1 Budget Report

The economy and public finances

1.1 The UK economy is recovering from the most damaging financial crisis in generations after a decade of growth built on unsustainable levels of debt. The Government inherited the largest deficit since the Second World War and the UK experienced one of the deepest recessions of any major economy. Across the world, recovery over the past four years has been slower than forecast and the euro area is now in recession.

1.2 The Government's economic strategy set out in the June Budget 2010 is designed to protect the economy through the recent period of global uncertainty and provide the foundations for recovery. This strategy is restoring the public finances to a sustainable path and the deficit has been reduced by a third over the three years from 2009-10. The UK is seen as a relative safe haven, with low market interest rates helping to keep interest payments lower for families, businesses and the taxpayer. This strategy has helped the Government to equip the UK to compete in the global race to build a stronger economy and a fairer society. The UK has the fourth lowest corporation tax rate in the G20 and will reduce the rate by an additional 1 percentage point in April 2015 to 20 per cent, the joint lowest in the G20; it has risen to eighth in the 2012 World Economic Forum Global Competitiveness Report; and the 2012 KPMG Annual Survey of Tax Competitiveness looked at six key competitor economies and found that out of these the UK was the most commonly cited as being in the top three.[1]

The UK economy since 2010

1.3 Three key factors, first set out in the Office for Budget Responsibility's (OBR) November 2011 *Economic and fiscal outlook*, have resulted in a more subdued and uneven recovery than expected and continued to weigh on the UK economy through 2012:

- evidence has accumulated that suggests the impact of the financial crisis on GDP and underlying productivity has been greater than expected;
- the euro area sovereign debt crisis and global uncertainty have damaged confidence and reduced external demand; and
- commodity price driven inflation since 2011 has reduced real incomes and raised business costs.

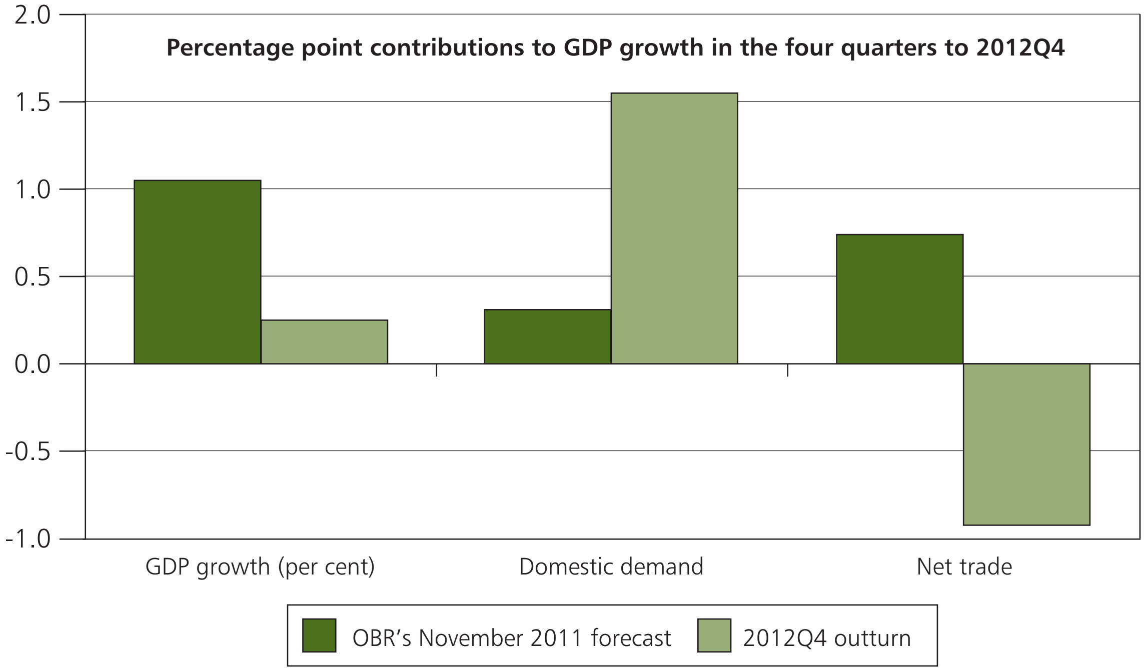
1.4 Economic recovery continues to be more uneven than originally expected. While UK GDP grew by 0.3 per cent in the year to the fourth quarter of 2012, slightly higher than forecast at Autumn Statement 2012, it was choppy through the year and fell 0.3 per cent in the fourth quarter.[2] Nominal GDP growth in the year to the fourth quarter of 2012 was only 1.3 per cent. Recovery has also been uneven in other countries. Euro area GDP fell by 0.9 per cent in the year to the fourth quarter of 2012, falling by 0.6 per cent in the fourth quarter alone. GDP growth for the US and Japan was also weak in the fourth quarter.[3] The OBR's Budget 2013 forecast revises down UK GDP growth slightly in 2013 and 2014, reflecting this reduced momentum

[1] *The Global Competitiveness Report 2012-13,* World Economic Forum, 2012. *KPMG Annual Survey of Tax Competitiveness*, KPMG, February 2013.
[2] All UK economy data from the Office for National Statistics (ONS) unless otherwise stated.
[3] *Main Economic Indicators*, Organisation for Economic Co-operation and Development (OECD).

in the UK and globally, and smaller contributions to growth from net trade and consumption. By the end of the forecast horizon, the level of GDP is 0.6 per cent below the level forecast at Autumn Statement 2012. The OBR assumes around two thirds of the reduction in real GDP growth to be cyclical rather than structural.

1.5 The UK economy's performance through 2012 included relative strength in domestic demand but relative weakness in external sources of growth. Compared with the OBR forecast in the November 2011 *Economic and fiscal outlook*, GDP growth in the year to the fourth quarter of 2012 under-performed by 0.8 percentage points. The contribution of domestic demand out-performed that forecast by 1.2 percentage points and net trade under-performed by 1.7 percentage points, as shown in Chart 1.1. Indeed, given the relative strength of domestic demand, GDP could have grown by 2.1 per cent in the year to the fourth quarter had exports grown by the 5.7 per cent forecast in November 2011, and adjusting for the likely import content of those additional exports. Over that period, goods export volumes to the European Union (EU) fell by 2.5 per cent, while goods export volumes outside the EU grew by 1.2 per cent.

Chart 1.1: Outturn compared with the OBR's November 2011 forecast[1]



[1] *The difference between the sum of the components and the total is accounted for by differences in the statistical discrepancy in the forecast and the latest estimate of GDP.*
Source: Office for Budget Responsibility and Office for National Statistics.

1.6 UK inflation has fallen by almost half from its peak of 5.2 per cent in September 2011 to 2.8 per cent in February 2013. Pressure from commodity price rises in 2011 has eased, though commodity prices remain high.

1.7 The OBR's October 2012 *Forecast evaluation report* showed that the shortfall in growth compared with its June Budget 2010 forecast could largely be explained by private consumption, investment and net trade, in roughly equal measure, reflecting shocks from commodity prices, financial conditions and confidence. The *Forecast evaluation report* noted that nominal consumer spending had been broadly in line with forecast, with unexpected inflation explaining the weakness of real private consumption relative to forecast. Table 1.1 shows a broadly similar breakdown across the private sector by the third quarter of 2012 using the same approach with the latest data. The direct contribution of government consumption and investment subtracted less from GDP growth than forecast at the June Budget 2010, largely due to lower than expected inflation in the government sector with nominal spending lower than forecast but real spending higher than forecast with higher public sector productivity.

1.8 Fiscal multipliers estimate the impact of different elements of tax and spending consolidation on GDP. The OBR's October 2012 *Forecast evaluation report* did not see evidence to suggest that multipliers were significantly different than estimated in the June Budget 2010 forecast. The OBR has not altered the estimated fiscal multipliers being used in its latest forecast.

Table 1.1: Contributions to real GDP growth from 2010Q1 to 2012Q3

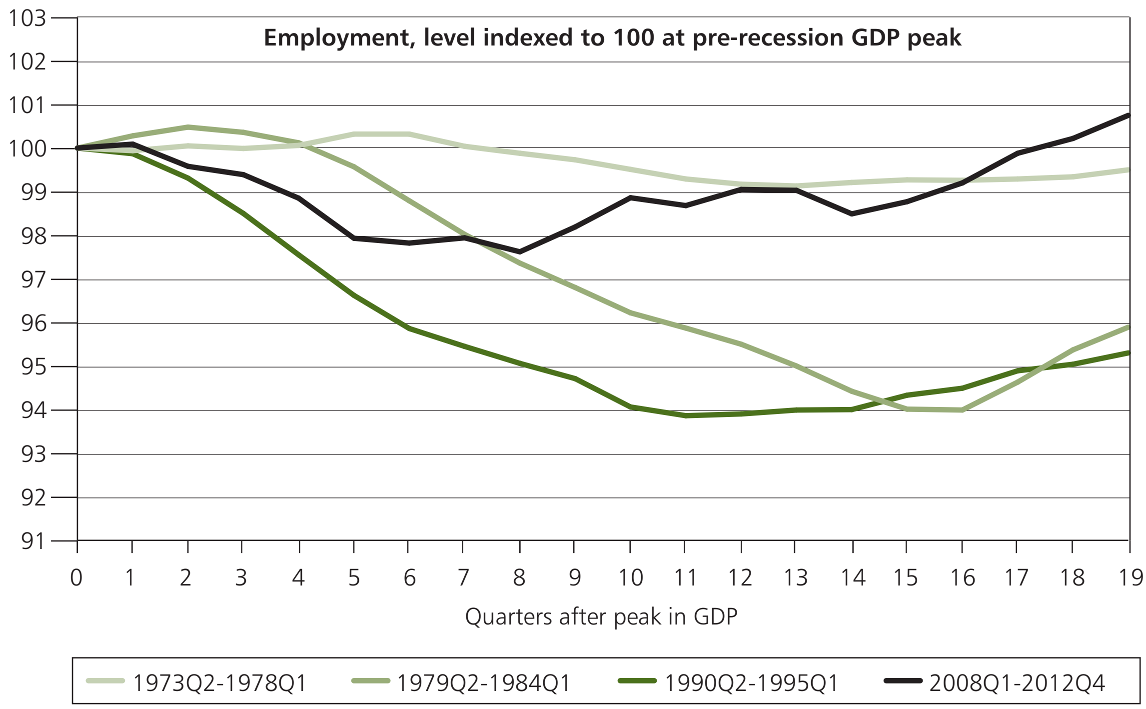
	Percentage points					
	Private consumption	**Private investment**	**Total government**	**Net trade**	**Stocks**	**GDP**
June 2010 forecast	2.3	2.9	-1.6	2.1	0.8	6.5
Latest data	0.6	0.7	-0.5	0.6	0.9	2.3
Difference[1]	-1.7	-2.2	1.1	-1.5	0.1	-4.2

[1] *Difference in unrounded numbers, rounded to one decimal place.*

Source: Office for Budget Responsibility and HM Treasury.

1.9 The UK labour market has continued to perform more strongly than forecast despite the headwinds to GDP growth, with a net increase of over one million jobs in the private sector since the first quarter of 2010.[4] Comparing the fourth quarter of 2012 to a year earlier, employment rose by 584,000, the fastest growth since 1989, with participation in the labour market rising by 428,000 and unemployment falling by 156,000. At the end of 2012, employment levels were the highest recorded and above the pre-crisis peak. Unemployment in the three months to December 2012 stood at 7.8 per cent in the UK, lower than in the euro area and lower than that following previous UK recessions. Employment performance in the UK compares favourably with post-war experience, as shown in Chart 1.2, and internationally, as discussed later in this chapter. The OBR expects employment to continue to rise over the forecast period.

Chart 1.2: Employment levels through recessions and recoveries



Source: Office for National Statistics and HM Treasury.

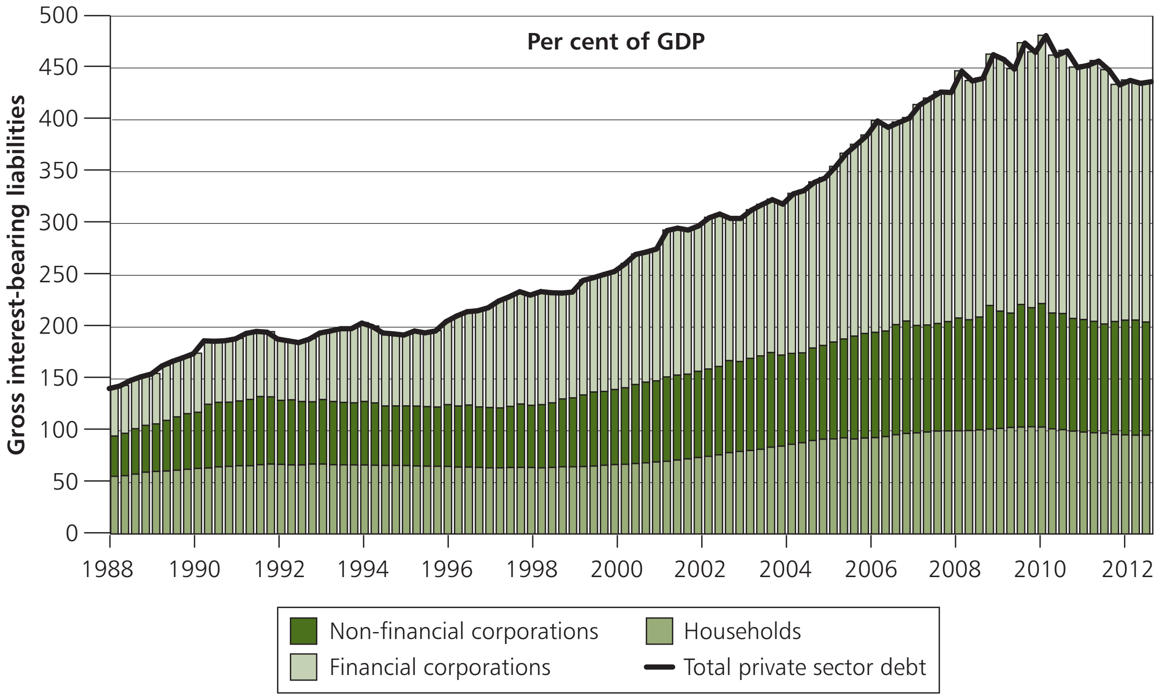
[4] *Labour Market Statistics*, ONS, January 2013. These figures exclude the impact of the reclassification from June 2012 of 196,000 employees in some educational bodies from the public to the private sector.

1.10 The persistent effects of the financial crisis continue to weigh on the UK recovery. The Bank of England's November 2012 *Inflation Report* and the OBR's December 2012 *Economic and fiscal outlook* set out the channels along which productivity might have been held back due to these persistent effects.[5] For example: the higher cost and availability of credit; the pace at which credit is reallocated to more efficient uses; and a lower risk appetite among lenders.

UK imbalances and relative economic performance

1.11 It has been estimated that by 2008, as the crisis hit, the UK private sector had become the most indebted in the world.[6] Deleveraging has since weighed on UK growth. Some progress has been made, with private sector debt falling by over 40 percentage points of GDP since its peak in the first quarter of 2010, as Chart 1.3 shows.

Chart 1.3: Private sector debt in the UK



Source: Office for National Statistics.

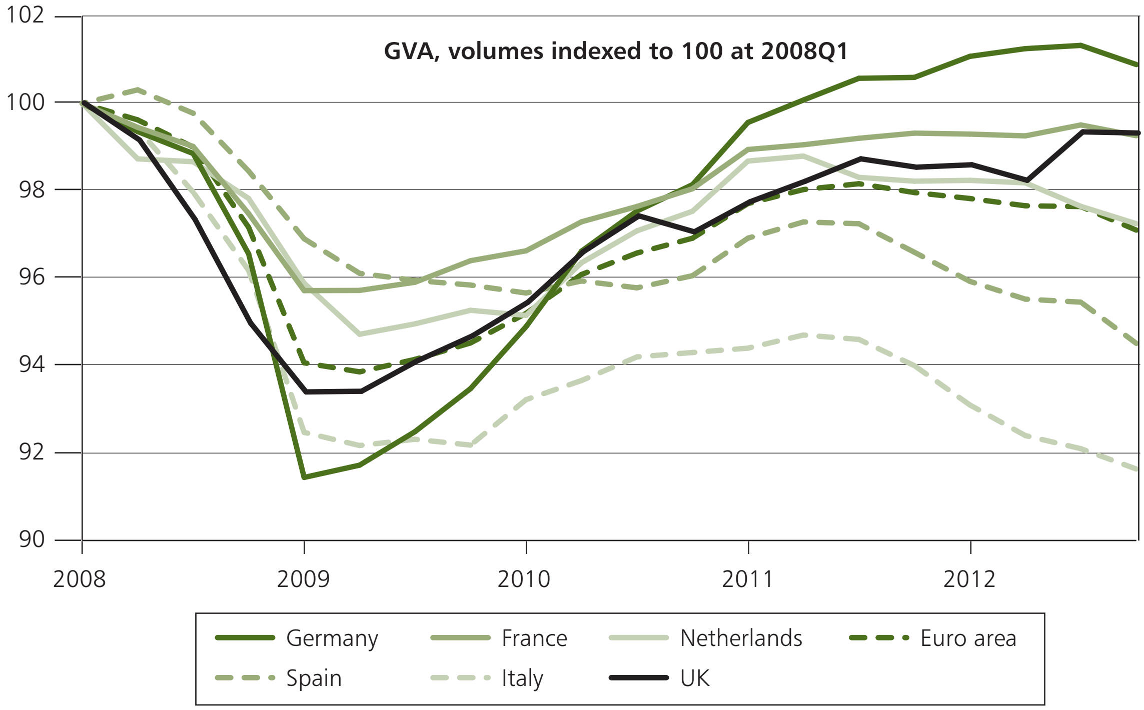
1.12 Autumn Statement 2012 illustrated the impact of the financial crisis and post-crisis deleveraging on the financial sector, which has contracted 13 per cent in real terms since the economy's pre-crisis peak. Output of the North Sea oil and gas sector, which has continued a long-term decline related to maturing fields, has fallen 47 per cent since the economy's pre-crisis peak. The rest of the economy, accounting for nearly 90 per cent of Gross Value Added (GVA), has performed more strongly.

1.13 Outside the energy and financial sectors, the UK economy has performed better than the euro area and similarly to France, as Chart 1.4 shows.[7]

1.14 Chart 1.5 shows employment in the UK has performed relatively strongly in international context. By comparison with the first quarter of 2008, UK employment is higher than all major advanced economies except Germany. UK employment growth was stronger than all G7 economies except the US between the third quarter of 2012 and a year earlier.

