraud. He has therefore invited me:
 - to determine whether the revenue impact of the direct taxation and national insurance contributions compliance and enforcement package, estimated for the purposes of the fiscal projections, is reasonable and cautious.
- 4 The Treasury has advised me that none of the other assumptions examined in previous Reports has been changed. As before, the Treasury remains responsible for making projections of future public expenditure and revenue on the basis of the audited and other assumptions.
- 5 The Chancellor has also requested that I conduct a three year rolling review of the assumptions I have audited previously. These arrangements were introduced at the time of Budget 2000, to provide a check both that the audited assumptions remain reasonable and cautious, and to see whether they were reasonable and cautious projections in the period since they were last audited. The remit is:
 - To ensure that the key audited assumptions underpinning projections of the public finances remain valid, the Comptroller and Auditor General shall examine each audited assumption three years after its most recent audit:
 - (a) to review whether the assumption has resulted in reasonable and cautious projections of the elements of the public finances projections it relates to since it was first audited; and
 - (b) to check that it remains a reasonable and cautious assumption to use in future projections of the public finances.
- 6 The rolling review for this Report covers the assumptions relating to privatisation proceeds, interest rates and tobacco anti-smuggling measures.

7 I first audited privatisation receipts and the interest rate methodology for the July 1997 Budget Projections¹ and again for Budget 2000². The assumption for tobacco anti-smuggling was introduced in my Report for Budget 2000. It was modified in November 2002 when I re-audited the assumption for the Pre-Budget Report³ and is now subject to further change as above. As a result, the rolling review for this assumption comprises only the backward looking element.

Basis of Report

8 I have considered the available evidence gathered for this audit from relevant papers and discussions with officials as appropriate in HM Treasury, the Bank of England, HM Customs and Excise and the Inland Revenue.

Report

Privatisation Proceeds

9 The convention adopted for the July 1997 Budget Projections, reviewed in March 2000, was that for the purposes of projecting the public finances, only the proceeds of those sales that have already been announced will be included in the projections. "Privatisation proceeds" are for these purposes defined as sales by central government of businesses, either by flotation (including subsequent equity and debt sales) or trade sale.

10 I have confirmed that only proceeds expected in respect of announced privatisations were included in the associated fiscal projections for each Budget and Pre-Budget Report since March 2000.

11 **Figure 1** sets out the differences between projected privatisation proceeds and outturns between Budget 2000 and Pre-Budget Report 2002.

1 Differences between projected proceeds and outturn/latest estimates, £ millions

	Projection in	Budget 2000	PBR 2000	Budget 2001	PBR 2001	Budget 2002	PBR 2002
Outturn/latest estimates in year							
1999-00		-147					
2000-01		339	300	0			
2001-02		-412	-432	115	-56	-56	
2002-03		-100	-100	-100	200	200	30
2003-04		-50	-50	-50	-50	-50	-50

NOTE:

A negative number indicates that proceeds were greater than projected. Proceeds for the financial year immediately before a Budget are not known until some months after that Budget and must be projected, potentially with associated errors

Source: HM Treasury

12 Over the period since March 2000, Figure 1 shows that privatisation proceeds were more often above projections than below. Nevertheless, when projections were greater than outturn - usually because sales were delayed - the difference was substantial. In particular, privatisation proceeds in 2002-03 were

1 Cm 3693, 19 June 1997.

2 HC 348, Session 1999-00.

3 HC 109, Session 2002-03.

£200 million lower than projected in the 2001 Pre-Budget Report and Budget 2002. HM Treasury accounts for this in terms of lower than expected proceeds from the sale of a minority stake in the Defence Evaluation and Research Agency, DERA, now known as QinetiQ. Although the convention has not always been as cautious as it might have been, on balance, taking account of the evidence over the whole rolling review period, the convention was reasonable and not incautious in operation.