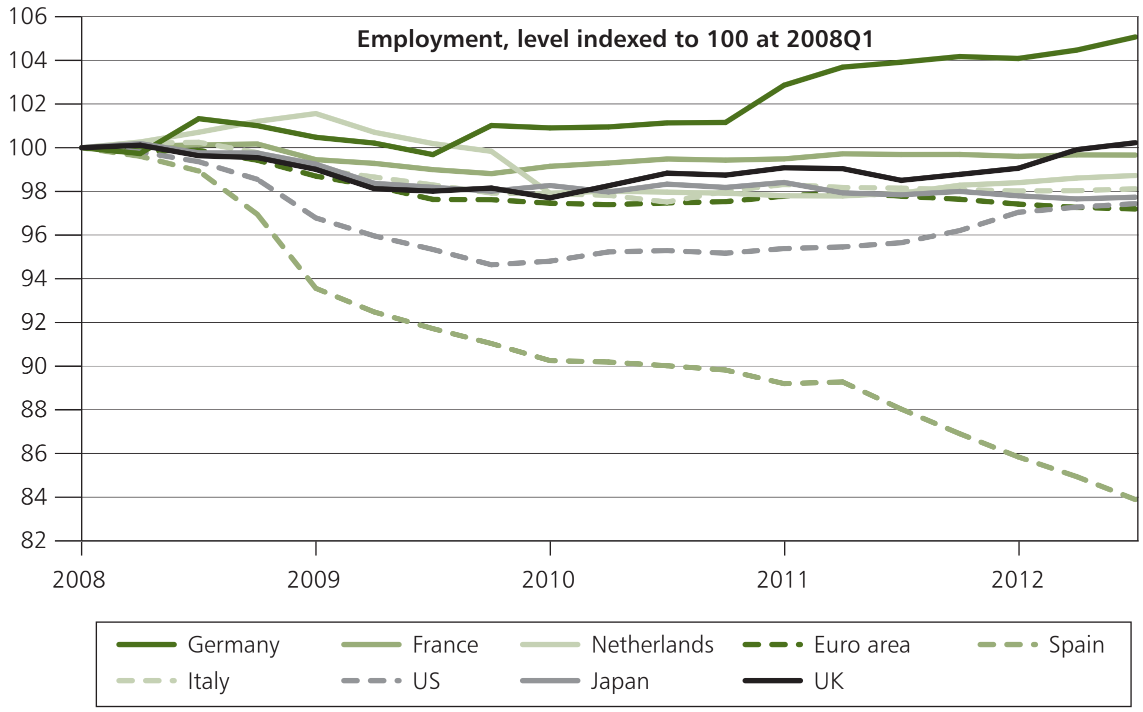
[5] *Inflation Report*, Bank of England, November 2012. *Economic and fiscal outlook*, OBR, December 2012.
[6] *Debt and deleveraging: The global credit bubble and its economic consequences,* McKinsey Global Institute, January 2010.
[7] Chart 1.4 uses OECD data and energy sector refers to the energy extraction and usage category. This is comprised of 'mining and quarrying (including oil and gas extraction)', 'electricity, gas, stream and air' and 'water supply and sewerage'.

Chart 1.4: GVA excluding energy and financial services in the largest EU economies



Source: OECD and HM Treasury.

Chart 1.5: International comparison of employment since the crisis



Source: OECD and HM Treasury.

Euro area crisis and global developments

1.15 Autumn Statement 2012 highlighted three key global risks to the UK economy: the euro area sovereign debt crisis, the US 'fiscal cliff' and slowing growth in emerging economies. These risks have started to ease in recent months and there are signs of confidence returning to financial markets, but this is yet to feed through to the performance of the wider economy.

1.16 The euro area is the key market for UK exporters, accounting for 42 per cent of UK exports in 2011. As a consequence, the euro area sovereign debt crisis and subsequent recession have weighed heavily on the UK recovery. Action by European policy makers in 2012 helped ease the crisis and there are signs of investor confidence improving, but as the situation in Cyprus demonstrates the challenges facing the euro area are not fully resolved. Output has been weaker than anticipated, and the OBR has revised down its forecast for 2013 GDP growth in the euro area to -0.5 per cent and does not expect it to start recovering until the second half of 2013.

1.17 The US was the destination for around 16 per cent of UK exports in 2011. The American Taxpayer Relief Act enacted on 2 January 2013 averted over half of the sharp fiscal tightening that was possible for 2013, the 'fiscal cliff'.[8] The US Congressional Budget Office expects the US fiscal consolidation to reduce US GDP growth by around 1½ percentage points in 2013, leaving growth for the year at around 1½ per cent.[9] However, with further US fiscal negotiations outstanding, there may be further changes to the US fiscal outlook in coming months.

1.18 Brazil, Russia, India and China taken together were the destination for 6.5 per cent of UK exports in 2011. Growth has stabilised in China and the International Monetary Fund (IMF) has forecast China's GDP will grow by 8.2 per cent in 2013 compared with 7.8 per cent in 2012. The IMF forecast for 2013 GDP growth in emerging economies as a whole is 5.5 per cent. Emerging markets and developing economies remain an important driver of global growth. In 2011 they accounted for 36 per cent of world GDP, up from 28 per cent in 2007 before the global crisis hit.[10] From a low base, UK exporters continue to take advantage of this trend through trade with emerging economies. Between 2009 and 2012 UK goods exports to Brazil increased by 49 per cent, to Russia by 133 per cent, to India by 59 per cent and to China by 96 per cent.[11]

1.19 The easing of risks has been reflected in global stock markets. Between Autumn Statement 2012 and Budget 2013 the UK's FTSE 100 index has risen 10 per cent, the US's S&P 500 index 11 per cent and the euro area's Euro Stoxx 50 index 5 per cent. Over the same period global stock market values have risen by more than $3 trillion.[12]

[8] The US 2013 financial year runs from October 2012 to September 2013.
[9] *The Budget and Economic Outlook: Fiscal Years 2013 to 2023*, US Congressional Budget Office, February 2013.
[10] *World Economic Outlook*, IMF, October 2012.
[11] *UK Trade – January 2013,* ONS, March 2013.
[12] Bloomberg. Closing price 5 December 2012 and 15 March 2013.

Economic forecast

Table 1.2: Summary of the OBR's central economic forecast[1]

	Percentage change on a year earlier, unless otherwise stated						
		Forecast					
	2011	2012	2013	2014	2015	2016	2017
GDP growth	**0.9**	**0.2**	**0.6**	**1.8**	**2.3**	**2.7**	**2.8**
Main components of GDP							
Household consumption[2]	-1.0	1.0	0.5	1.2	1.7	2.4	2.8
General government consumption	-0.1	2.6	0.4	-0.7	-0.4	-1.0	-1.8
Fixed investment	-2.9	1.4	2.2	6.7	8.1	7.7	7.8
Business	3.1	4.9	1.9	6.1	8.6	8.6	8.6
General government	-26.2	2.7	2.6	5.0	1.8	-1.5	-1.2
Private dwellings	2.3	-5.4	2.0	8.9	10.0	10.0	9.7
Change in inventories[3]	0.3	-0.2	-0.2	0.0	0.0	0.0	0.0
Net trade[3]	1.2	-0.8	0.1	0.1	0.1	0.1	0.1
CPI inflation	**4.5**	**2.8**	**2.8**	**2.4**	**2.1**	**2.0**	**2.0**
Employment (millions)	**29.2**	**29.5**	**29.8**	**29.9**	**30.1**	**30.3**	**30.5**

[1] All figures in this table are rounded to the nearest decimal place. This is not intended to convey a degree of unwarranted accuracy. Components may not sum to total due to rounding, omission of transfer costs of land and existing buildings, and the statistical discrepancy.

[2] Includes households and non-profit institutions serving households.

[3] Contribution to GDP growth, percentage points.

Source: Office for Budget Responsibility.

1.20 GDP growth in 2012 was slightly stronger than expected at Autumn Statement 2012. However, reflecting the lower-than-expected momentum in the final quarter of 2012, the OBR has revised its forecast for GDP growth in 2013 from 1.2 per cent to 0.6 per cent. The OBR has revised its forecast for GDP growth in 2014 from 2.0 per cent to 1.8 per cent. These revisions reflect smaller contributions to growth from net trade and consumption. The OBR forecast for GDP growth from 2015 onwards is unchanged from its forecast at Autumn Statement 2012. By the end of the forecast horizon, the level of GDP is 0.6 per cent below the level forecast at Autumn Statement 2012. The OBR assumes around two thirds of the reduction in real GDP growth to be cyclical rather than structural.

1.21 Risks to UK growth have become more balanced. Global risks have started to ease. As the Funding for Lending Scheme (FLS) begins to gain traction, UK credit conditions have improved. Interest rates have fallen, in particular mortgage rates, and credit availability for businesses has increased. House prices increased by 2.2 per cent in the year to January 2013 and property transactions have risen.[13] As credit conditions continue to ease, the property market is expected to pick up and growth in transactions to continue. While growth remains subdued, the Governor of the Bank of England has said *"there are good reasons to suppose that a gentle recovery is underway"*.[14] The IMF forecasts UK GDP per person to grow faster than the rest of the G7 between 2012 and 2017, with the exception of the US.[15]

1.22 The OBR has revised up its forecast for UK employment from 2013. It has revised down its unemployment forecast by 0.3 percentage points to 7.9 per cent in 2013 and by 0.2 percentage points in 2017 to 6.9 per cent. It expects employment to rise in every year of the forecast period, reaching 30.5 million by 2017. The OBR expects total market sector employment to rise by around 2.6 million between the start of 2011 and the start of 2018, more than offsetting the total reduction in general government employment of around 1.2 million.

[13] *House Price Index, January 2013*, ONS, March 2013. *Monthly Property Transactions, January 2013,* HM Revenue and Customs, February 2013.
[14] Mervyn King, speech, the Confederation of British Industry (CBI), Northern Ireland Mid-Winter Dinner, Belfast, 22 January 2013.
[15] *World Economic Outlook*, IMF, October 2012.

1.23 The OBR has revised its inflation forecast up, broadly in line with the Bank of England's February 2013 *Inflation Report* forecast. The OBR attributes this to higher oil prices and higher import prices as a result of recent exchange rate movements. This upward pressure is partially offset in 2013 and 2014 by cancellation of the fuel duty rise that was planned for 1 September 2013. The OBR forecasts inflation to return to target by early 2016 and remain close to target thereafter. The OBR's forecast for the GDP deflator, a broader measure of inflation in the economy, has been revised down. This, combined with the revisions to real GDP, leaves the level of nominal GDP 2.5 per cent lower in 2017 than was forecast at Autumn Statement 2012. Real GDP accounts for around 0.6 percentage points of this revision, with the remainder reflecting a lower GDP deflator.

1.24 The OBR forecast shows the UK economy rebalancing over the forecast period. Having grown by almost 5 per cent in 2012, business investment is forecast to pick up again in 2014 and make an increasing contribution to GDP growth thereafter, rising to nearly 1 percentage point by 2017. After falling in 2012, UK exports are also expected to pick up and net trade is forecast to make a small positive contribution to growth from 2013. Household consumption is forecast to grow more slowly than GDP on average, with the saving ratio declining but remaining at 5 per cent or above throughout.

The Government's strategy

1.25 The Government's strategy is designed to protect the economy through this period of global uncertainty, to maintain market confidence in the UK and to lay the foundations for a stronger, more balanced economy in the future. The Government is taking decisive action through:

- monetary activism and credit easing, stimulating demand, maintaining price stability and supporting the flow of credit in the economy;
- deficit reduction, returning the public finances to a sustainable position and ensuring that fiscal credibility underpins low long-term interest rates;
- reform of the financial system, improving the regulatory framework to reduce risks to the taxpayer and build the resilience of the system; and
- a comprehensive package of structural reforms, rebalancing and strengthening the economy for the future, including an ambitious housing package and programme of infrastructure investment.

Monetary activism

Monetary policy

1.26 Monetary policy has a critical role to play in supporting the economy as the Government delivers on its commitment to necessary fiscal consolidation. To ensure that it can continue to play that role fully, **the Government has reviewed the monetary policy framework in international and historical context. This *Review of the monetary policy framework* is published alongside this Budget.**[16] As a result, the Government has:

- **retained a flexible inflation targeting framework and reaffirmed the 2 per cent inflation target, which applies at all times;**
- **updated the remit to clarify the trade-offs that are involved in setting monetary policy to meet a forward-looking inflation target;** and
- **requested that the Monetary Policy Committee (MPC) provides in its August 2013 *Inflation Report* an assessment of the merits of using intermediate thresholds in the operation and communication of monetary policy.**

[16] Available on the HM Treasury website at www.hm-treasury.gov.uk.

1.27 The Government has concluded that a flexible inflation targeting framework has served, and will continue to serve, the UK well, and that the credible commitment to medium-term price stability provided by the 2 per cent inflation target must remain at the core of the framework. Price stability is an essential pre-requisite for economic prosperity. **In this Budget, the Government reaffirms the operational target for the MPC remains an inflation rate of 2 per cent, measured by the 12-month increase in the Consumer Prices Index (CPI). The target applies at all times.**

1.28 The remit continues to recognise that the actual inflation rate may depart from its target as a result of shocks and disturbances, and that the MPC may therefore wish to allow inflation to deviate from the target temporarily in order not to cause undesirable volatility in output. It clarifies the consideration that, in some circumstances, may be given to financial imbalances and requires that the MPC should have regard to the policy actions of the Financial Policy Committee (FPC). The remit goes further by clarifying that in exceptional circumstances, where shocks are particularly large and with persistent effects, the MPC is likely to be faced with more significant trade-offs between the speed with which it aims to bring inflation back to target and the consideration that should be placed on the variability of output. **The remit requires that in forming and communicating its judgements the MPC should promote understanding of the trade-offs inherent in setting monetary policy to meet a forward-looking inflation target while giving due consideration to output volatility.**

1.29 The remit also continues to require an exchange of open letters between the Governor of the Bank of England and the Chancellor of the Exchequer if inflation moves away from the target by more than 1 percentage point in either direction. The Government believes the open letter system, required in the remits for the MPC since 1997, provides a formal mechanism of transparency and accountability. **The remit now requires that the open letter from the Governor should be sent alongside the minutes of the MPC meeting that followed the publication of the CPI data, referring as necessary to the Bank's latest *Inflation Report* and forecasts and covering the MPC's judgements on the trade-offs inherent in setting monetary policy.** The reason for publishing this letter alongside the minutes is to allow the MPC time to form and communicate its strategy towards returning inflation to the target after consideration of the trade-offs. The Government believes that any future open letters will therefore result in a more meaningful exchange about the MPC's strategy than has been possible before now.

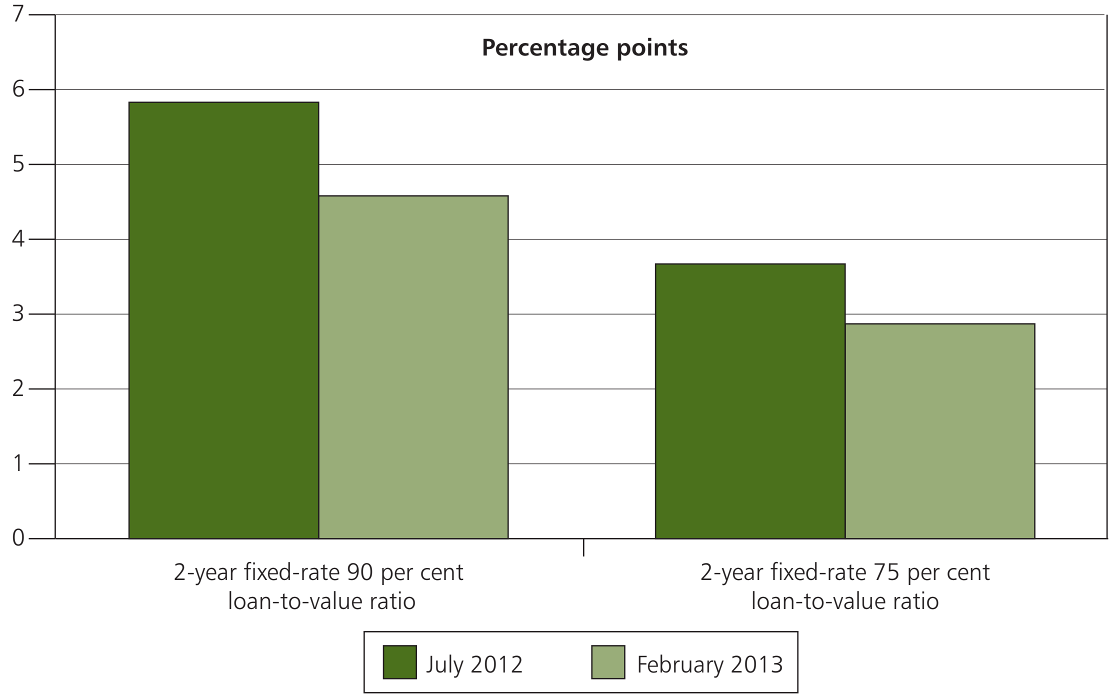
1.30 As with many central banks in advanced economies since the global financial crisis hit, the Bank of England has deployed a range of unconventional instruments in order to deliver the support it judged necessary. Alongside holding Bank Rate at a record low, the Bank of England, with the Treasury, has launched the FLS, discussed below, and the MPC's programme of asset purchases financed by the issuance of central bank reserves reached a stock of £375 billion in November 2012. **The Government confirms in Budget 2013 that the Asset Purchase Facility will remain in place for the financial year 2013-14.**

1.31 With the UK continuing to face exceptional economic challenges, the remit recognises that the MPC may judge it necessary to use other unconventional instruments in order to support the economy in the context of price stability. Where those instruments have implications for credit risk or credit allocation, the remit ensures that appropriate governance arrangements are in place to ensure accountability. The MPC may also judge it to be appropriate to deploy explicit forward guidance including intermediate thresholds – policy commitments conditional on future economic developments – in order to influence expectations and thereby meet its objectives more effectively. **The remit requests that the MPC provides in its August 2013 *Inflation Report* an assessment of the merits of using intermediate thresholds.**

Credit easing

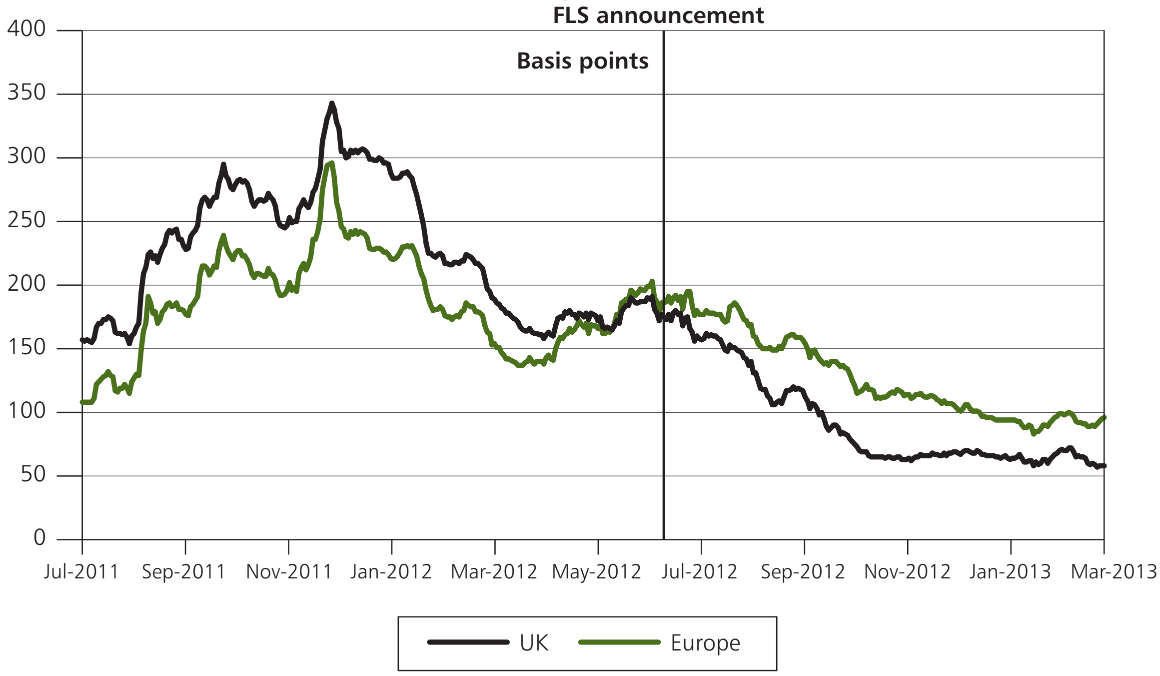
1.32 The FLS complements the Bank of England's asset purchase programme by delivering support to the economy through the banking system. The FLS reduces bank funding costs and provides strong incentives for banks to increase their lending to households and non-financial businesses in the UK. There are currently 39 banks and building societies participating in the Scheme, who make up over 80 per cent of the stock of loans.

Chart 1.6: Average quoted interest rates on mortgages



Source: Bank of England.

Chart 1.7: Indicative senior unsecured bond spreads[1]



[1]The data show an unweighted average of the spread between euro-denominated senior unsecured bonds and equivalent-maturity swap rates for a selected bond issued by each of a selection of large banks in the region. The selected bonds have residual maturities of up to six years.
Source: Bank of England.

1.33 The FLS is improving credit conditions in the UK. Wholesale bank funding costs have declined significantly as a result of the FLS and wider international developments and are now at very low levels. This is feeding through to the wider economy. The number of high loan-to-value mortgage products available in the market has increased by about 30 per cent and mortgage approvals are increasing. Between July 2012 and January 2013, the average quoted rate for 2-year fixed-rate mortgages with 90 per cent loan-to-value ratio fell by more than one percentage point, as shown in Chart 1.6. Chart 1.7 shows that, together with a general improvement in financial markets, the FLS has led to reductions in bank funding costs.

1.34 Credit availability for businesses has also improved and is expected to improve further in the coming months. Several banks participating in the FLS have introduced discounted loans for small and medium-sized enterprises.

1.35 The FLS has been a clear success, with strong signs that lower bank funding costs are now being reflected in lower lending rates and increased credit availability. Banks expect to expand their lending to the real economy and their use of the Scheme throughout the year. HM Treasury and the Bank of England are now actively considering whether there are potential extensions to the scheme that will boost lending further.

1.36 Building on the FLS, the Government wants to go further in order to deliver on its commitment to make the aspiration of home ownership a reality for as many households as possible. **Budget 2013 therefore announces Help to Buy, a package of measures that will increase the supply of low-deposit mortgages for credit-worthy households, increase the supply of new housing and contribute to economic growth.** Details of the Help to Buy package are set out in the next section.

Deficit reduction

Fiscal strategy

1.37 The Government inherited the largest deficit in post-war history due to the financial crisis of 2008 and 2009 and unsustainable pre-crisis increases in public spending. The historically high level of borrowing risked undermining fairness, growth and economic stability in the UK. In 2010 the Government set out clear, credible and specific medium-term fiscal consolidation plans to return the public finances to a sustainable path.

1.38 The Government's fiscal strategy has been effective in providing protection against a challenging backdrop of global uncertainty and fiscal vulnerabilities. This has restored fiscal credibility, allowing activist monetary policy and the automatic stabilisers to support the economy, and is consistent with the approach recommended by international organisations. As stated by the Organisation for Economic Co-operation and Development (OECD), *"monetary policy and the operation of the automatic stabilisers should support the economy in the short term"*.[17] Uncertainty in the global outlook further reinforces the case for stability in the Government's consolidation plans.

1.39 In line with the Government's fiscal strategy, Budget 2013 sets out:

- **a fiscally neutral Budget that reinforces the Government's commitment to deficit reduction,** primarily through spending consolidation;
- **a reduction in Resource Departmental Expenditure Limits (RDEL) of £1.1 billion in 2013-14 and £1.2 billion in 2014-15,** helping to support the housing package in the short term and contributing to the overall savings required from current spending in 2015-16;

[17] *OECD Economic Survey: United Kingdom 2013*, OECD, February 2013.

- **an envelope for current spending in 2015-16 of £694.2 billion, enabling the Government to increase capital spending plans by £3 billion a year** and ensuring consolidation is underpinned by clear, credible and specific medium-term plans for delivery; and
- **a sustained decline in the structural deficit as headwinds to growth ease,** with cyclically-adjusted net borrowing falling by an annual average of around 1 per cent of GDP over the forecast period.

Implementing fiscal consolidation

1.40 The Government remains committed to reducing the deficit and addressing the permanent structural deterioration in the public finances caused by the lasting impact of the financial crisis. Implementation of the fiscal consolidation plans is well underway:

- by the end of 2012-13, around 70 per cent of the annual fiscal consolidation planned for the Spending Review 2010 period will have been achieved, with around 65 per cent of the spending and around 90 per cent of the tax consolidation in place. As set out in Table 1.4, 80 per cent of the total consolidation in 2015-16 will be delivered by lower spending;
- by the end of April 2013, the Government will have implemented measures to deliver over 90 per cent of the total savings expected from reforms to the welfare system; and
- the majority of tax consolidation measures announced before Budget 2013 will have been legislated by 6 April 2013.[18]

1.41 As a result, the Government has made significant progress in reversing the unprecedented rise in borrowing between 2007-08 and 2009-10:

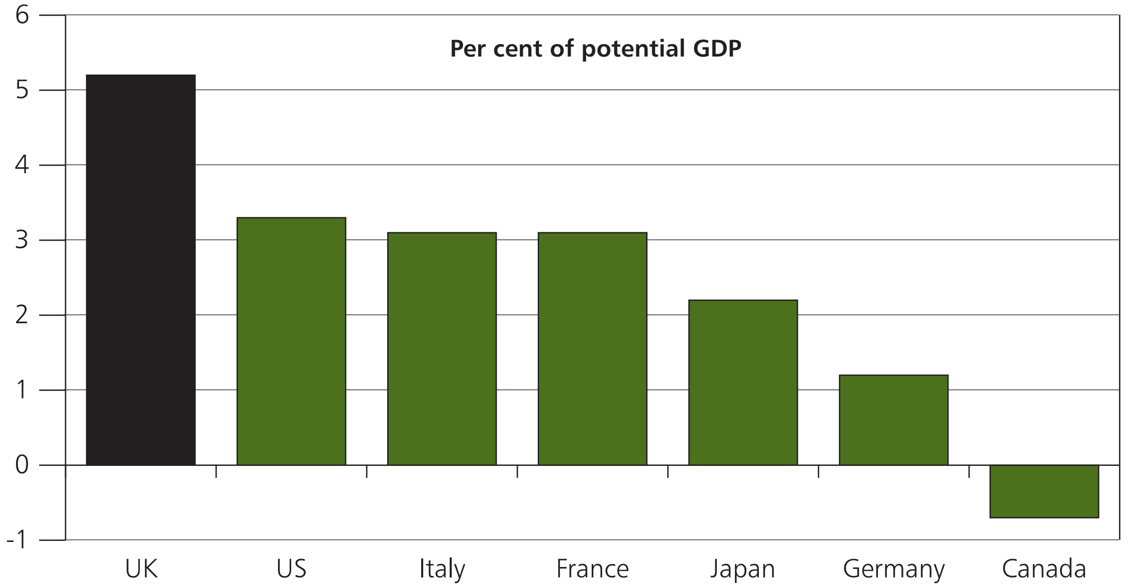
- public sector net borrowing is forecast to fall by a third over the three years from 2009-10, from 11.2 per cent of GDP in 2009-10 to 7.4 per cent of GDP in 2012-13 (as shown in Table 1.5);
- cyclically-adjusted general government net borrowing – a measure of the deficit that excludes the effects of the cycle, and so illustrates the structural fiscal position – is forecast by the IMF to fall by 4.3 percentage points of GDP between 2009 and 2012, which is a larger reduction than any other country in the G7;
- Total Managed Expenditure (TME) is planned to be £10.2 billion lower in 2012-13 than forecast at Budget 2012, ensuring the deficit continues to fall; and
- cumulative debt interest payments from 2010-11 to 2015-16 are forecast to be £31 billion lower than expected at the June Budget 2010.[19]

Reducing risks

1.42 The UK's fiscal vulnerabilities argue strongly in favour of maintaining a credible path of deficit reduction. Despite significant progress since 2010, the UK is forecast to have the largest deficit in the EU in 2013.[20] Among the G7, only the US and Japan are forecast to have larger deficits in 2013.[21] Uncertainty in the global outlook reinforces the case for stability in the Government's plans for fiscal consolidation.

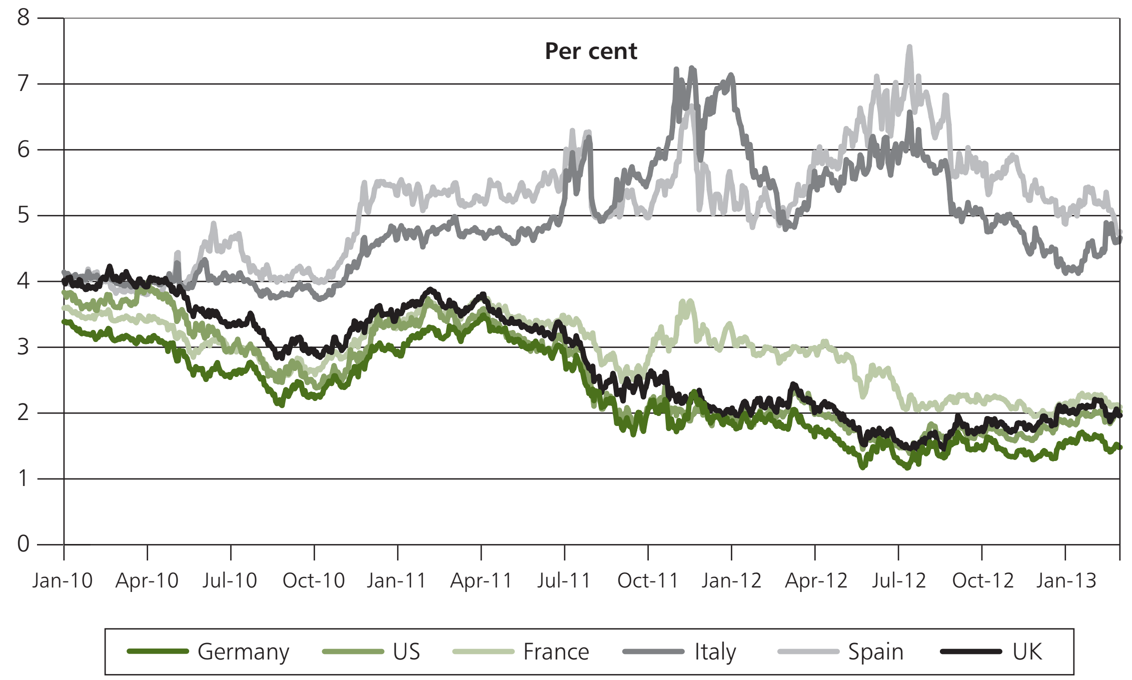
[18] Based on net savings in 2014-15. This estimate is consistent with Table 1.4.
[19] *Fiscal Monitor*, IMF, October 2012.
[20] *European Economic Forecast Winter 2013*, European Commission, February 2013.
[21] *Fiscal Monitor*, IMF, October 2012.

Chart 1.8: General government cyclically-adjusted deficit in 2007



Source: International Monetary Fund.

Chart 1.9: 10-year government bond yields



Source: Bloomberg.

1.43 In February Moody's downgraded the UK sovereign credit rating from Aaa to Aa1 with stable outlook, reflecting *"the anticipated slow growth of the global economy and the drag on the UK economy from the ongoing public and private sector deleveraging process"*. Moody's highlighted a number of factors that could lead them to downgrading the UK further, including *"reduced political commitment to fiscal consolidation"* and *"additional material deterioration in the country's economic prospects"*.[22] Among the G7, only Canada and Germany are now rated AAA by all three major credit rating agencies; Canada and Germany had the lowest pre-crisis structural deficits in 2007, while Chart 1.8 shows that the UK had the largest pre-crisis structural deficit in 2007.[23]

1.44 The credit rating is one of many important benchmarks, but near historic low gilt yields continue to reflect the market-tested credibility earned by the Government's economic strategy. As Chart 1.9 shows, UK long-term interest rates were around the same level as those of Italy and Spain in May 2010. Italy and Spain now face long-term interest rates of around 5 per cent, compared with near record lows of around 2 per cent for the UK.

1.45 Clear and credible consolidation plans remain essential for reducing the risk of a costly loss of market confidence in the UK. As noted by the OECD, *"global developments have shown that the consequences of losing market confidence can be sudden and severe and a sharp rise in interest rates would be particularly damaging to an economy with the United Kingdom's level of indebtedness"*.[24] Table 1.3 shows that a 1 percentage point increase in government bond yields would add around £8.1 billion to annual debt interest payments by 2017-18. A 1 percentage point rise in effective mortgage rates would add £12 billion a year to households' mortgage interest payments.

Table 1.3: Impact of higher interest rates on debt interest payments

	£ billion					
	Annual increase in debt interest payments					
	2013-14	2014-15	2015-16	2016-17	2017-18	Total
Increase in interest rates[1]						
1 percentage point	0.8	2.6	4.4	6.2	8.1	**22.1**
2 percentage points	1.6	5.1	8.8	12.6	16.4	**44.6**
3 percentage points	2.5	7.7	13.3	19.0	25.0	**67.5**
4 percentage points	3.3	10.3	17.9	25.6	33.8	**90.8**
5 percentage points	4.1	12.9	22.4	32.4	42.8	**114.6**

[1] *Above market gilt rates, consistent with the OBR's March 2013 Economic and fiscal outlook. Increases are applied to each gilt maturity from 2013Q2 and are assumed to continue throughout the forecast period.*
Source: HM Treasury.

1.46 Fiscal consolidation also reduces the risk of adverse feedback between weak public finances and a strained financial sector. This feedback can be very damaging, as evidenced by recent events in the euro area. Globally, the UK has one of the largest financial systems relative to the size of its economy, meaning that any loss of investor confidence in the UK's fiscal position would not only affect the UK, but also the global economy. As the IMF has stated, *"the UK financial system thus serves as a global public good"*.[25] It is the IMF's view that the UK's economic and financial sector policies have a systemic impact on the global economy.

[22] *Press notice: Moody's downgrades UK's government bond rating to Aa1 from Aaa; outlook is now stable*, Moody's, 22 February 2013.
[23] *Fiscal Monitor*, IMF, October 2012.
[24] *OECD Economic Survey: United Kingdom 2013*, OECD, February 2013.
[25] *2012 Spillover Report*, IMF, July 2012.

Spending consolidation

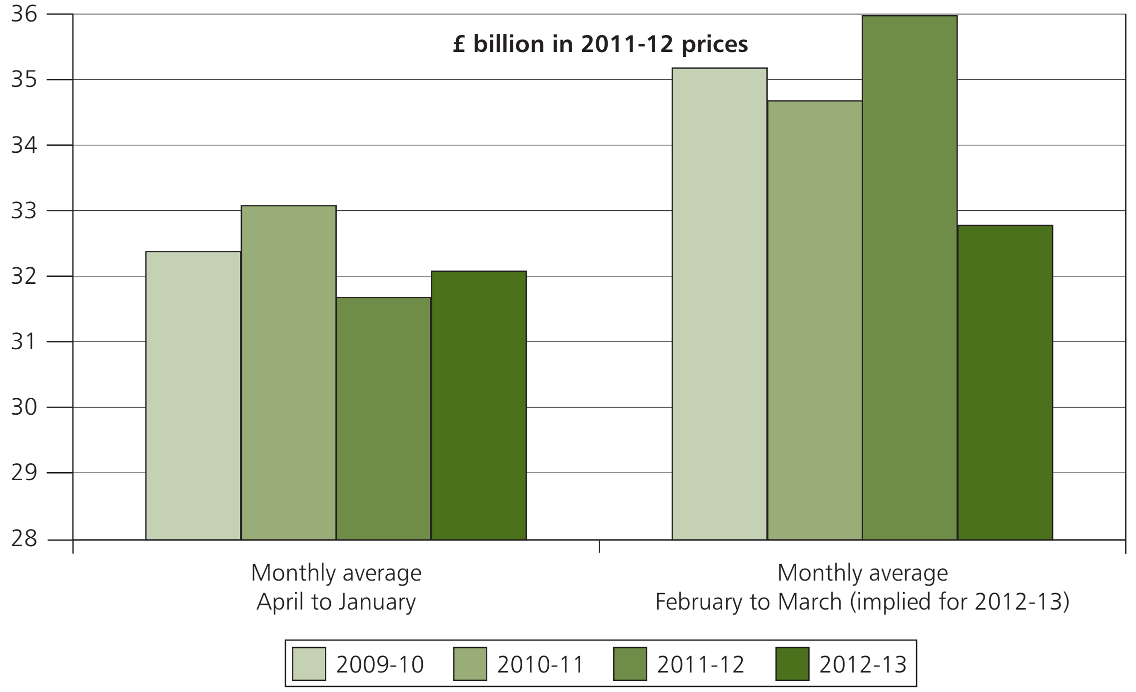
Spending control

1.47 Public spending control is central to the Government's commitment to reduce the deficit. Since 2010 the Government has taken firm action to ensure good financial management in departments and to improve spending control by:

- delivering £6.2 billion of in-year efficiency savings in 2010-11;
- establishing the Cabinet Office Efficiency and Reform Group in 2010 and introducing tighter spending controls over areas of corporate spending including procurement, property and information communications technology;
- taking a zero-based approach to capital spending at Spending Review 2010 to prioritise those projects with the highest economic value;
- tightening in-year spending control by departments, including through the guidance published in *Improving Spending Control*; and
- as a result of the Government's successful negotiation, agreeing the new Multi-annual Financial Framework at the February European Council, which reduces the UK's contributions to the EU by £3.5 billion over the forecast period to 2017-18.[26]

1.48 Action to improve financial management and spending control has continued this year. Analysis of spending patterns has demonstrated that there is a longstanding trend of departmental spending rising in the final few months of the year, partly because departments seek to avoid losing access to funds. This year there has been a strengthened cross-government effort to scrutinise end-of-year spending to address this trend and ensure that value-for-money criteria around departmental spending are upheld. In addition increased focus has been placed on departments making payments at the appropriate time.

Chart 1.10: Current spending on public services in real terms



Source: Office for Budget Responsibility, Office for National Statistics and HM Treasury.

[26] Available on the Treasury website at www.hm-treasury.gov.uk.