- 13 For the period ahead, the fiscal projections for Budget 2003 include proceeds of £100 million in 2002-03 and a further £50 million spread over 2004-05 and subsequent years. These are the remaining proceeds from the sale of a minority stake in QinetiQ announced in December 2002. No further sales have been announced and I have confirmed that no others have been included in the fiscal projections. The convention remains a reasonable and cautious one to use for the purposes of projecting the public finances.

Interest Rates

- 14 Assumptions for future interest rates are needed by the Treasury for projecting the cost of paying interest on central government debt, as well as for certain other elements of the fiscal projections, including some tax receipts. An increase in interest rates leads to higher central government net debt interest payments and to lower corporation tax receipts due to an increase in tax-deductible interest payments made by corporations. This will be partly offset by an increase in the tax paid on savers' deposit income.
- 15 HM Treasury currently estimates that the net impact of a one percentage point increase in short-term interest rates would be a deterioration in the public finances of about £90 million in the first year and by an approximate total of £600 million over the five-year forecast period. This is less than the £1 billion sensitivity described in my March 2000 audit⁴, largely because the effect on the public finances of a change in interest rates has reduced following the abolition of Mortgage Interest Relief at Source.
- 16 The convention is that for the purposes of projecting the public finances, three month forward interest rates will be based on market expectations, as calculated by Bloomberg. Bloomberg is a major commercial company, based in the United States, which specialises in market information and whose services are widely used in financial circles.
- 17 Using commercial rates builds in an element of caution: the 'risk premium' incorporated in these rates will be higher than that applied to government borrowing. Bloomberg data are also transparent, available to the public by subscription and regularly updated.
- 18 **Figure 2** shows the differences between projections for three month forward interest rates and outturns over the rolling review period since Budget 2000. It shows that projections for the year ahead have proved reasonably accurate, and the tendency has been for assumed short term interest rates to exceed subsequent outturn rates. This was due to wider macroeconomic developments. Global demand was weaker than expected, partly as a result of the events of 11 September 2001 and the subdued global recovery.

⁴ HC 348, Session 1999-00.

2 Differences between forecasts and outturn for three month forward interest rates, percentage points

Forecast made for	Difference between forecast and outturn in		
	2000-01	2001-02	2002-03
Budget 2000	0.7	2.4	2.9
PBR 2000	0.2	1.6	2.2
Budget 2001		0.8	1.4
PBR 2001		0.0	0.3
Budget 2002			0.8
PBR 2002			0.0

NOTE:

A positive number indicates that forecasts were higher than outturn

Source: HM Treasury

- 19 The observed tendency for forecast interest rates to exceed outturn suggests that the convention for interest rates was cautious over the rolling review period. In addition, the average error on forecasts for short-term rates up to two years ahead since Budget 2000 has been less than one percentage point, suggesting that the convention has been reasonable.
- 20 When projecting market expectations, the Bank of England uses an approach similar though not identical to that underlying the Bloomberg data. Other methods for projecting interest rates include rules which describe how interest rates have been adjusted in the past by the authorities in respect of factors such as the difference between actual inflation and the target. As in my audits for the July 1997 Budget Projections and for Budget 2000⁵, I have no reason to believe that such alternative methods offer superior results to those resulting from the current convention. The convention remains a reasonable one to use for the purposes of projecting the public finances.

Tobacco Revenues

- 21 The assumption I audited for Budget 2000 concerning forecasts of revenue from duty on tobacco was that:
- For the purposes of projecting the revenue from duties on tobacco, the estimates of additional revenue resulting from the tobacco anti-smuggling measures announced in the November 1999 Pre-Budget Report and the further measures the Government is committed to introducing, are based on the direct effect of these measures, including the deterrent effect of fiscal marks, and exclude their indirect effects.
- 22 The aim of the measures introduced by HM Customs and Excise was to slow, stabilise and then reduce tobacco smuggling within three years. The measures included deployment of additional staff; investment in X-ray scanners to examine freight consignments; fiscal marks on tobacco products to show that duty has been paid; new criminal offences, confiscation policies and a licensing framework for sale of tobacco products; and a publicity campaign.

- 23 For the purposes of the fiscal projections, HM Customs and Excise estimated the total revenue yield from the direct effects of these measures at £2.3 billion over the three years 2000-01 to 2002-03, as shown in **Figure 3**. This estimate included only revenue that could be estimated with some certainty and the possible impact of several measures was omitted from the projections. For the measures that were included, only the effect of the increased seizures was counted in most cases. The exception was for fiscal marks, where the balance between seizures and deterrence was uncertain, but where the deterrent effect was expected to be more direct than for other measures.

3 Revenue included in the Budget 2000 fiscal projections, £ millions

Revenue accruing from:	2000-01	2001-02	2002-03	Total
Seizures made by additional staff	290	525	675	1,490
Seizures resulting from the installation of scanners	25	80	230	335
Seizures resulting from the introduction of fiscal marks	0	44	53	97
Deterrence resulting from the introduction of fiscal marks	0	176	212	388
Total excluding deterrent effects of fiscal marks	315	649	958	1,922
Total including deterrent effects of fiscal marks	315	825	1,170	2,310

Source: HM Customs and Excise

- 24 HM Customs and Excise has monitored the total impact of the package on revenue and the smuggled market share, and the direct effects of additional seizures. The actual deterrent effects of fiscal marks have not been assessed, on the grounds that they cannot be disaggregated from the wider indirect effects of the tobacco anti-smuggling strategy.
- 25 According to HM Customs and Excise estimates, the direct revenue impact of additional seizures was greater than expected during 2000-01, but lower than expected in 2001-02, **Figure 4**. Figures for 2002-03 are not yet available, but the indications are that outturn will again be lower than expected. Over the three year period to 2002-03, it therefore appears that actual revenue effects of seizures have been lower than projected in Budget 2000.

4 Actual revenue impact of the tobacco anti-smuggling measures included in Budget 2000 fiscal projections, other than the deterrent effect of fiscal marks, £ millions

Revenue accruing from:	2000-01	2001-02	Total
Seizures made by additional staff	515	350	865
Seizures resulting from the installation of scanners	5	65	70
Seizures resulting from the introduction of fiscal marks	0	5	5
Deterrence resulting from the introduction of fiscal marks	Not available	Not available	-
Total recorded effect	520	420	940
As projected in Budget 2000 (excluding deterrent effects of fiscal marks)	315	649	964

Source: HM Customs and Excise

26 HM Customs and Excise believes that the indirect deterrent effects of the tobacco anti-smuggling measures have been much greater than originally expected, and resulted in less smuggling and fewer seizures in consequence. This view is supported by the fact that actual tobacco revenue receipts have been higher than forecast. HM Treasury and Customs and Excise estimate that £760 million in additional tobacco revenue was collected over the three year period to 2002-03, compared to forecast, **Figure 5**.

5 Comparison of tobacco revenue receipts as forecast in Budget 2000 and outturn

	2000-01 £m	2001-02 £m	2002-03 £m
Forecasts of receipts	7356	7599	7740
Outturn	7648	7754	8053
Difference	+292	+155	+313

Source: HM Treasury and Customs and Excise

27 HM Customs and Excise estimates of the outturn market share taken by smuggled cigarettes have been lower than forecast in Budget 2000, **Figure 6**, and this also supports the view that the additional revenue from the tobacco anti-smuggling measures has been higher than expected. I reviewed these trends as part of my examination of a proposal for Pre-Budget Report 2002 to include the indirect as well as the direct effects of the tobacco anti-smuggling strategy in the fiscal projections. Though there were uncertainties about the estimates of market share, I concluded that it was reasonable to attribute the difference between the market share assumed in Budget 2000 and the outturn share, in part at least, to the effects of the tobacco anti-smuggling measures⁶.