1.49 Over the last three years departments have underspent against plans by an average of £4.0 billion across total Departmental Expenditure Limits (DEL). This has been spread across a number of departments. For example, the forecast underspend for the Department of Health is £2.2 billion in 2012-13 compared to an average of £2.1 billion against original provision over the last Parliament.[27] Faster progress in delivering savings, combined with the improvements to spending control set out above, mean that departmental underspends in 2012-13 are higher than usual and above the £7.5 billion included in the OBR December 2012 forecast. Departments are collectively expected to spend £11.5 billion less in total DEL in 2012-13 than in the plans set out at Budget 2012. Details of this are set out in Table 2.5.

1.50 Departments are ahead of their consolidation targets. As set out in Table 1.4, by the end of 2012-13 around 65 per cent of the £80 billion of spending reductions planned by 2014-15 will have been delivered, compared to around 50 per cent at the time of the 2010 Spending Review. To reflect this, and in line with the Government's commitment to ensuring that borrowing continues to fall, **Budget 2013 announces a reduction in RDEL by £1.1 billion in 2013-14 and £1.2 billion in 2014-15.** This is equivalent to a 1 per cent reduction for most departments. The schools and health budgets remain unchanged. Local Government and police allocations that have been set out for 2013-14 will not be changed. HM Revenue and Customs (HMRC) will be excluded, to ensure that they are able to focus on delivering the additional revenue target set out at Autumn Statement 2012. **The budget of the Department for International Development will be reduced by £135 million in 2013-14 and £165 million in 2014-15 to reflect the downward revisions to nominal Gross National Income set out in the OBR forecast.** There is also a reprofiling of funding for broadband programmes, to support local delivery. These savings will be used to help support housing in the short term and contribute to the overall savings required from current spending in 2015-16.

The 2015-16 Spending Round

1.51 This Budget sets out the next steps in the UK's fiscal consolidation by fixing an envelope for TME for 2015-16. The Government has set this envelope in line with the assumption that total spending will continue to fall in 2015-16 at the same rate as over the Spending Review 2010 period. The Government will make savings from current spending of £11.5 billion in 2015-16. As set out in Table 2.3, **the envelope for current spending in 2015-16 is therefore set at £694.2 billion.** Individual departmental budgets will be published in the 2015-16 Spending Round to be announced on 26 June 2013. Health, schools and Official Development Assistance (ODA) will be protected.

1.52 As a result of these savings, **Budget 2013 announces that the Government will increase capital spending plans by £3 billion a year from 2015-16 onwards,** maintaining the temporary increases to capital announced at Autumn Statement 2011 and Autumn Statement 2012. The capital envelope for 2015-16 will be £50.4 billion. As the IMF has stated, *"Deeper budget-neutral reallocations could also support recovery. Such reallocations within the current overall fiscal stance could include greater investment spending".*[28] As a result of this increase, public investment as a percentage of GDP will now be higher on average over this Parliament and the next Parliament collectively than it was under the previous government. **The Government will take a long-term approach to capital as part of the 2015-16 Spending Round, setting plans out to 2020-21 for the most economically valuable areas of capital expenditure.**

1.53 Public sector pay restraint has been a key part of the fiscal consolidation so far. **Budget 2013 announces that public sector pay awards in 2015-16 will be limited to an average of up to 1 per cent.** It will be for departments and Pay Review Bodies to determine the level of award based on affordability and individual recruitment and retention needs.

[27] All underspends are in 2011-12 prices.
[28] *United Kingdom: Staff Report for the 2012 Article IV Consultation*, IMF, July 2012.

1.54 Although the majority of the public sector has been subject to pay restraint, some have continued to receive annual pay increases of 7 per cent or more due to progression pay arrangements. In some workforces reforms are already under way. **The Government will seek significant further savings through reforms to progression pay in the Spending Round.** The Armed Forces will be excluded due to the unique nature of their careers.

1.55 The Government's themes for the 2015-16 Spending Round will be growth, efficiency and public service reform, including localism and fairness. The increase to capital spending plans and long-term approach to capital planning set out above will strengthen UK infrastructure and support growth in the economy. The Spending Round will require a continued focus on delivering higher-quality services and better outcomes at lower cost. This will be achieved both through further operational efficiencies in central government and the wider public sector, and ongoing reform of public services – including strengthened joint working at a local level and across services. The Government is committed to ensuring that decisions on public spending are as transparent, accountable and fair as possible, and will again publish analysis of the distributional impact of the Spending Round.

1.56 The 2015-16 Spending Round will extend the efficiency programme into 2015-16, with the expectation of generating a further £5 billion of savings. Departments saved £5.5 billion in 2011-12, supported by the Efficiency and Reform Group, through efficiencies and reducing wasteful expenditure.[29] Departments are expected to deliver comparable additional efficiency savings in each of the succeeding years including 2015-16. Moving transactional services online will save £1.2 billion in this Parliament and the Government's programme for improving back-office shared services across departments and Arm's Length Bodies will deliver savings of around £250 million in 2015-16.[30] Further savings will come from the review of projects announced at the Autumn Statement 2012, further centralisation of the procurement of common goods and services, and reducing the cost of information technology.[31]

1.57 In the wider public sector, the Department for Education will conduct a review of the level of efficiency in the schools system to report alongside the 2015-16 Spending Round, and the Government will publish an action plan in May with measures to improve the efficiency and effectiveness of the Criminal Justice System. Her Majesty's Inspectorate of Constabulary (HMIC) data suggests that one-sixth of policing will be delivered collaboratively across forces by 2014-15, but there is further to go to maximise savings whilst protecting the service to the public.[32]

1.58 Ongoing reform of public services will also be required. The four areas that participated in the recent Whole Place Community Budget pilots estimate that they can save £800 million over five years by implementing their plans.[33] To support the local adoption of similar approaches, **the Government is establishing a new multi-agency network and will announce plans to extend the benefits of this approach across the country at the 2015-16 Spending Round.**

Spending beyond 2015-16

1.59 Budget 2013 updates the fiscal assumption for 2016-17 and 2017-18. **In line with previous policy, this Budget sets a fiscal assumption that TME in 2016-17 and 2017-18 will continue to fall in real terms at the same rate as over the Spending Review 2010 period.**[34] Fiscal consolidation for 2016-17 and 2017-18 is expressed as a reduction in TME. It would, of course, be possible to do more of this further consolidation through tax instead.

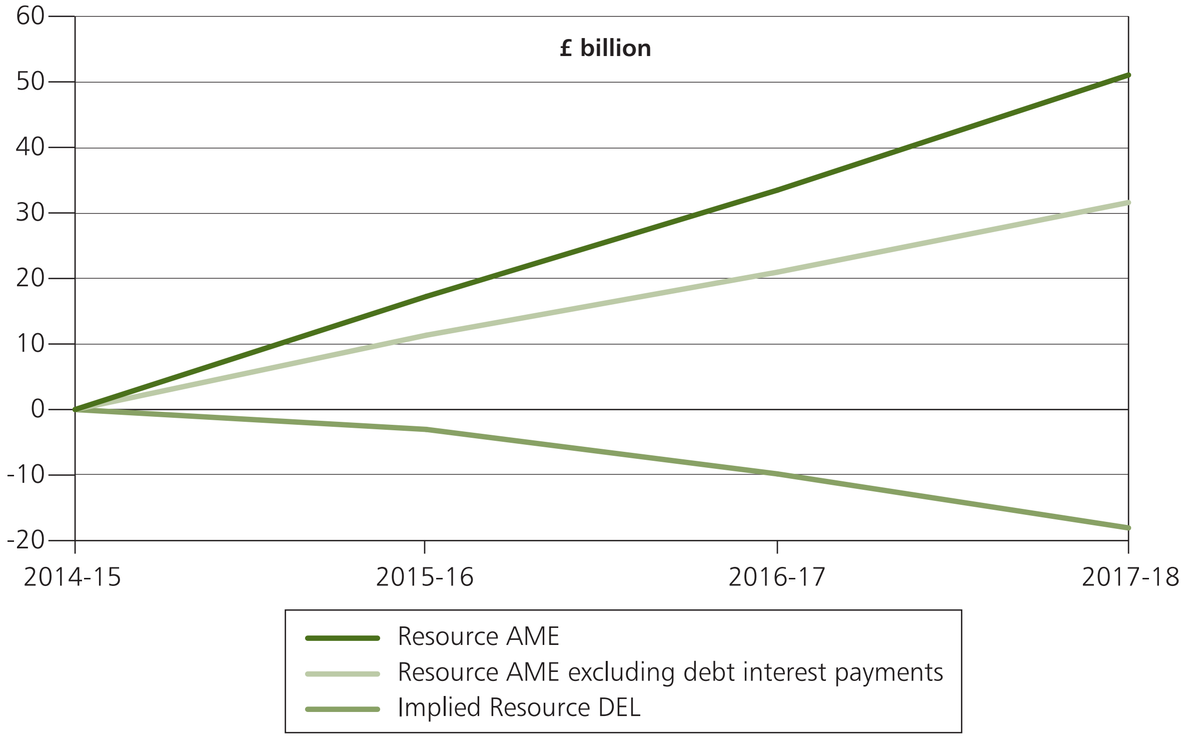
[29] Available on the Government website at www.gov.uk.
[30] Available on the Cabinet Office and Government websites at www.cabinetoffice.gov.uk and www.gov.uk.
[31] Available on the Government website at www.gov.uk.
[32] *Increasing efficiency in the Police Service: the role of collaboration*, HMIC, July 2012.
[33] *Cabinet Office and HM Treasury – Integration across Government*, National Audit Office, March 2013.
[34] The Government's fiscal assumption excludes the effect of measures announced at Budget 2013 and Autumn Statement 2012, all capital measures announced at Autumn Statement 2011, and the OBR's underspends forecast.

Reform of the spending framework

1.60 Annually Managed Expenditure (AME) typically consists of large, demand-led programmes. Under the current public spending framework, AME accounts for around half (some £350 billion) of total public expenditure, the largest component of which is welfare spending. However, AME is not subject to fixed spending controls.

1.61 The Government has already taken action to manage AME spending pressures, including through the delivery of significant welfare reforms. As a result, working-age welfare expenditure is projected to fall in real terms over the current spending review period. Despite this, as shown by Chart 1.11, rapid growth in AME spending is reducing the resources available for other key public services. These pressures are set to persist over the longer term.

Chart 1.11: Cumulative changes to Resource AME and implied Resource DEL



Source: HM Treasury and Office for Budget Responsibility.

1.62 It is important that the Government can manage increases in spending and make trade-offs across different areas of expenditure, ensuring that limited resources are directed toward public spending priorities. To deliver this, a more robust public spending framework is required. **Budget 2013 announces that the Government will strengthen the spending framework by introducing a firm limit on a significant proportion of AME, including areas of welfare expenditure. This will be designed in a way that allows the automatic stabilisers to operate to support the economy.** Action to improve control over AME spending will support the delivery of fiscal consolidation. An update will be provided at the Spending Round.

1.63 As set out in Autumn Statement 2012, the Government is also developing a framework for managing liabilities that do not appear in the fiscal aggregates and a control total for the commitments arising from off-balance sheet Private Finance Two (PF2) contracts signed. The Government will provide further details in the 2015-16 Spending Round.

Composition of consolidation

1.64 As a result of the plans set out in Budget 2013, public spending is projected by the OBR to fall from 47.4 per cent of GDP in 2009-10 to 40.5 per cent of GDP by 2017-18, around the same level as 2004-05 and close to its long-run average. Public sector current receipts are projected to rise from around 36.2 per cent of GDP in 2009-10 to around 38.3 per cent of GDP by 2017-18.

1.65 As set out in Table 1.4, 80 per cent of the total consolidation in 2015-16 will be delivered by lower spending. This is consistent with OECD and IMF research, which suggests that fiscal consolidation efforts that are focused on spending are more likely to be successful.[35]

Table 1.4: Total consolidation plans over this Parliament

	£ billion				
	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**
Policy inherited by the Government	**25**	**40**	**54**	**68**	
Spending[1,2]	14	25	37	48	
Tax[2]	11	15	17	20	
Spending share of consolidation (per cent)	*57*	*62*	*69*	*71*	
Total discretionary consolidation	**41**	**74**	**84**	**103**	**130**
Spending[1,2,3,4]	23	53	58	80	105
Tax[2,3]	18	21	25	23	25
Spending share of consolidation (per cent)	*56*	*72*	*70*	*77*	*80*

[1] Spending consolidation is attributable to three factors: (a) reductions in DEL are calculated by assessing nominal DEL totals against a counterfactual of growing DEL from 2010-11 in line with general inflation in the economy, as set out in Table 4.8 of the OBR's pre-Budget forecast (June 2010); (b) reductions in AME due to the net effect of policy changes announced since the June Budget 2010; and (c) estimated debt interest savings, updated for market interest rates consistent with the OBR's March 2013 Economic and fiscal outlook.

[2] This takes account of the latest costings.

[3] Where costings do not go out to 2015-16, they have been grown in line with general inflation in the economy.

[4] The Government will set DEL budgets for 2015-16 at the Spending Round. Figures shown for 2015-16 are based on overall Resource and Capital DEL envelopes, as set out in Table 2.3.

Source: Office for Budget Responsibility and HM Treasury.

Fiscal forecast

1.66 The establishment of the OBR has placed the UK at the forefront of institutional reform internationally. It has significantly enhanced the credibility of the UK's fiscal framework by ensuring that the Government's fiscal policy decisions are based on independent forecasts for the economy and public finances.

1.67 The deficit forecasts in Budget 2013 are presented excluding the effect of the transfer of assets from the Royal Mail Pension Plan to the public sector, except where otherwise indicated. On this basis, public sector net borrowing is forecast to continue to fall from its post-war peak of 11.2 per cent of GDP in 2009-10 to:

- 5.0 per cent of GDP in 2015-16, the end of this Parliament; and
- 2.2 per cent of GDP in 2017-18.

1.68 Public sector net debt as a percentage of GDP is forecast to:

- be 5.1 percentage points higher in 2015-16 than forecast at Autumn Statement 2012; and
- peak at 85.6 per cent of GDP in 2016-17, before falling to 84.8 per cent of GDP in 2017-18.

[35] See *Economic Outlook*, OECD, June 2007; *OECD Economic Survey: United Kingdom 2011*, OECD, March 2011; and *UK Article IV consultation*, IMF, May 2009.

Table 1.5: Overview of the OBR's central fiscal forecast

	Per cent of GDP							
	Outturn		Forecast					
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Deficit								
Public sector net borrowing	9.5	7.9	7.4	6.8	5.9	5.0	3.4	2.2
Surplus on current budget	-6.9	-6.0	-6.0	-5.2	-4.3	-3.5	-1.9	-0.9
Primary balance	-6.8	-5.1	-5.3	-4.8	-3.8	-2.6	-0.6	0.9
Cyclically-adjusted net borrowing	7.3	6.0	5.4	4.3	3.3	2.7	1.3	0.6
Cyclically-adjusted surplus on current budget	-4.7	-4.2	-4.0	-2.8	-1.7	-1.2	0.1	0.8
Cyclically-adjusted primary balance	-4.6	-3.2	-3.3	-2.3	-1.2	-0.3	1.4	2.5
Treaty deficit[1]	9.6	7.8	7.4	6.8	6.0	5.2	3.5	2.3
Cyclically-adjusted Treaty deficit	7.4	5.9	5.4	4.4	3.4	2.8	1.5	0.7
Memo: Public sector net borrowing including Royal Mail Pension Plan transfer	*9.5*	*7.9*	*5.6*	*6.8*	*5.9*	*5.0*	*3.4*	*2.2*
Memo: Treaty deficit including Royal Mail Pension Plan transfer[1]	*9.6*	*7.8*	*5.6*	*6.8*	*6.0*	*5.2*	*3.5*	*2.3*
Debt								
Public sector net debt[2]	66.5	71.8	75.9	79.2	82.6	85.1	85.6	84.8
Treaty debt ratio[3]	79.9	86.0	90.7	94.9	98.6	100.8	100.8	99.4
Output gap	-2.8	-2.7	-2.9	-3.7	-3.6	-3.3	-2.7	-2.1
Memo: total policy decisions[4]				*0.1*	*-0.1*	*-0.2*	*0.1*	*0.1*

Note: Deficit figures exclude the effect on public sector net investment in 2012-13 of transferring assets from the Royal Mail Pension Plan to the public sector, which reduces net borrowing by £28 billion (1.8 per cent of GDP) in that year, unless otherwise stated.

[1] General government net borrowing on a Maastricht basis.

[2] Debt at end March; GDP centred on end March.

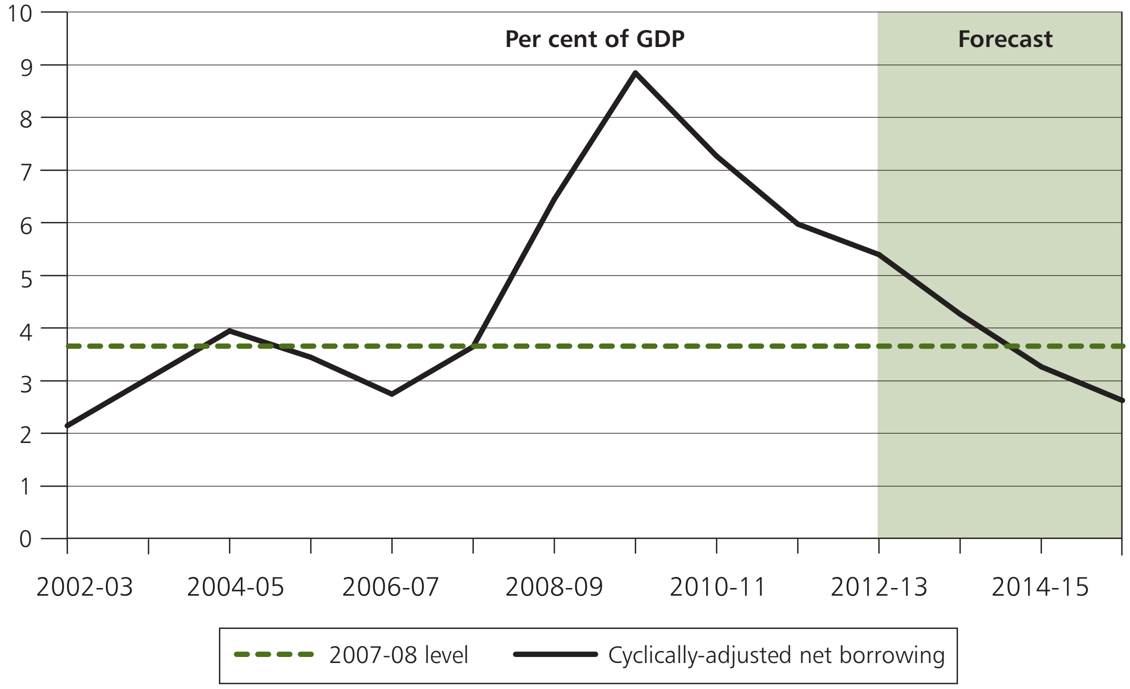
[3] General government gross debt on a Maastricht basis.

[4] Equivalent to the 'Total policy decisions' line in Table 2.1.

Source: Office for Budget Responsibility, Office for National Statistics and HM Treasury.