6 Market share of smuggled cigarettes assumed in Budget 2000 compared with outturn, percentage

	2000-01	2001-02	2002-03
Share assumed in Budget 2000 forecast	22	24	25
Estimated actual share	21	21	Not available*
Difference	1	3	

* Early indications suggest that the market share has fallen slightly during 2002-03

Source: HM Customs and Excise

28 The outturn direct effects of seizures have been lower than forecast and the assumption was therefore strictly less cautious than expected. But as tobacco revenues were greater than forecast, the fiscal projections over the rolling review period were cautious in this respect. As I commented in my Report for Budget 2000, there were inevitable uncertainties in estimating the revenue effects, given the lack of previous experience in using some of the tobacco anti-smuggling measures⁷ and in these circumstances I conclude overall that the approach was not unreasonable.

6 Paragraph 41, HC109 Session 2002-03.

7 Paragraph 20, HC 348, Session 1999-00.

New method for estimating the effects of the tobacco anti-smuggling strategy

- 29 The impact of the tobacco anti-smuggling strategy assumed in the Budget 2000 fiscal projections was developed by HM Customs and Excise on the basis of limited evidence about the likely effects of introducing X-ray scanners, fiscal marks and other measures. These had not previously been used to tackle tobacco smuggling in the UK. As a cautious basis, no account was taken of possible indirect effects arising from the deterrent impact of additional staff and the introduction of scanners.
- 30 In the light of accumulating evidence about the impact of tobacco anti-smuggling measures, I reviewed for Pre-Budget Report 2002 a proposal to take account of these indirect effects observed up to that date⁸. This was based on lower than forecast outturn smuggled cigarette market share figures, as at the end of 2001-02.
- 31 The effect of including indirect effects was to reduce the projected smuggled market share from 2003-04 onwards, compared to the original Budget 2000 projections, by 3 percentage points. The smuggled market share was assumed still to grow by 2 percentage points a year, in line with the assumption made at the time of Budget 2000, **Figure 7**.

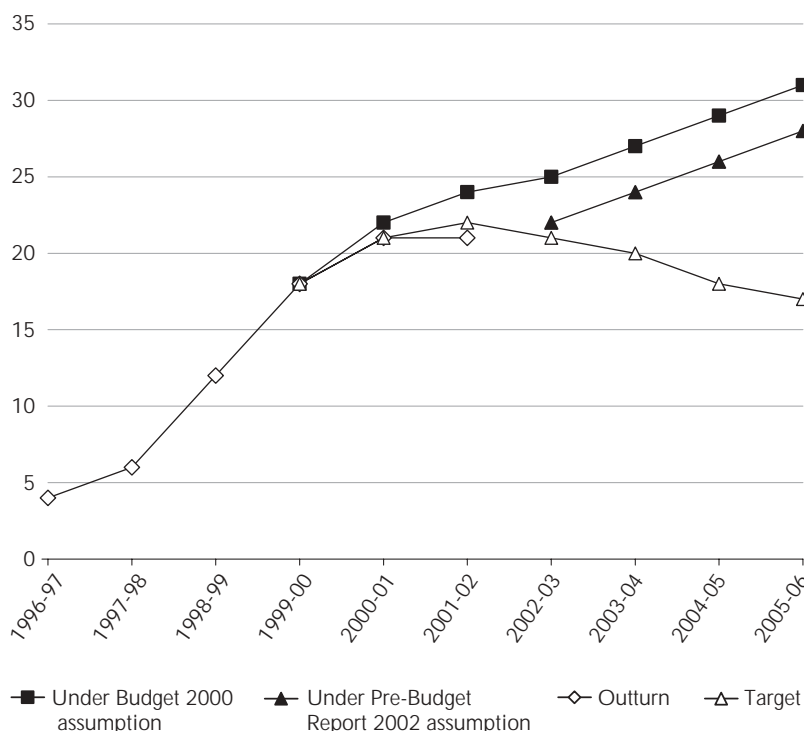
7 Comparison of the assumed market share taken by smuggled cigarettes for Budget 2000 and the revised assumption used for Pre-Budget Report 2002

	2002-03 %	2003-04 %	2004-05 %	2005-06 %
Assumed for Budget 2000 and subsequent forecasts	25	27	29	31
Assumed for Pre-Budget Report 2002 forecast	22	24	26	28

Source: HM Treasury and Customs and Excise

- 32 Even with this revision, however, the assumed share taken by smuggled cigarettes has looked increasingly out of line with recent experience. HM Customs and Excise data indicate that the smuggled share has stopped growing since 2000-01, while the revised projected share shows a continuing upwards growth. HM Customs and Excise also has targets to reduce the share to 17 per cent by 2005-06, **Figure 8**.
- 33 In the light of these developments, HM Treasury proposes to replace the existing tobacco anti-smuggling assumption with the following:
- For the purposes of projecting the revenue from duties on tobacco, the underlying market share of smuggled cigarettes will be set at least at the latest published outturn.

8 Assumptions, outturn and current target for market share of smuggled cigarettes



Source: HM Treasury and Customs and Excise

- 34** This formulation results in the assumed smuggled market share for the purposes of the fiscal projections being no less than the latest published outturn, but in the event of an unexpected increase in this share contrary to existing trends, a higher figure may be used. HM Treasury has told me that it is not sensible to specify in advance precisely how such an increase would be reflected in the projections. This is because any upward revision will depend on the size of any observed increase, the available information on the reasons for the observed increase and the expected trend. HM Treasury has, however, indicated that it would add at least one percentage point to the smuggled share assumed in the fiscal projections in the event of an increase. HM Treasury will not make any changes when in-year revenue receipts indicate that the smuggled market share has fallen below the most recently published level. HM Treasury will also set out in each future Budget and Pre-Budget Report the shares that have been used in the forecast.
- 35** For the Budget 2003 forecast, HM Treasury has used a smuggled share of 21 per cent for future years. This is in line with the most recently published outturn figure and takes cautious account of the indications from duty receipts for 2002-03 that the smuggled share in this year is likely to be lower than 21 per cent⁹. **Figure 9** shows the impact of applying this assumption on projected tobacco revenues.

⁹ The most recently published figure is for 2001-02, at 21 per cent, HM Customs and Excise paper *Measuring Indirect Tax Losses*, November 2002.

9 Assumed market shares and the revenue impact of the new assumption, £ millions

	2003-04	2004-05	2005-06
Market share taken by smuggled cigarettes assumed in Pre-Budget Report 2002 (per cent)	24	26	28
Market share under new assumption (per cent)	21	21	21
Effect on revenue forecast of changing the projected smuggled market share (£m)	+317	+537	+767

Source: HM Treasury and Customs and Excise

- 36 In one sense, the new assumption is clearly less cautious than the present assumption relating to tobacco revenues, which I audited in November 2002¹⁰. Higher tobacco duties will now be included in the fiscal projections. On the other hand, the growing divergence between the assumed and outturn smuggled market shares was becoming increasingly unreasonable as a basis for the projections. The new assumption is cautious for the forecast to which it relates, to the extent that it does not take account of any further expected falls in the smuggled share, as implied by the targets set for HM Customs and Excise.
- 37 HM Treasury has not defined the exact method for calculating the projected smuggled market share figure when outturn data indicate an increase. While the proposal to use a higher level in these circumstances introduces caution, the absence of a rule means that the upward adjustment made might or might not fully reflect the underlying circumstances. Therefore, to ensure that the new assumption is transparent, future Budgets and Pre-Budget Reports will set out and explain the figure used in the fiscal projections.

Direct Tax and National Insurance Contributions Compliance and Enforcement Package

- 38 As announced in Budget 2003, the Inland Revenue is introducing a new compliance and enforcement package for direct tax and national insurance contributions. I have been asked by the Chancellor to determine whether the revenue impact of the package estimated for the purposes of the fiscal projections is reasonable and cautious.
- 39 Additional Inland Revenue staff in new specialist teams, backed up by new IT and the use of outside legal and other expertise, are being deployed in three areas where significant risks to revenue have been identified:
- protecting the Exchequer from non-payment of tax and national insurance contribution debts and from failure to file tax returns;
 - tackling fraud involving concealment of undeclared income or profits offshore; and
 - countering avoidance of corporation tax and of national insurance contributions and tax on earnings.