1.69 The structural position of the public finances remains on a sustainable path. The Government's plans ensure a sustained decline in the structural deficit. Chart 1.12 shows that cyclically-adjusted net borrowing – a measure of the deficit that excludes the effects of the cycle and so illustrates the structural fiscal position – is forecast to fall below the pre-crisis level by the end of this Parliament. Cyclically-adjusted net borrowing falls by an annual average of around 1 per cent of GDP over the forecast period, in line with the structural consolidation set out in Autumn Statement 2012.

Chart 1.12: Cyclically-adjusted net borrowing until the end of this Parliament[1]



[1] Cyclically-adjusted net borrowing excluding the effect on public sector net investment in 2012-13 of transferring assets from the Royal Mail Pension Plan to the public sector.
Source: Office for Budget Responsibility, Office for National Statistics and HM Treasury.

The fiscal mandate

1.70 As announced in the June Budget 2010, the Government's fiscal strategy is underpinned by a forward-looking fiscal mandate to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period. The fiscal mandate guides fiscal policy decisions over the medium term, ensuring that the Government sets plans consistent with a reduction in the structural deficit. The fiscal mandate is based on:

- a cyclically-adjusted aggregate, to allow some fiscal flexibility at times of economic uncertainty and to allow the automatic stabilisers to operate;
- a rolling five-year forecast period, to ensure that fiscal consolidation is delivered over a realistic and credible timeframe; and
- the current balance, to protect the most productive public investment expenditure.

1.71 The Government's fiscal mandate is supplemented by a target for public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16.

Performance against the mandate

1.72 Including all measures set out in this Budget, the OBR's March 2013 *Economic and fiscal outlook* concludes that the Government remains on course to meet the fiscal mandate. The OBR's judgement is that the Government's policies are consistent with a roughly 70 per cent chance of achieving the fiscal mandate in 2017-18. The OBR's forecast is for the fiscal mandate to be achieved a year early, in 2016-17.

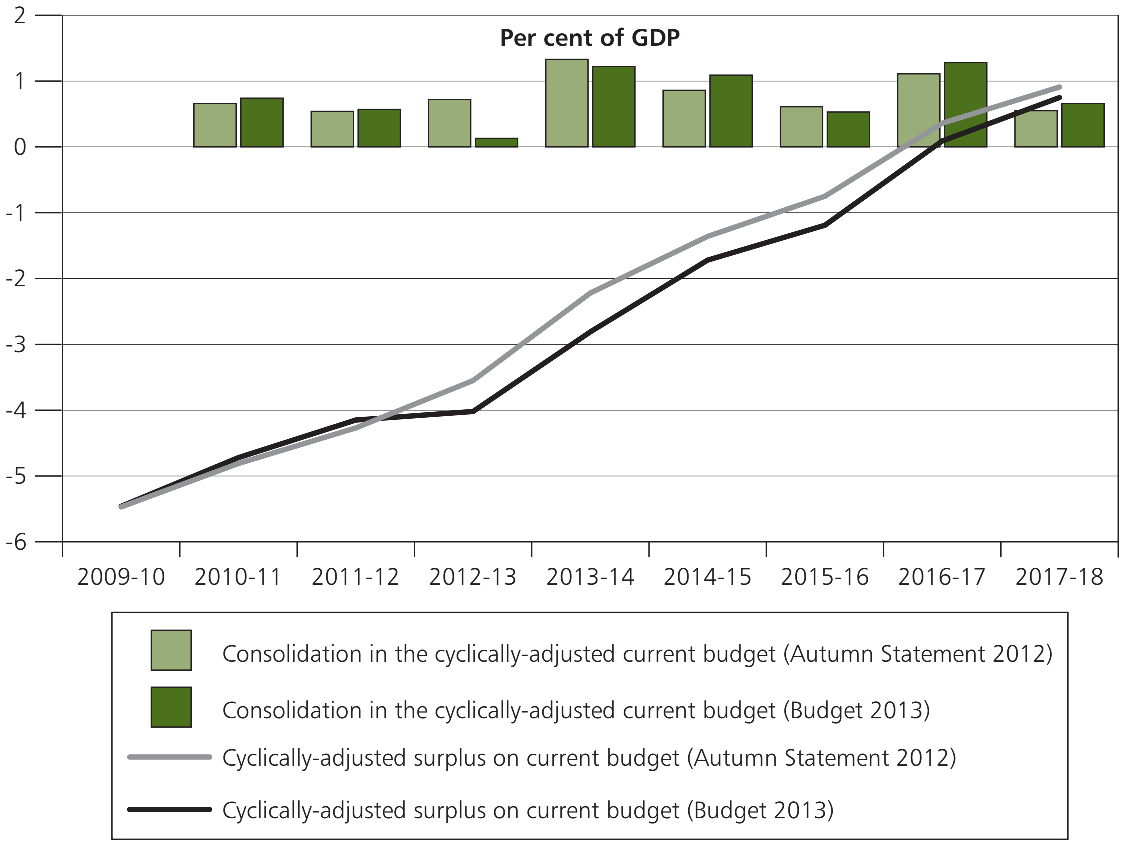
1.73 The OBR has also forecast that public sector net debt as a percentage of GDP will be falling in 2017-18, two years later than set out in the supplementary debt target.

1.74 The Government's judgement is that significant changes to the path of consolidation in the short term would constrain the operation of the automatic stabilisers, limiting their ability to support the economy. The Government's response is in line with the recommendations of international organisations. The OECD stated that *"the Government's decision in the December 2012 Autumn Statement to continue with its existing consolidation plans and not override the automatic stabilisers in order to meet the supplementary debt target is appropriate."*[36] At this time of rising debt, the Government remains committed to restoring debt to a sustainable, downward path and will retain the existing supplementary debt target.

1.75 As set out in the June Budget 2010, once the public finances are closer to balance, the period over which cyclically-adjusted current balance must be achieved could safely be shortened in order to create a tighter constraint. In addition, once the exceptional rise in debt has been addressed, a new target for debt as a percentage of GDP will be set, taking account of the OBR's assessment of the long-term sustainability of the public finances.

1.76 Charts 1.13 and 1.14 show performance against the Government's fiscal mandate and the supplementary debt target. The cyclically-adjusted current balance in 2017-18 is broadly unchanged from the OBR's December 2012 forecast.

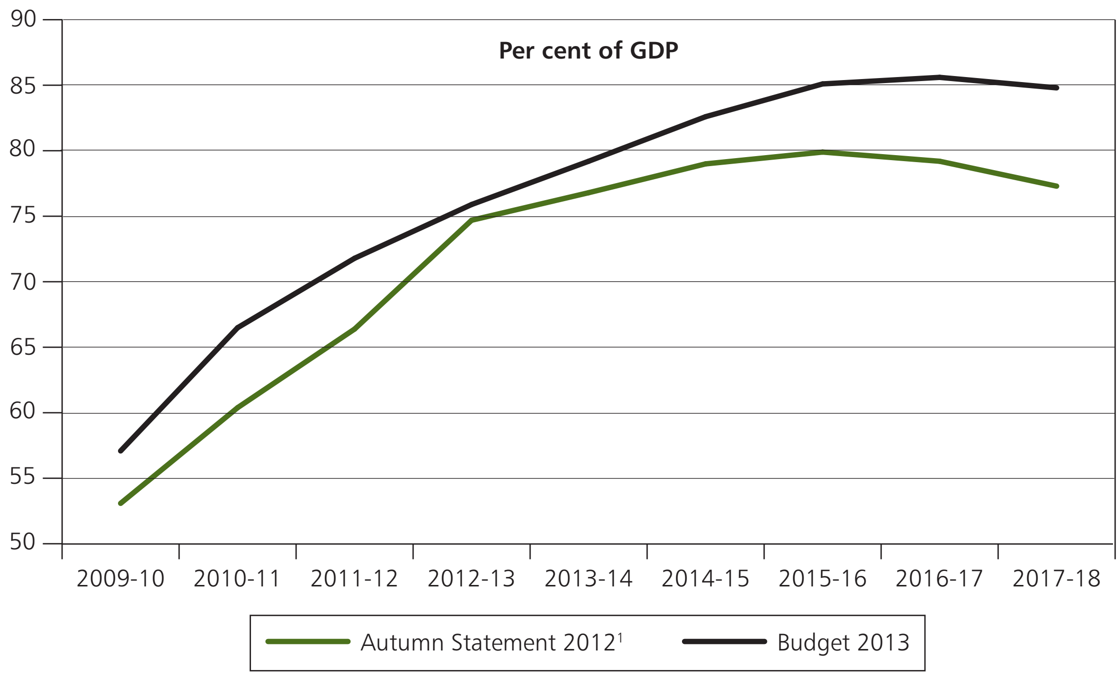
Chart 1.13: Consolidation in the cyclically-adjusted current budget



Source: Office for Budget Responsibility, Office for National Statistics and HM Treasury.

[36] *OECD Economic Survey: United Kingdom 2013*, OECD, February 2013.

Chart 1.14: Public sector net debt



[1] *Autumn Statement 2012 excluded the reclassification of Northern Rock (Asset Management) and Bradford and Bingley plc between 2009-10 and 2011-12.*
Source: Office for Budget Responsibility, Office for National Statistics and HM Treasury.

Performance against EU targets

1.77 The Government remains committed to bringing the UK's Treaty deficit in line with the 3 per cent target set out in the Stability and Growth Pact (SGP). The UK is forecast to meet the EU SGP target for the Treaty deficit in 2017-18.

Debt management

1.78 The Government's financing plans for 2013-14 are set out in full in the *Debt and reserves management report 2013-14*, published alongside the Budget and summarised in Annex A. It is anticipated that the net financing requirement of £162.9 billion will be met through gilt issuance of £151.0 billion and an increase of £11.9 billion in the stock of Treasury bills.

1.79 The financing arithmetic provides for £6 billion of sterling financing for the Official Reserves in 2013-14. The Government continues to envisage sterling financing being held at a similar level in 2014-15. This additional financing, announced at Budget 2011, is intended to meet potential calls on the Official Reserves that may arise and ensure that the level of foreign currency reserves held is sufficient.

RPI indexation

1.80 The National Statistician's announcement in January, which confirmed that the Retail Prices Index (RPI) would remain unchanged, stated that a method of calculation used in the RPI would not be chosen were the Office for National Statistics (ONS) to construct a new price index. The Government will keep the use of RPI for indexation purposes under evaluation until after the UK Statistics Authority has concluded reviewing the governance arrangements and structures supporting the production of price indices and how best to ensure that these statistics best meet the needs of users in future. This will allow sufficient time for new ONS price indices, Consumer Prices Index including Housing and Retail Prices Index Jevons, to become established. For gilt investors, their future cash flows on existing index-linked gilts will continue to be calculated by reference to the RPI in accordance with the terms and conditions of those gilts. The Government will continue to issue new index-linked gilts linked to the RPI.

Reform of the financial system

1.81 As set out in February 2013, this is the year that the Government's financial sector reforms will reset the banking system.

1.82 Following the London Inter-Bank Offered Rate (LIBOR) rate-fixing and other recent scandals, the Government intends to reform the culture and ethics of the banking industry to improve the way that banks work for their customers. In summer 2012, the Government proposed the establishment of the Parliamentary Commission on Banking Standards, which completed its pre-legislative scrutiny work on the Draft Financial Services (Banking Reform) Bill in December. The Commission has said it will produce a final report in mid-May, and is expected to produce far reaching proposals to improve professional standards and culture in the banking industry.

1.83 The Government is also undertaking ambitious reform to create a more resilient, stable and competitive banking sector, based on the recommendations of the Independent Commission on Banking (ICB), chaired by Sir John Vickers. The Financial Services (Banking Reform) Bill was introduced into the House of Commons in February 2013 and has had its second reading. The Government will be bringing forward further measures in the Bill, in line with recommendations from the Parliamentary Commission on Banking Standards, to create a powerful new tool for the regulator to ensure the independence of the ring-fence bank. The Government will seek to amend the Bill to include provisions giving the regulator the power to enforce full separation between retail and wholesale banking in a specified group, subject to approval from the Treasury.

1.84 The Government continues to implement its plans to overhaul the tripartite system of financial regulation. The Financial Services Act 2012 comes into force on 1 April 2013. It provides the Bank of England with control of macro-prudential regulation, through the FPC, and with the establishment of the Prudential Regulation Authority (PRA) as a subsidiary of the Bank of England, creates a new micro-prudential regulator of deposit-takers, insurers and large investment firms. The new Financial Conduct Authority (FCA) will be responsible for ensuring the markets it regulates function well and in a way that supports consumer protection, market integrity and competition with strong statutory objectives.

Growth

1.85 The Government is delivering an ambitious programme of structural reform to equip the UK to succeed in the global race and support aspiration. Reflecting these reforms, the UK was ranked eighth overall in the World Economic Forum Global Competitiveness Report in 2012-13, up from twelfth in 2010-11.[37] A full implementation update on the Government's *Plan for Growth* has been published alongside this Budget.[38]

1.86 Budget 2013 sets out further action the Government will take to help UK businesses create jobs and to help people buy their own home. The Budget announces reforms to:

- improve the UK's infrastructure with a commitment to increase capital spending by £3 billion a year from 2015-16;
- help those who want to buy a home and increase the number of new homes being built with £5.4 billion of additional financial support. This includes a £3.5 billion investment in a Help to Buy: equity loan scheme in England open to all those who aspire to own a new build home, and the creation of a major new Help to Buy: mortgage guarantee to increase the availability of mortgages for new or existing properties for those with small deposits. To further support the supply of new housing, the Build to Rent and affordable homes guarantee programmes will also both be significantly expanded;
- support small business, including those looking to take on their first employee, by introducing a new £2,000 Employment Allowance to reduce employer National Insurance contributions (NICs) for all businesses;
- achieve the Government's ambition for the UK tax system to be the most competitive in the G20, cutting corporation tax to 20 per cent from April 2015;
- build on the UK's strengths, with £1.6 billion of funding to support long-term strategies for 11 sectors where the UK can be world-leading, including funding for a new Aerospace Technology Institute; and
- devolve significant funding to Local Enterprise Partnerships (LEPs), in response to Lord Heseltine's review, enabling them to tackle the barriers to growth that hold back the private sector in their areas.

[37] *The Global Competitiveness Report 2012–2013*, World Economic Forum, 2012.
[38] *Plan for Growth implementation update*, HM Treasury, March 2013.

Figure 1.1: Implementation of growth commitments[39]

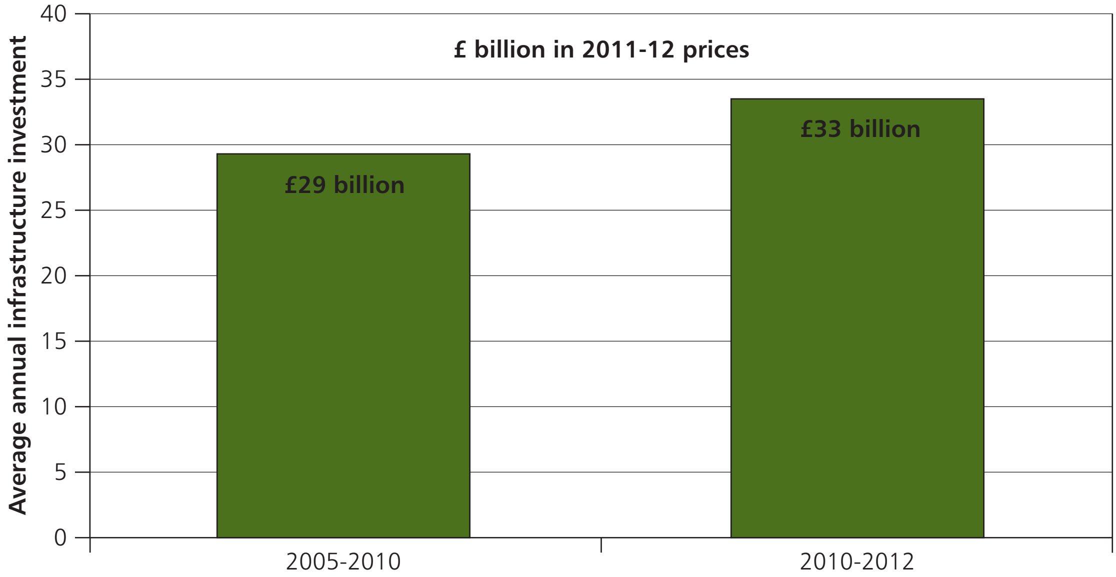
COMMITMENTS		PROGRESS TO DATE	FORTHCOMING IMPLEMENTATION
COMPETITIVE TAX SYSTEM	*Make the UK the best location for corporate headquarters in Europe*	• Main rate of corporation tax cut to 24 per cent, the lowest in the G7 • Corporation tax for smaller companies cut to 20 per cent • Reform of Controlled Foreign Company rules • Small and medium-sized enterprises (SME) research and development (R&D) tax credit increased to 225 per cent	• By 2015, main rate will fall to 20 per cent • By 2015, a single, unified rate at 20 per cent • From April 2013, new tax reliefs for the animation, high-end television and video games industries[40] • From April 2013, a Patent Box worth £700m a year • From April 2013, an 'above the line' R&D credit at a headline rate of 10 per cent
	Reduce tax on employment and work	• Personal allowance to rise to £9,440 from April taking 1.1m people out of income tax • Threshold for employer NICs raised, with 650,000 employees taken out of employer NICs	• Personal allowance to £10,000 by April 2014 • From April 2014, £2,000 Employment Allowance for businesses and charities • From April 2013, top rate of income tax of 45 per cent
INVESTMENT AND EXPORTS	*Develop UK infrastructure*	• The largest rail investment since the Victorian era with support for £9.4bn of enhancements • Seven national and eighteen local major roads complete • UK Guarantees to support £1bn for the Northern Line Extension and £75m for Drax conversion • A tripling of support for low carbon generation, providing up to £7.6bn by 2020	• Completion in 2013 of major projects worth over £2bn, including major upgrades to roads • Consulting on the route for the second phase of High Speed Two in 2013 • From April 2013, a new carbon price floor • Legislation to provide certainty in energy infrastructure and bring forward investment
	Promote exports and inward investment	• Support for 32,000 SMEs to export in 2012-13 • Support for UK exporters to win contracts worth over £3.2bn since 2011-12	• From April 2013, £140m over two years to support more SME exporters and attract overseas investment • Financial Services Trade and Investment Board to open up trade opportunities and investment
	Encourage investment across sectors and regions	• Annual Investment Allowance increased to £250,000 for two years from January 2013 • 24 Enterprise Zones established, creating 1,700 jobs and almost £156m of investment	• From April 2013, £5.4bn on housing including Help to Buy and Build to Rent • From 2015, a Single Local Growth Fund to give local areas control over growth-related spending
BEST PLACE FOR BUSINESS	*Improve access to finance and support to new and growing businesses*	• 39 banks and building societies signed up to the Funding for Lending Scheme • £1.7bn of funding raised so far through the Business Finance Partnership • New Seed Enterprise Investment Scheme and expanded Venture Capital Trusts and Enterprise Investment Scheme	• Business Bank will start investing in 2013, and will be fully operational from 2014 • By summer 2013, further investments by the Business Finance Partnership • From April 2013, a limited extension of the capital gains tax relief for the Seed Enterprise Investment Scheme
	Reduce burdens on businesses	• New emphasis on sustainable growth in planning policy, and approvals at a 10-year high • Deregulation to save businesses £840m a year • Qualifying period for unfair dismissal increased from one year to two	• Reforms to employment law saving employers an estimated £40m a year by 2015 • By 2015, at least 3,000 regulations abolished or reduced through the Red Tape Challenge
EDUCATED, FLEXIBLE WORKFORCE	*Radical reform to every stage of education and skills provision*	• 2,724 Academies and 80 free schools open • Almost 1m apprenticeship starts this Parliament • Five University Technical Colleges (UTCs) open • Pupil Premium benefitting 1.3m deprived pupils	• In 2013, 100 free schools expected to open • 30 UTCs expected to be open by September 2014 • In 2013-14, up to £240m of skills funding will be directed to employers
	UK as a world leader on science and technology	• Four Catapult Centres opened including high-value manufacturing and cell therapy • 14 science and innovation capital projects from the Research Partnership Investment Fund	• Three more Catapult Centres to open by June 2013 • A new Aerospace Technology Institute, providing £2.1bn of R&D support to the aerospace sector

[39] For further details and data sources see Plan for Growth implementation update, HM Treasury, March 2013.
[40] Subject to state aid approval.

Infrastructure

1.87 Following years of historic underinvestment in UK infrastructure, the Government has made infrastructure a key economic policy priority. The UK's first ever *National Infrastructure Plan*, published in 2010, set out a comprehensive approach to strengthening the nation's infrastructure.[41] An update on delivery of the Top 40 Projects identified in the *National Infrastructure Plan 2011* is published alongside Budget 2013.[42,43] As Chart 1.15 shows, annual investment in infrastructure has grown since 2010.

Chart 1.15: Average annual infrastructure investment in the UK, public and private



Source: HM Treasury estimates using data from company accounts, regulators, Office for National Statistics and government departments, including private and public investment.

Government investment

1.88 Budget 2013 announces that capital investment plans will be increased by £3 billion a year from 2015-16, to lock in recent increases in capital spending over the Spending Review 2010 period, funded through reductions in current spending. This will mean £18 billion additional capital spending over the next Parliament. Together with the additions to infrastructure spending announced at Spending Review 2010, Autumn Statement 2011, and Autumn Statement 2012, this means that public investment as a share of GDP will be higher on average over this Parliament and the next Parliament collectively than under the previous government.

1.89 The Government will set out how this capital spending will be allocated at the 2015-16 Spending Round. **The Spending Round will take a long term approach to capital planning, including setting planning assumptions out to 2020-21 for key areas of capital expenditure.** The Spending Round will set social rental policy until 2025. This will provide the long-term policy certainty necessary to attract private investment today.

Support for private investment in infrastructure

1.90 The Government is acting to give private investors the confidence to invest in the UK's energy sector. From April 2013 the carbon price floor announced at Budget 2011 will come

[41] *National Infrastructure Plan 2010*, HM Treasury and Infrastructure UK, October 2010.
[42] *National Infrastructure Plan 2011*, HM Treasury and Infrastructure UK, November 2011.
[43] *Infrastructure Delivery Update*, HM Treasury and Infrastructure UK, March 2013.

into effect, providing a clear and credible long-term signal to support investment in low carbon electricity generation.

1.91 The Energy Bill, currently making its passage through Parliament, will introduce Electricity Market Reform. By providing stable revenues for investors at a fixed level known as a strike price, Contracts for Difference, as set out in the Bill, will provide long-term certainty for investors in low carbon generation. This will lower the cost of capital and help developers secure the large upfront amounts of capital investment required. Support available for low carbon electricity investment through the Levy Control Framework up to 2020 will rise to £7.6 billion a year (in 2012 prices), more than triple the £2.35 billion available in 2012-13. Together with the Government's Energy Bill and *Gas Generation Strategy*, published in 2012, this will provide the framework needed for new energy investment.[44]

1.92 The Government intends to take forward two Carbon Capture and Storage projects to the detailed planning and design stage of the competition. This represents the next step in the £1 billion Carbon Capture and Storage commercialisation programme and follows a period of intensive commercial negotiations with a number of bidders. The Department for Energy and Climate Change will set out the details of the preferred bidders, next steps on these front end engineering and design studies, and the process to final investment decision.

1.93 A successful UK shale gas industry has the potential to provide new employment and support UK energy security, benefiting the economy, taxpayers and communities. The Government will:

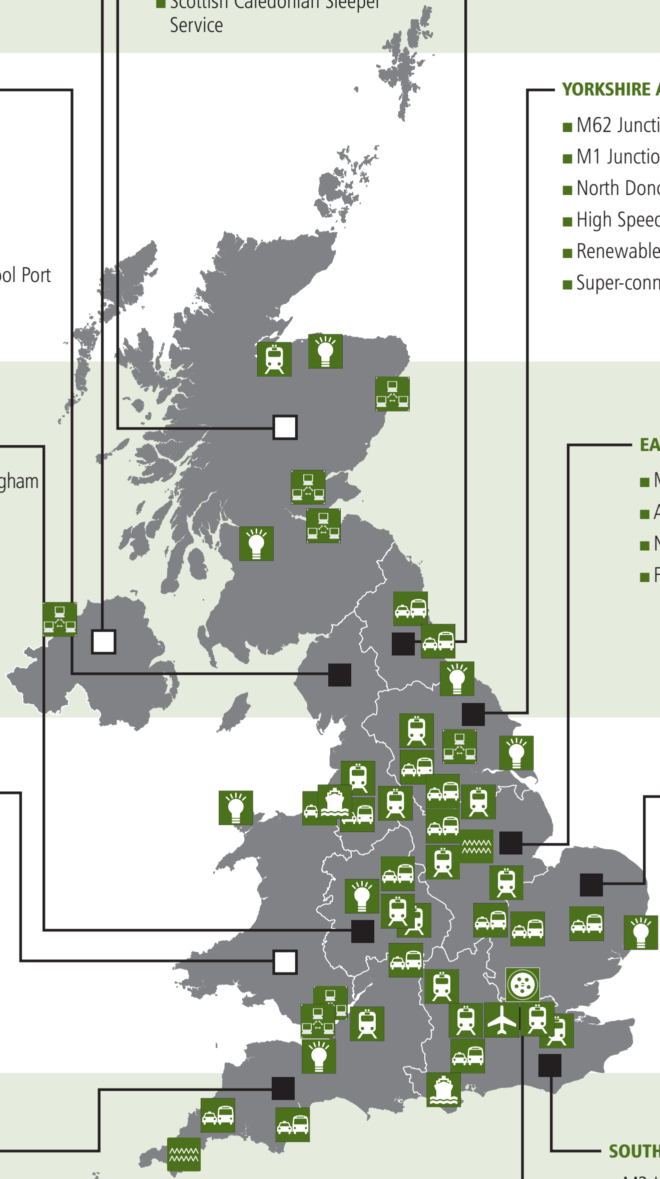
- **introduce a new shale gas field allowance and extend the ring-fence expenditure supplement from six to ten years for shale gas projects to promote investment in this industry at an early stage of its development.** The Government will consult on the detail of these reforms, including whether they should be extended to other forms of onshore unconventional gas;
- **produce technical planning guidance on shale gas by July 2013 to provide clarity around planning for shale gas during the important exploration phase for the industry.** As the shale gas industry develops the Government will ensure an effective planning system is in place and by the end of the year will produce guidance for the industry to ensure the planning system is properly aligned with the licensing regime and regulatory regimes principally: health and safety; and environmental protection. The Government will keep under review whether the largest shale gas projects should have the option to apply to the major infrastructure regime;
- **develop proposals by summer 2013 to ensure that local communities will benefit from shale gas projects in their area;** and
- **provide detail of the objectives, remit and responsibilities of the Office of Unconventional Gas and Oil.**

1.94 In addition, the Government is acting to support investment in offshore oil and gas. At Budget 2012, the Government committed to introducing a new contractual approach to provide further certainty on decommissioning relief on the UK Continental Shelf. Following successful consultation, **Budget 2013 announces that contracts will be signed later in 2013, providing the certainty needed to unlock billions of pounds of additional investment.**

[44] *Gas Generation Strategy*, Department of Energy and Climate Change, December 2012.

Figure 1.2: Range of projects and programmes from the Top 40 priority investments

- Energy
- Super-connected cities
- Roads
- Railways
- Ports
- Water
- Flood defence
- Airports



NORTHERN IRELAND

- Devolved responsibilities include: rail, roads, local transport, water, flood and waste
- Super-connected city: Derry/Londonderry

SCOTLAND

- Devolved responsibilities include: rail, roads, local transport, water, flood and waste
- Super-connected city: Aberdeen
- Super-connected city: Perth
- Super-connected city: Edinburgh
- Onshore wind: Whitlee
- Biomass: Rothe
- Scottish Caledonian Sleeper Service

NORTH EAST

- Sunderland Strategic Corridor
- Morpeth Nothern Bypass
- Offshore wind: Teesside

NORTH WEST

- M60 Junction 12-15 Salford, Greater Manchester
- Mersey Gateway Bridge
- High Speed 2 (Manchester)
- Rail: Northern Hub
- Container terminal project: Liverpool Port

YORKSHIRE AND THE HUMBER

- M62 Junction 25-30 Morley, West Yorkshire
- M1 Junction 39-42 Wakefield, West Yorkshire
- North Doncaster Chord
- High Speed 2 (Leeds)
- Renewable energy: Port of Hull
- Super-connected city: York

WEST MIDLANDS

- M6 Junction 5-8 Gravelly Hill, Birmingham
- Birmingham New Street upgrade
- Evesham Bridge
- High Speed 2 (Birmingham)
- Biomass: Ironbridge

EAST MIDLANDS

- M1 Junction 28-31 Chesterfield, Derbyshire
- A14 Kettering Bypass
- Nottingham Tram Extension
- Flood defence: Nottingham

WALES

- Devolved responsibilities include: roads, local transport, water, flood and waste
- Super-connected city: Newport
- Super-connected city: Cardiff
- Nuclear: Wlyfa Power Station

EAST OF ENGLAND

- A11 Fiveways to Thetford
- A14 corridor
- Peterborough station enhancements
- Nuclear: Sizewell

SOUTH WEST

- Kingskerswell Bypass
- Intercity Express: Stoke Gifford (Bristol)
- Nuclear: Hinkley Point
- Flood defence: Truro
- A30 (Temple)

LONDON

- Thames Tideway Tunnel
- Crossrail
- London Underground upgrade
- Heathrow Investment Programme

SOUTH EAST

- M3 Junction 2-4a Staines, Surrey
- Great Western Electrification
- Reading station upgrade
- Container terminal project: Southampton Port

1.95 The sale of 4G mobile spectrum will enable the delivery of competitive high speed mobile broadband from summer 2013 onwards, bringing benefits to businesses and consumers. However, the public sector still holds a large amount of valuable spectrum. In order to meet the commitment to release 500MHz of spectrum by 2020, **the Government will look to introduce further financial incentives to ensure more efficient use and management of public sector spectrum holdings.**

Infrastructure planning and delivery

1.96 Following Lord Deighton's assessment of Whitehall's ability to deliver infrastructure, which was announced at Autumn Statement 2012 and undertaken with Infrastructure UK (IUK) and the Major Projects Authority, **the Government will implement a series of reforms to effect a step change in its approach to infrastructure delivery.** Using the experience of delivering the Olympic and Paralympic Games and drawing on private sector best practice, these reforms include creating an enhanced central cadre of commercial infrastructure specialists in IUK who will be deployed into infrastructure projects across government, and the establishment by the summer of tough new Infrastructure Capacity Plans to drive forward progress in key government departments. These reforms will be undertaken in conjunction with Cabinet Office-led efforts to strengthen Whitehall's commercial capability and Lord Browne's work to improve the Government's management of major projects including through an enhanced Major Projects Authority.

1.97 The Government is committed to ensuring that investors have the confidence to make long-term decisions on major infrastructure projects, based on a policy framework that is informed by an objective and evidence-based assessment of the UK's infrastructure needs and priorities. **The Government will therefore consider options for making more use of independent expertise in shaping its infrastructure strategy.**

Housing and planning

1.98 The Government is committed to making the aspiration of home ownership a reality for as many households as possible. The Government wants the next generation to experience the benefits of owning their own home, in the same way their parents and grandparents were able to.

1.99 The Government has already committed to invest over £11 billion during the 2010 Spending Review period in housing. This Budget announces major reforms, including £5.4 billion of financial support, of which £1.3 billion is in 2013-14. This will tackle long-term problems in the housing market and support those who want to get on or move up the housing ladder, while also ensuring an increased number of new homes get built both now and in the future. This includes Barnett consequentials for the Scottish Government, Welsh Government and Northern Ireland Executive.

Support for home ownership

1.100 Since the financial crisis in 2007, increased requirements for larger deposits and falling equity values have meant many credit-worthy households cannot get a mortgage, or are trapped in their existing homes unable to take the next step. **The Government will support these households through Help to Buy, a package of measures that will increase the supply of low-deposit mortgages for credit-worthy households, increase the supply of new housing and contribute to economic growth.**

1.101 From 1 April 2013, building on the success of First Buy, Help to Buy: equity loan will be opened up to all those who aspire to own a new build home. The Government will:

- **provide an equity loan worth up to 20 per cent of the value of a new build home, repayable once the home is sold;**
- **significantly widen the eligibility criteria to ensure as many people as possible are able to benefit. The maximum home value will be £600,000 and there will be no income cap constraint;** and
- **ensure that the scheme is open not only to first-time buyers but also to all those looking to move up the housing ladder.**

1.102 Help to Buy: equity loan will be open for the next three years, providing £3.5 billion of investment in England, supporting up to 74,000 more home buyers as well as providing a boost to the construction sector.

1.103 The Government will create a major new Help to Buy: mortgage guarantee to increase the availability of mortgages on new or existing properties for those with small deposits. The Help to Buy: mortgage guarantee, a temporary scheme that will run for three years from January 2014, will:

- **increase the supply of high loan-to-value mortgages by offering a government guarantee to lenders who offer mortgages to people with a deposit of between 5 per cent and 20 per cent;**
- **be open not only to first-time buyers but also to existing homeowners;**
- **have no income cap constraint;** and
- **be available on homes with a value of up to £600,000.**

1.104 Help to Buy: mortgage guarantee will, subject to the final design, make available up to £12 billion of government guarantees, sufficient to support £130 billion of high loan-to-value mortgages.

1.105 The Government wants to give more social housing tenants the opportunity to benefit from home ownership. Since its introduction in the 1980s Right to Buy has helped almost 2 million households to experience the benefits of home ownership. In April 2012 the Government reinvigorated the scheme by increasing the maximum discount to £75,000. To broaden opportunity the Government will:

- **look at ways to simplify the application process to ensure applicants are not hampered by a burdensome administrative process;**
- **reduce the qualifying period before tenants become eligible for Right to Buy from five years to three years;** and
- **from 25 March raise the maximum discount cash cap in London to £100,000 where the current cap is most keenly felt.**

1.106 The additional receipts from increased sales will be used to pay down housing debt and support the Government's commitment to 1:1 replacement of all additional homes sold.

Support for new development

1.107 The Government wants to ensure that there is a long-term supply of housing that is better matched to demand.

1.108 The £200 million Build to Rent fund announced at Autumn Statement 2012 was significantly oversubscribed. **Budget 2013 announces that this fund will be expanded to £1 billion to support the development of more homes in England.** The fund will provide equity or loan finance to support the development finance stage of building new homes for private rent.

1.109 The Government is committed to implementing 'zero carbon homes' from 2016. The Department for Communities and Local Government (DCLG) will publish a detailed plan, setting out its response to the 2012 consultation on the energy efficiency requirements in building regulations, by May 2013. The Government will then consult on next steps, including on the means of delivering allowable solutions, by Summer Recess.

1.110 In London, the Mayor will work with the Homes and Communities Agency to support new build home purchases through Help to Buy: equity loan and new private rented homes through Build to Rent. This will involve a minimum of £750 million of funding up to 2015-16.

Support for affordable housing

1.111 Affordable housing plays an important part in the Government's overall drive to boost housing supply and stimulate economic growth. The Government has recently issued a prospectus to support affordable homes delivered through the guarantee programme. **The Government now wants to go further and will double the existing affordable homes guarantee programme, providing up to an additional £225 million to support a further 15,000 affordable homes starting in England by 2015.**

1.112 The Government also recognises the concerns of social landlords regarding uncertainty on social rents after 2014-15. Certainty is important to help landlords plan future housing development, providing affordable housing and boosting the construction sector. **At the 2015-16 Spending Round the Government will therefore set out a social rental policy that gives social landlords certainty until 2025.**

1.113 The Government also wants to make sure that affordable housing is available to those who need it most. The Government recently consulted on 'Pay to Stay' proposals to ensure that those social housing households on high incomes make a fairer contribution. **The Government will shortly take steps towards allowing social landlords to charge market rents to tenants with income of over £60,000.** The Government intends to require these tenants to declare their income to ensure they make a fair contribution, with all additional income reinvested in housing.

Reform of the planning system

1.114 Alongside measures to increase home ownership the Government is reforming the planning system to ensure that reforms will increase housing supply. Planning constraints have depressed the supply of new homes. Over the last 10 years, there have been an average of only 161,000 net additions to the housing stock a year while the number of households in England is projected to grow to 27.5 million in 2033, an increase of 232,000 households a year.

1.115 The *National Planning Policy Framework*, published in March 2012, is already having an effect.[45] The proportion of planning applications being approved is at a ten year high and the pace of local plan making has increased, with 70 per cent of councils now with at least a published plan. The Government will continue with the reform of the planning system to ensure the regime is simple to access, supports growth and is responsive to housing need. The Government will:

- **publish significantly reduced planning guidance by this summer, in line with Lord Matthew Taylor's recommendations, providing much needed simplicity and clarity. The Government will make greater use of information on prices to ensure that sufficient land is allocated to meet housing and employment need;**
- **ask local areas to put in place bespoke pro-growth planning policies and delivery arrangements, as part of new Local Growth Deals, pursued in response to Lord Heseltine's review, and through City Deals;** and

---

[45] *National Planning Policy Framework*, Department for Communities and Local Government, March 2012.

- **consult on allowing further flexibilities between use classes to support change of use from certain agricultural and retail uses to residential use to increase responsiveness within the planning system.**

1.116 In addition, DCLG is progressing a public sector land auctions model and will work with HM Treasury to conduct a feasibility study into wider use of the model.

1.117 The Government believes judicial reviews have created unacceptable delays to the development of crucial infrastructure and housing projects. The Ministry of Justice has already consulted on shortening the time limits for bringing a planning judicial review and will set out its plans in the spring. The Government will also develop further measures to streamline the process for planning judicial reviews by summer 2013.