¹⁰ Paragraphs 30-41, HC 109, Session 2002-03.

- 40 The Inland Revenue expects the package to produce additional revenue in three ways:
- **direct effects** as revenue is produced as a direct result of the extra Inland Revenue activities in relation to the tax affairs of individuals and companies or the schemes that they use;
 - **preventive effects** as these individuals or businesses are more compliant in future years; and
 - **indirect/deterrent effects** as other individuals and companies improve their compliance as they learn of the new measures being undertaken.
- 41 For the purposes of the fiscal projections HM Treasury has included only the direct effects of the package and the preventive effects of improved filing. It estimates that these will generate an additional £1370 million over the three years to 2005-06.
- 42 The fiscal projections are made for a five year period and a further total yield of £1425 million has been projected for 2006-07 and 2007-08 together on the assumption that funding for the package is continued for a further two years.

Direct effects

- 43 Direct effects include amounts raised through more people submitting tax returns and paying the associated tax; through contacts with taxpayers with debts to the Inland Revenue leading to new payment arrangements; through investigations into taxpayers that have evaded tax; and through action leading, where appropriate, to litigation in cases of avoidance. Generally only revenue raised from taxpayers subject to specific contact by the Inland Revenue has been included. But in the case of litigation, allowance has been made for successful prosecution of one user of a particular scheme leading to other users of the same or closely related schemes choosing to settle.
- 44 The estimates of these effects have been built up in two stages. First, assessments have been made of the number of additional cases that the new teams will be able to handle. These have been based largely on experience with similar activities now, supplemented by detailed assessments by business managers on, for example, the amount of expert resources needed to take forward particular cases. Second, estimates have been made of the amount of revenue that each of these cases will generate. Where the activities are broadly similar to those being undertaken now, as for example with improved filing and debt recovery, evidence on the existing yield per case has been used. In others, the estimates are based on already known revenue losses in particular cases.
- 45 The Inland Revenue has made a number of adjustments to the assumptions underlying the estimates to introduce caution, their nature and scale depending on the strength of the evidence underlying the particular assumption. For example:
- the number of additional returns generated by activities designed to improve filing rates has been assumed to be substantially less than that indicated by current operational experience;
 - the amount of revenue obtained from each extra return or debt case has been assumed to be lower than that suggested by existing experience;
 - only amounts of tax at risk that have already been identified in fraud and avoidance cases have been included. In practice, part of the role of the new specialist teams will be to identify and pursue other cases of tax loss; and

- part of the aim in setting up specialist teams is also that these should be more efficient in terms of the number and choice of cases they tackle. The estimates generally do not include an allowance for the revenue effects of such improvements.

Preventive and indirect/deterrent effects

- 46 Inland Revenue considers that taxpayers that are the subject of litigation or investigation or are contacted in relation to outstanding returns or debts are more likely to comply with their obligations in the future. Estimates of such preventive effects have been included for the measures to improve filing of returns based on existing evidence on the extent to which taxpayers that are traced or investigated remain compliant.
- 47 Caution has been introduced into the estimates of preventive effects in two ways:
- the number of taxpayers that continue to comply has been assumed to decline in future years at a rate substantially faster than that suggested by existing evidence; and
 - no allowance has been made for preventive effects of the other measures because of uncertainty as to their scale and persistence.
- 48 Inland Revenue also considers that the measures are likely to have indirect effects that will increase compliance by other taxpayers. In particular, the greater chances of being subject to litigation or penalties in cases of avoidance or fraud and the publicity associated with the package are likely to encourage more taxpayers to come forward and settle outstanding cases voluntarily and make them less likely to engage in such practices in future. Inland Revenue believes that such effects could both accelerate the yield and increase its amount; and if substantial they could also affect the magnitude of the direct effects and reduce the need for action by the new teams. But because it is difficult to predict the scale of such effects with certainty they have not been included in the estimates.