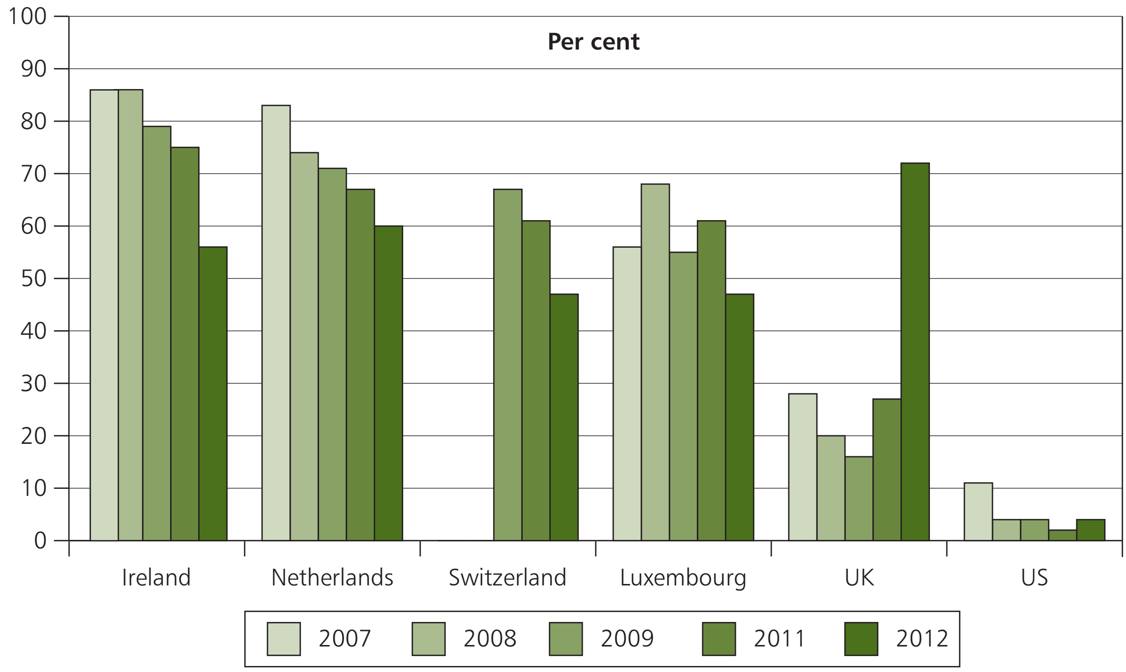
A competitive tax system

1.118 The Government's *Corporate Tax Roadmap*, published in 2010, set out major reforms to the tax system designed to support UK businesses and ensure the UK is an attractive location for foreign investment.[46]

1.119 At the heart of the reform package was a commitment to reduce the main rate of corporation tax. So far the Government has cut the main rate from 28 per cent to 24 per cent, and announced further reductions to come, to 23 per cent from April 2013 and 21 per cent from April 2014.

1.120 The Government's reforms to the corporate tax system have been welcomed by businesses. For example, Chart 1.16 shows the dramatic improvement in the UK's performance in KPMG's Annual Survey of Tax Competitiveness.

Chart 1.16: Results of KPMG Annual Survey of Tax Competitiveness[1]



[1] *Chart shows percentage of respondents mentioning country in response to: overall, which of the following countries do you think a) has the most competitive tax regime? b) and which is second? c) and third (any mention).*

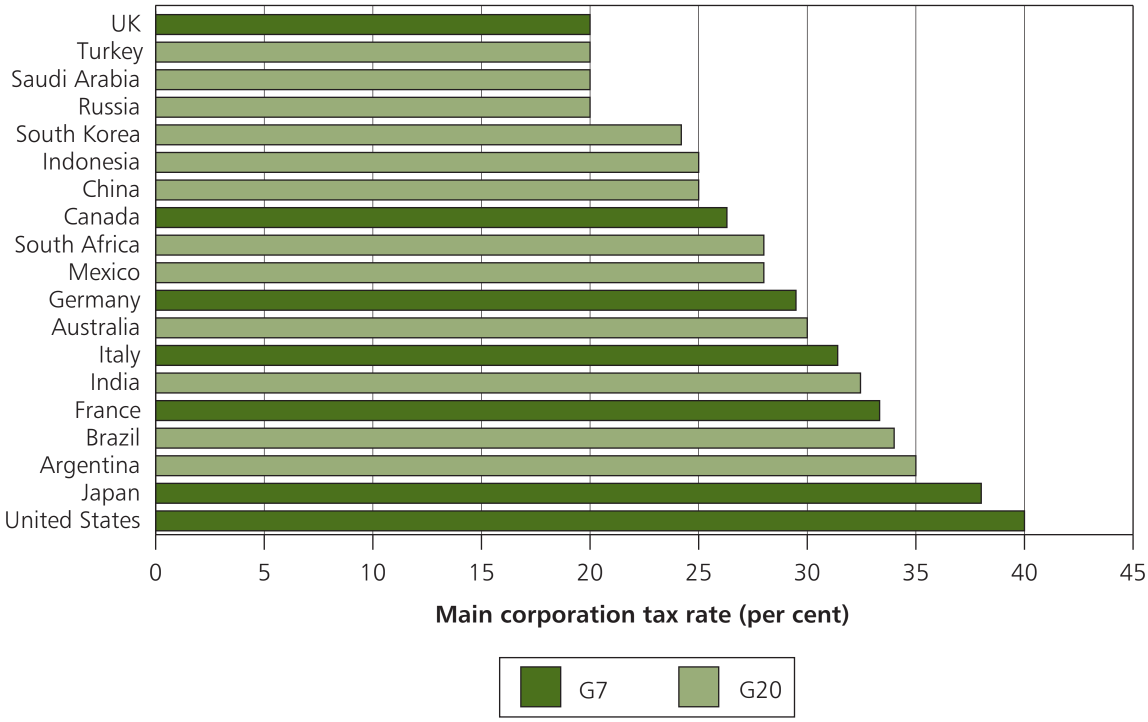
Source: KPMG.

[46] *Corporate Tax Reform: delivering a more competitive system*, HM Treasury and HM Revenue and Customs, November 2010.

1.121 At Budget 2013 the Government announces it will go further, and will reduce the main rate of corporation tax by an additional 1 percentage point in April 2015, so it will reach 20 per cent. In the process, the Government will unify the small profits rate and the main rate so there is a single rate of corporation tax, simplifying the tax system.

1.122 This means that by the end of this Parliament the UK will have the joint lowest rate of corporation tax in the G20, as shown in Chart 1.17 – and a rate that is significantly lower than key competitors, including the US, Japan, France and Germany. This will support British businesses and encourage investment. It will also show that Britain is open for business.

Chart 1.17: Main corporation tax rates in the G20 (2015 based on announced plans)



Sources: International Bureau of Fiscal Documentation, Deloitte, KPMG and PwC.

1.123 To take account of the benefit to the banking sector of the additional reductions in corporation tax, **the rate of the Bank Levy will increase to 0.142 per cent from 1 January 2014.** The levy ensures that banks make a fair contribution and reflects the risks they pose to the financial system and the wider economy.

1.124 The Government is also delivering on the other aspects of the Roadmap. In January 2013, the UK implemented a modernised Controlled Foreign Companies regime that strikes the right balance between making the corporate tax system more competitive and providing adequate protection of the UK tax base. From April 2013, the Patent Box will give a reduced 10 per cent rate of corporation tax on profits from patents, driving growth and investment in UK innovation.

1.125 Research and development (R&D) incentives recognise the importance of business investment in new ideas and technologies and form a key part of the Government's commitment to an internationally competitive tax system. As announced at Autumn Statement 2011, the Government will introduce a new 'above the line' (ATL) credit for large company R&D investment from April 2013. The ATL credit is designed to make R&D relief more visible to those making investment decisions and provide greater cash flow support to companies with no corporation tax liability.

1.126 The headline rate of the ATL credit will be 10 per cent, increased from the 9.1 per cent rate proposed at Budget 2012. This will make the UK a more attractive location for large company R&D activity by further reducing the after tax cost of investment. The introduction of the ATL credit follows an increase in the rate of the small and medium-sized enterprises (SME) R&D tax credit from 175 per cent to 225 per cent at Budget 2011, which continues to provide targeted support for early stage companies and start-ups investing in R&D in the UK.

1.127 Alongside reforms to increase the competitiveness of the tax system, the Government is acting both nationally and internationally to ensure that all businesses pay their fair share of tax. Additional reforms are set out in the next section.

Support for enterprise

1.128 The Government's ambition is for the UK to be the best place in Europe to start, finance and grow a business. Small businesses report that costs of employment are one of the biggest barriers to success they face. **Budget 2013 announces that from April 2014 every business and charity will be entitled to a £2,000 Employment Allowance towards their employer NICs bill.**[47]

A new Employment Allowance for every business and charity

From April 2014, all businesses and charities will be eligible for a new £2,000 Employment Allowance. This will reduce their employer NICs bill. Up to 1.25 million employers will benefit, with over 90 per cent of the benefit going to small businesses. The scale of the allowance means that 450,000 of the UK's small businesses will no longer pay any employer NICs. On average, employers with fewer than 10 employees over the course of the year will see their employer NICs bill reduced by 80 per cent.

The Employment Allowance will reduce the cost of taking on new staff for small businesses; supporting those with an ambition to grow by hiring their first employee or expanding their workforce. Every business will be able to employ one worker on a salary of £22,400, or four employees working full time on the adult National Minimum Wage, without paying any employer NICs at all.

The Employment Allowance will be introduced from April 2014, delivered through standard payroll software and HMRC's Real Time Information system. To ensure maximum take-up, it will be simple to administer: employers will only need to confirm their eligibility through their regular payroll processes. This confirmation will ensure that up to £2,000 will be deducted from their employer NICs liability over the course of the year's PAYE payments.

The Government will engage with business representative bodies on the details of the design and operation of the new allowance, in order to ensure the system is as simple and effective as possible.

1.129 This builds on action taken at Autumn Statement 2012 to help businesses succeed, including:

- the increase of the Annual Investment Allowance limit from £25,000 to £250,000 for two years from January 2013 to help businesses invest; and
- the doubling of the Small Business Rate Relief scheme for a further 12 months from April 2013, benefiting over half a million small businesses.

[47] Estimated impacts from HMRC analysis based on PAYE administrative data grown in line with OBR determinants.

1.130 As in previous years, the Small Business Rate Relief scheme will be considered at Autumn Statement 2013. Budget 2013 also announces wider action that will help businesses, including on fuel duty, as set out in the next section.

1.131 In addition, the Seed Enterprise Investment Scheme, launched at Budget 2012, offers 50 per cent income tax relief on investments made into small, early-stage companies. **The Government has decided to provide a limited extension of the capital gains tax holiday to continue to encourage investors to take up the new scheme. Any investors making capital gains in 2013-14 will receive a 50 per cent capital gains tax relief when they reinvest those gains into seed companies in either 2013-14 or 2014-15.** The recent expansions to Venture Capital Trusts (VCTs) and the Enterprise Investment Scheme, alongside the new Seed Enterprise Investment Scheme, mean that the UK now offers generous enterprise tax reliefs to support small and growing businesses. The Government is committed to ensuring that these schemes are effective and has sought to maintain stability by not making major changes. However, following a number of representations from investors, the Government is concerned that VCTs offering enhanced buy-backs are not operating within the spirit of the legislation. The Government will continue to monitor particular aspects of the venture capital schemes to ensure that they remain well-focused and supportive of businesses needs.

1.132 Long-term economic success depends on today's small and high growth companies being able to access affordable long term financing to grow into the large businesses of tomorrow. On 13 March 2013 the Government launched a consultation on extending Individual Savings Account (ISA) eligibility to include a wider range of small company shares. To further support these companies, **the Government will abolish Stamp Tax on Shares for companies listed on growth markets including the Alternative Investment Market (AIM) and the ISDX Growth Market, from April 2014.** This will directly benefit hundreds of smaller quoted UK firms, lowering their cost of capital, helping to promote jobs and growth across the UK.

1.133 The Government is legislating to introduce a new employee shareholder status that will give staff a stake in their firms' future success and give firms greater choice about the contracts they can offer to individuals. Employee shareholders will have different employee rights and shares worth a minimum of £2,000 in the firm they work for. As already announced, the Government will exempt gains on up to £50,000 of shares acquired by employee shareholders from capital gains tax. **The Government has also decided that the first £2,000 of share value that anyone receives under the new status will be free from income tax and NICs.** This will be of particular benefit to anyone receiving the minimum amount of shares, as it will ensure that no tax is due when they receive their shares. This will take effect from 1 September 2013, when the new status comes into force.

1.134 The Government supports employee ownership as a business model and welcomes work by the Implementation Group on Employee Ownership to take forward the recommendations of the Nuttall Review. In order to further incentivise growth of the sector, the Government is providing £50 million annually from 2014-15. This will be used to respond to recommendations from the Nuttall Review and other relevant organisations who aim to encourage employee ownership. It will also be used to **fund the introduction of a capital gains tax relief on the sale of a controlling interest in a business into an employee ownership structure.** Consultation on this measure will take into account the progress of work by the Department for Business, Innovation and Skills (BIS) and the Implementation Group to develop an 'off the shelf' employee owned company model, with the intention that the new capital gains tax relief will be introduced in Finance Bill 2014. The Government will also look at further incentives in this area, including measures targeted at employees through indirect ownership models.

1.135 Social enterprises play an important role in growing the economy, reforming public services and promoting social justice. **The Government will introduce a new tax relief to**

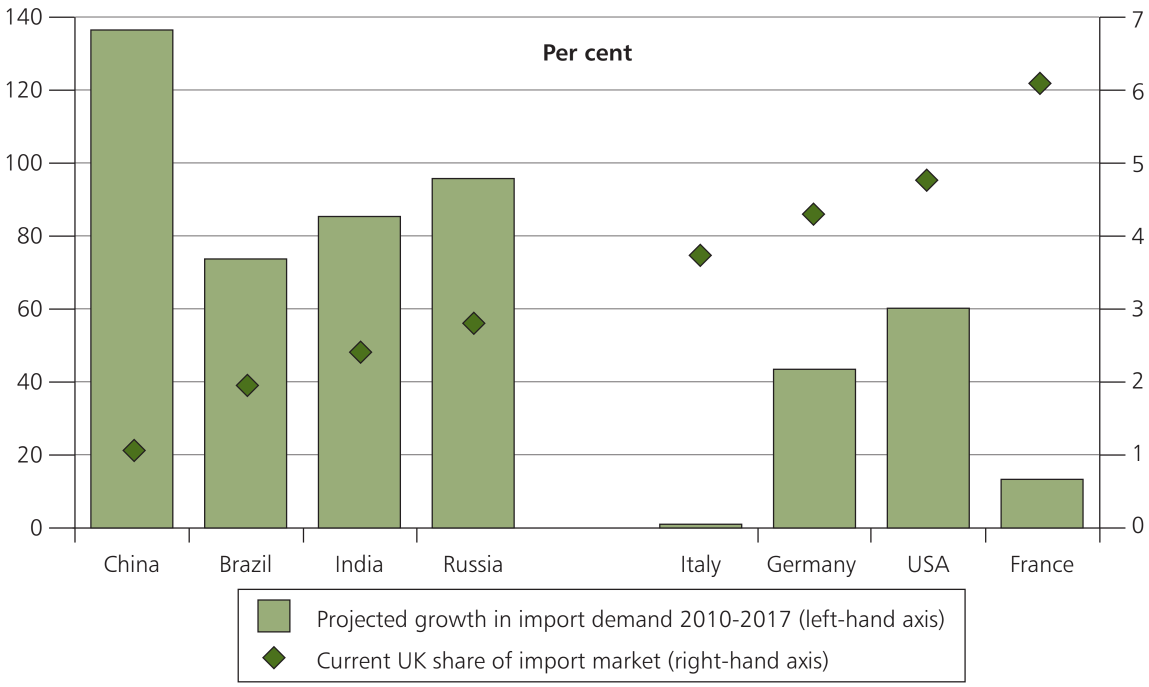
encourage private investment in social enterprise. The tax relief will complement the Government's other recent measures to help social enterprises access the capital they need, such as the launch in 2012 of Big Society Capital. The Government will consult formally on the details of the relief by summer 2013 and the relief will be introduced in Finance Bill 2014.

1.136 Each year over 130 million working days are lost to sickness absence.[48] The Government believes that more can be done to support employees to return to work, and commissioned Dame Carol Black and David Frost to conduct an independent review of sickness absence. Following their recommendations, as announced in January 2013, the Government will abolish the Percentage Threshold Scheme and recycle funding into creating the health and work assessment and advisory service for those in danger of long-term sickness absence. **The Government will also introduce a targeted tax relief so that amounts up to a cap of £500 paid by employers on health-related interventions recommended by the service are not treated as a taxable benefit in kind. The Government will consult on implementation later in 2013.**

Partnership between government and industry

1.137 As well as providing the conditions for private sector growth, both central and local government can engage more directly in supporting UK businesses to succeed in global markets, through strategic partnerships between the public and private sectors. Chart 1.18 shows that the UK currently only captures a small share of high growth import markets. These partnerships will enhance the UK's ability to compete in the global race by identifying and addressing barriers to growth including those specific to particular industries and local areas.

Chart 1.18: International comparisons of projected growth of import demand 2010–2017 and current UK share of import market



Sources: HM Treasury calculations using International Monetary Fund, Office for National Statistics and United Nations Conference on Trade and Development data.

[48] *Sickness Absence in the Labour Market, April 2012*, ONS, 2012.

Support for industry at national level

1.138 The Government's Industrial Strategy, announced in September 2012, aims to maintain and enhance the UK's global position in 11 key sectors: automotive, aerospace, life sciences, agri-tech, professional business services, information economy, construction, education, nuclear, oil and gas, and offshore wind. The Government is working with industry to create sector strategies that identify long-term opportunities and address barriers to growth. Each strategy will set out actions for both industry and the Government, such as bridging skills gaps or strengthening supply chains. The Government will also create or strengthen sector councils as a long-term platform for engagement with business, ensuring that policy making is informed by business needs. The life sciences and aerospace sector strategies have been published. The remaining sector strategies will be published during 2013.

1.139 The Government will provide £1.6 billion of funding to support these strategies. This funding will be allocated over the course of 2013.

1.140 From this fund the Government, in partnership with industry, will create an Aerospace Technology Institute (ATI). This will provide £2.1 billion of R&D support to the aerospace sector over seven years, with Government and industry contributing equal shares. The ATI will also set a strategic direction for R&D in the sector and secure additional funding from external sources. Providing certainty on government support will give the sector the stability it needs to develop the next generation of aircraft technologies in the UK. The UK currently has the second largest aerospace sector in the world (after the US), and the Government is determined to maintain the UK's position as a global leader in this growing market.

1.141 In addition, the Government is providing further support for the creative industries. The UK represents a global centre of excellence in digital media production, including visual effects. To further support this high-tech and export-oriented sector, build capacity and support growth:

- **the Technology Strategy Board will design and launch a new competition of up to £15 million inviting consortia bids to support digital content production through partnerships with industry, including specialist SMEs, educational research facilities and training providers;**
- **funding for the Skills Investment Fund will be increased to £8 million each year over the next two years, with Government match-funding voluntary industry contributions to support skills development in the UK digital content sectors;** and
- **the Government will launch a public consultation on options to provide further support for the visual effects industry through the tax system.**

1.142 The UK financial services industry plays a central role in the UK economy, contributing £129 billion to the economy, £63 billion in tax, a trade surplus of £47 billion, and over 1 million jobs, two-thirds of which are outside London.[49] To strengthen the competitiveness of the industry, it is critical that UK firms can secure access to markets around the world and that government creates the right environment and provides the right support to allow firms to win market share – especially in emerging market economies where new investors, savers and markets are appearing.