Revenue effects included in the fiscal projections

- 49 The estimates of revenue effects that have been taken into account for the fiscal projections are shown in **Figure 10**. These build in the Inland Revenue's cautious adjustments as described above. The direct effects account for the bulk of the total effects that have been included in the forecast - in excess of 90 per cent over the first three years.

10 **Inland Revenue's estimates of the impact of the new direct taxation and national insurance contributions compliance and enforcement package, for the purposes of the fiscal projections, £ millions**

	2003-04	2004-05	2005-06	Total 2003-04 to 2005-06	2006-07	2007-08
Direct effects	170	555	560	1285	570	605
Preventive effects	0	15	70	85	110	140
Deterrent effect	nil	nil	nil	nil	nil	nil
Total	170	570	630	1370	680	745

Source: Inland Revenue

- 50 My examination of each of the significant assumptions underlying the elements of the new compliance measures confirmed their internal consistency, and where possible, consistency with other data readily available within the Inland Revenue, and with other changes in train or proposed within the Inland Revenue.
- 51 The approaches adopted by the Inland Revenue for projecting the yield of the compliance and enforcement package for the purposes of the fiscal projections incorporate a number of elements of caution. They are based in part on experience with existing similar measures, and while current experience may not necessarily be a good guide to the effectiveness of new measures this is a reasonable approach. There is also a degree of judgemental projection, which though discounted for reasons of caution, may or may not be borne out in practice. But sensitivity tests carried out by the Inland Revenue on key assumptions that have a large judgemental element indicate that moderate changes in these generally have limited effects on the revenue effects of the package overall.
- 52 In view of the uncertainties and as good practice the Inland Revenue is putting in place arrangements to monitor and evaluate the package. The Inland Revenue has told me that detailed monitoring plans will be in place by July 2003. It will be important that these arrangements are implemented as planned. I have not been asked to audit these arrangements.

Overall conclusions

- 53 My rolling review of the treatment of privatisation receipts shows that the convention was reasonable and has not been incautious in application over the last three years, though it has on occasion resulted in overestimates of proceeds. It remains a reasonable and cautious one to use for the purposes of the fiscal projections.
- 54 The methodology for projecting interest rates remains a reasonable one, and over the rolling review period has resulted in projected interest rates that exceeded outturn, suggesting it was a cautious approach in this period. No clearly better alternative methodologies are available for making future projections of interest rates.
- 55 The outturn direct effects of seizures have been lower than forecast over the rolling review period to 2002-03, and the assumption relating to the direct impact of the tobacco anti-smuggling measures was therefore strictly less cautious than expected. But as tobacco revenues were greater than forecast, the fiscal projections over the rolling review period were cautious in this respect. Given the uncertainties in estimating the effects of a new package of measures at the time of Budget 2000, the approach adopted was not unreasonable. The new assumption for tobacco revenues is currently a reasonable one to adopt in the light of outturn data on the smuggled market share and duty receipts, and cautious to the extent that the new projections for Budget 2003 will take no account of expected further reductions in the smuggled market share. To ensure transparency, it will be important that HM Treasury sets out the way in which the assumption is applied in each future Budget and Pre-Budget Report.

- 56 There are also uncertainties and judgements underlying the projected impact of the new Inland Revenue direct tax and national insurance contributions compliance and enforcement package. The projections incorporate caution however, and take into account for the most part only the direct effects of the measures, which can be more certainly estimated on the basis of past and current experience. They exclude the wider deterrent effects that are hard to predict. Overall, the approach to projecting the revenue benefits of the package is reasonable, though given the inevitable uncertainties, it is important that information emerging from the Inland Revenue's planned work to monitor the impact of the measures is taken into account on a timely basis, to ensure that the projections of additional yield are revised if they appear not to be cautious in practice.