1.143 To support these efforts, the Government has created a new Financial Services Trade and Investment Board (FSTIB), chaired by a senior Treasury official and comprising senior representatives from UK Trade and Investment (UKTI), HM Treasury, and TheCityUK, and representing financial institutions. This will have the authority and expertise to identify trade and investment priorities, and to support UK firms in pursuing these vigorously across the globe.

[49] *Economic Contribution of UK Financial and Professional Services,* TheCityUK, 2013.

1.144 The Government is also creating a new unit within UKTI, led by an industry expert, to drive this work forward. By co-ordinating action across key departments, industry and UKTI, the FSTIB will work with partner jurisdictions to help open up opportunities for trade; advance the interests of UK financial institutions – large and small; bring new investment from global financial institutions to the UK's cities and regions; and find ways to support jobs and growth not only in the UK, but across the entire global economy that London serves.

1.145 The UK is the leading centre in Europe for asset management, but many of the funds managed here are based overseas. **This Budget announces a targeted package of measures to improve the competitiveness of the UK as a location for fund domicile covering regulation, marketing and tax.** This will bring tax revenues, stimulate growth, and create jobs across the country. **At the heart of the package is the abolition of the Schedule 19 (Finance Act 1999) charge on funds, which will be included in Finance Bill 2014.** Schedule 19 has been consistently cited by the industry as one of the chief obstacles to establishing new funds in the UK.

1.146 Businesses, especially early stage companies, often struggle to fund the feasibility and prototyping stages of the development of new technologies and government departments can find it difficult to engage with these companies. The Small Business Research Initiative (SBRI) aims to address this barrier to innovation and help departments meet their objectives by bringing fresh ideas to bear. Under the SBRI, businesses compete for government contracts to develop new ideas with the potential to tackle public sector challenges. **The Government will substantially expand SBRI among key departments so that the value of contracts through this route increases from £40 million in 2012-13 to over £100 million in 2013-14 and over £200 million in 2014-15.** An evaluation will be carried out alongside this expansion to ensure departments are making best use of the scheme and review whether a further expansion is possible. The evaluation will produce an interim report in autumn 2014 and a final report in February 2015.

Exports

1.147 Winning business abroad and attracting global talent and investment to the UK are central to the UK's future prosperity. At Autumn Statement 2012 the Government announced £70 million in additional funding for UKTI, along with additional flexibilities, to enable it to deliver improved services and refocus its activities on the highest value opportunities and emerging markets. UKTI has moved quickly to mobilise this extra support, and has already:

- doubled the number of companies included in its Strategic Relationship Management model to 76, as set out in Autumn Statement 2012. These key companies have been drawn from sectors with high growth potential identified in the Government's Industrial Strategy, such as education, digital and advanced manufacturing;
- increased the number of projects being pursued by its High Value Opportunity (HVO) programme to 100. UKTI have identified HVOs with a total of £80 billion (up from £51 billion), of contracts potentially available to UK firms over the next two years which UKTI will help firms to win; and
- scaled up its successful work with leading Industry Associations to increase the number of SMEs that attend overseas trade exhibitions. More than 8,000 companies are expected to benefit from this programme in 2013-14.

Lord Heseltine's review

1.148 The Government welcomes Lord Heseltine's review on economic growth, *No Stone Unturned*, which reported on 31 October 2012. His review makes a powerful case for increasing the devolution of economic powers from central government to LEPs, and for a stronger voice and role for the private sector in promoting growth. Autumn Statement 2012 set out the

Government's initial response to the review. The Government has published a full response, *Government's response to the Heseltine review*,[50] addressing his wide-ranging recommendations on all aspects of government policy that affect economic growth. **The Government can confirm that the overwhelming majority of his recommendations have been accepted.**

1.149 Building on announcements made at Autumn Statement 2012, **the Government confirms its endorsement of Lord Heseltine's recommendation on the creation of a Single Local Growth Fund, devolved to the local level through new Local Growth Deals.** This represents a step-change in decentralisation, so that the responsibility for decisions on how funding should be spent is taken by those with knowledge of, and a stake in, the local area. Funding will be allocated to LEPs on the basis of strategic multi-year plans for local growth. In developing these plans, LEPs and their partners will be challenged by government to leverage private and local funding and commit to governance reform – those that offer the most will be more likely to benefit in terms of funding and flexibilities. The competitive tension in this something-for-something approach will incentivise LEPs to offer more, and drive improvements in local areas. The Single Local Growth Fund will be operational by April 2015 and further detail will be set out at the 2015-16 Spending Round.

Business environment

1.150 The quality of the business environment is essential to the UK's success in the global race. The Government is acting to ensure that UK businesses are competitive in both domestic markets and important overseas markets, and that the UK is attractive to inward investors. The UK's overall competitiveness is improving, but further reform is needed in key areas.

Access to Finance

1.151 Following the financial crisis, access to finance remains challenging, particularly for SMEs. Progress has already been made through the FLS and the Business Finance Partnership.

1.152 The introduction of the Business Bank will make a significant difference to both the level and diversity of finance provision while also improving competition in the market and supporting SME growth. It will simplify and improve the finance and support landscape for businesses. **The Government is publishing the first strategy for the Business Bank which sets out an accelerated timetable for how the Business Bank will deploy £1 billion of new capital, improve existing schemes and develop a lasting new institution to support SME growth by the end of 2014.**

1.153 In addition, Budget 2013 announces that the Business Bank will:

- **launch a £300 million investment scheme this spring to invest alongside private investors in financial institutions and non-bank lending channels to help diversify and expand the supply of lending to SMEs and mid-sized businesses;**
- **provide £75 million of new funding for venture capital through an extension to the Enterprise Capital Fund programme and an expanded Business Angel Co-investment Fund to support start ups and early stage companies;** and
- **support more lenders to increase SME lending through the Enterprise Finance Guarantee by maintaining the generous guarantee cap introduced at Budget 2012. Through the trade credit pilot, Kingfisher aims to support an additional £30 million of credit to SMEs.**

[50] *Government's response to the Heseltine review,* Department for Business, Innovation and Skills and HM Treasury, March 2013.

1.154 To provide further support for SMEs, **the Government will provide £30 million for a Growth Vouchers programme in England**. This programme will test a variety of innovative approaches to helping SMEs overcome barriers to achieving growth, such as limited use of external advice. It will target a number of specific areas of advice such as making a successful loan application to a bank or taking on an employee.

1.155 Across the entire regulatory system, the Government is taking action to shift the balance of regulation in favour of private sector investment and growth. This is particularly important for the regulation of defined benefit (DB) pensions as recent economic conditions have put companies sponsoring DB schemes under significant financial pressure. The Government will provide the Pensions Regulator (TPR) with a new objective to support scheme funding arrangements that are compatible with sustainable growth for the sponsoring employer and fully consistent with the 2004 funding legislation. The precise wording of this new objective will be set out in legislation that the Department for Work and Pensions (DWP) will publish later in spring 2013. Implementation of the new objective will be subject to review after 6 months and TPR will revise is Code of Practice to reflect their forthcoming new objective as soon as possible in 2013. The Government is also consulting on a new growth duty for non-economic regulators and is attracted, subject to the results of that consultation, to applying such a new duty to TPR.

1.156 DWP's call for evidence on asset and liability smoothing did not reveal a strong case for changing legislation to permit smoothing. The Government will therefore not be pursuing this measure.

Competition in the banking sector

1.157 The Government is committed to fostering a strong, diverse and competitive banking sector to ensure that the banks are driven to offer better products and services, based on the needs of consumers. The Government demonstrated this commitment by asking the Independent Commission on Banking (ICB) to consider competition as part of its remit. Having accepted the competition recommendations of the ICB in full, the Government is currently delivering an extensive programme of reform. A major part of the reform is being legislated in the Financial Services (Banking Reform) Bill, which will substantially reduce the perceived implicit government guarantee that benefits the large incumbents in the banking sector. The Government is also driving the banking industry to deliver a new seven-day switching service from September 2013 to make it easier for people to switch their current account provider. In addition to the existing reform programme, Budget 2013 announces:

- **that the Government will shortly issue a consultation document on bringing payment systems into a competition-focused regulatory regime.** The regulator will have strong powers to ensure that challenger banks have the opportunity to compete on a level playing field with their larger competitors by requiring that challengers can access the payments infrastructure fairly and transparently. Subject to the outcome of the consultation, the Government intends to legislate for the new regime in the Financial Services (Banking Reform) Bill; and
- **that the Financial Services Authority will shortly publish a government commissioned review on barriers to entry and expansion in banking.** As a result of the review, the FCA and PRA will make major changes to the way they deal with new and existing small banks. The authorisation process for becoming a bank will be quicker and easier and there will be a comprehensive series of changes to the capital and liquidity rules to level the playing field for new banks. The changes will make a significant difference to the ease with which challengers can enter the UK banking system.

Competition and Regulation

1.158 The Government is driving down the burden of red tape on business. The One-In One-Out policy on new regulation, which has already reduced costs to business by almost £840 million a year, increased to a One-In Two-Out policy in January 2013. The Red Tape Challenge has already implemented reforms that will save businesses over £155 million a year. By the end of 2013 the first phase of the Red Tape Challenge will have identified three thousand regulations to be abolished or simplified.

1.159 To further improve the efficiency and effectiveness of regulation, the Government will:

- **launch a second phase of the Red Tape Challenge. Alongside implementing the Red Tape Challenge and Focus on Enforcement reforms, this second phase will look at the whole regulatory system – including laws, guidance, compliance, and enforcement, through short targeted reviews.** The reviews will look at areas such as infrastructure, key stages in the growth of companies, and business activities where negotiating the system is overly complex. The Government will seek views from business on what specific problems should reviewed before the launch in summer 2013;
- **drive efficiency and reduce fees charged to businesses through additional budgeting controls placed on regulators in the 2015-16 Spending Round.** This will reduce the costs imposed by regulators of doing business in the UK, without reducing the effectiveness of regulatory enforcement; and
- **make economic regulator appeals quicker, simpler and more efficient.** A consultation on a new framework will begin by summer 2013.

1.160 The Government has asked the economic regulators to develop a coordinated and streamlined approach to charging and conditions on new infrastructure where it crosses existing infrastructure. The economic regulators have agreed to investigate this. A coordinated approach has the potential to simplify the UK's infrastructure landscape for investors, making the UK more welcoming to new investment and building on our world class infrastructure regulatory environment.

1.161 The Government is committed to supporting competition to deliver better value for money to consumers. **The Government has made a renewed commitment to accept Office of Fair Trading (OFT) and Competition Commission recommendations and will also extend this commitment to the Competition and Markets Authority.** As part of this, following recent OFT recommendations, **the Government will work with motorway service areas and other relevant bodies to improve the availability of fuel price information to motorway users**.

Apprenticeships

1.162 This Government recognises the vital role apprenticeships play in promoting growth, improving skills and providing individuals with real opportunities. The Government has demonstrated its commitment to the apprenticeship programme with nearly a million apprenticeship starts since 2010.

1.163 Doug Richard's review on behalf of BIS, published in November 2012, was a thorough review of the quality of apprenticeships and the best way for employers to interact with the skills system. **The Government has launched a consultation on implementation of the Richard Review, to put employers at the centre of the apprenticeship system and raise standards.**

Fairness

1.164 The Government's economic and fiscal strategy is underpinned by its commitment to fairness and its desire to support those who want to work hard and get on. Budget 2013 builds on announcements made at Autumn Statement 2012 with further action to make the tax and welfare system fairer, support aspiration and keep costs down for households and businesses:

- the income tax personal allowance will increase by £1,335 to £9,440 in April 2013 – the largest ever cash increase. **Budget 2013 announces that from April 2014 the personal allowance will rise to £10,000, meeting the Government's objective one year early;**
- the planned January 2013 fuel duty increase was cancelled, and the April 2013 increase was deferred to September. **Budget 2013 announces further support for motorists through the cancellation of the fuel duty increase that was planned for 1 September 2013;**
- from April 2013, local authorities that decide to freeze or reduce council tax in 2013 will be provided with a grant;
- **Budget 2013 announces a new Tax-Free Childcare Scheme which will support around 2.5 million working families with 20 per cent of their childcare costs;** and
- **Budget 2013 announces further measures to ensure that all individuals and businesses pay their fair share of tax, raising £4.6 billion over five years.**

Supporting households and rewarding work

1.165 The Government is committed to promoting aspiration, rewarding work and supporting households' standard of living. Budget 2013 announces policies that cut income tax for those on low and middle incomes, and reduce pressures on the cost of living. In total, Budget 2013 provides an additional £7 billion of support for households over the forecast period.

Supporting low and middle incomes

Personal allowance

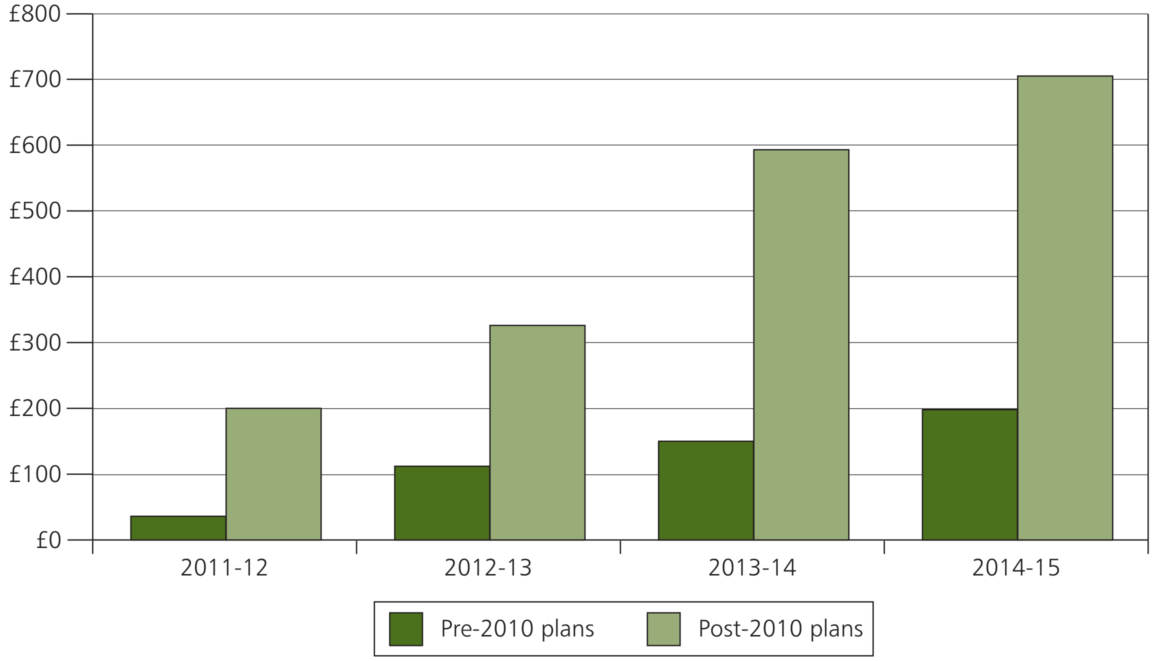
1.166 In May 2010, the Coalition Agreement set out the Government's commitment to make the first £10,000 of income free from income tax. The ambition was to reach this level by the end of the Parliament. **Budget 2013 announces that this commitment will be met a year ahead of schedule: the personal allowance will be increased by £560 to £10,000 in 2014-15.** Meeting the commitment earlier will benefit an estimated 24.5 million individuals in 2014-15. The Government believes this is the most effective way to support those on low and middle incomes, because it enables people to keep more of the money they earn. Reducing the amount of income tax that people pay also rewards those who want to work hard and progress.

1.167 In each year of this Parliament, the Government has taken significant steps towards meeting this objective. In 2010, the personal allowance was just £6,475, but successive above-inflation increases totalling £3,525 will mean that it has risen by more than 50 per cent in just four years.

1.168 As a result of this Government's actions, by April 2014 2.7 million low income individuals under 65 will have been lifted out of income tax altogether. This includes anyone whose income would have been in the 10 per cent starting rate band in 2007-08.[51]

1.169 The Government's increases to the personal allowance have also helped middle income households affected by rising prices and low average earnings growth. From April 2014, the typical basic rate taxpayer will pay £705 less income tax per year in cash terms, leaving them £493 better off than under the previous government's plans as Chart 1.19 shows.

Chart 1.19: Cumulative cash benefit for a typical basic rate taxpayer from personal allowance changes since 2010-11



Source: HM Revenue and Customs analysis.

1.170 As set out in Budget 2011, once the personal allowance has reached £10,000 in 2014-15 it will increase by CPI in future years, starting from 2015-16.

1.171 Table 1.6 shows the reduction in the amount of income tax paid by most individuals at each income level as a result of the Government's personal allowance increases since 2010, up until the point at which the personal allowance is removed for high earners. The National Minimum Wage for full-time employees is £12,070, so these individuals will have benefitted from a substantial cut in the amount of income tax they pay once the personal allowance reaches £10,000 in 2014-15.[52]

[51] Based on an individual with an income in 2007-08 of up to £7,455, equal to the personal allowance plus the starting rate threshold, and adjusted in line with earnings growth to £8,520 in 2014-15.
[52] Income on National Minimum Wage based on 37.5 hours per week.

Table 1.6: Illustration of income tax and National Insurance contributions paid per year, by income level in nominal terms[1]

Gross income (£)	2010-11 (£)	2011-12 (£)	2012-13 (£)	2013-14 (£)	2014-15 (£)	Change over period
7,500	400	40	0	0	0	-100.0%
10,000	1,180	840	670	380	250	-78.8%
15,000	2,730	2,440	2,270	1,980	1,850	-32.2%
20,000	4,280	4,040	3,870	3,580	3,450	-19.4%
30,000	7,380	7,240	7,070	6,780	6,650	-9.9%
40,000	10,480	10,440	10,270	9,980	9,850	-6.0%
50,000	14,190	14,390	14,220	14,040	13,860	-2.3%
75,000	24,440	24,890	24,720	24,540	24,360	-0.3%
100,000	34,690	35,390	35,220	35,040	34,860	0.5%
150,000	57,780	59,380	59,460	59,810	59,860	3.6%

[1] Calculations are based on announced parameters of the tax system up to 2014-15. The table is also based on an individual born after 5 April 1948 paying employee NICs (not contracted out). Gross income refers to earnings only (i.e. all gross income is subject to income tax and Class 1 NICs). Income tax calculations assume no other allowances or deductions. NICs are calculated on a weekly basis and then annualised. All figures are rounded to the nearest £10.

Source: HM Revenue and Customs calculations.

Supporting households

Fuel duty

1.172 The Government has taken extensive action to support households and businesses with the high cost of fuel by abolishing the fuel duty escalator, cutting fuel duty and introducing the fair fuel stabiliser (FFS). The FFS ensures that when oil prices are high, fuel duty will increase by no more than inflation. Under the FFS, fuel duty would only increase by inflation in 2013.

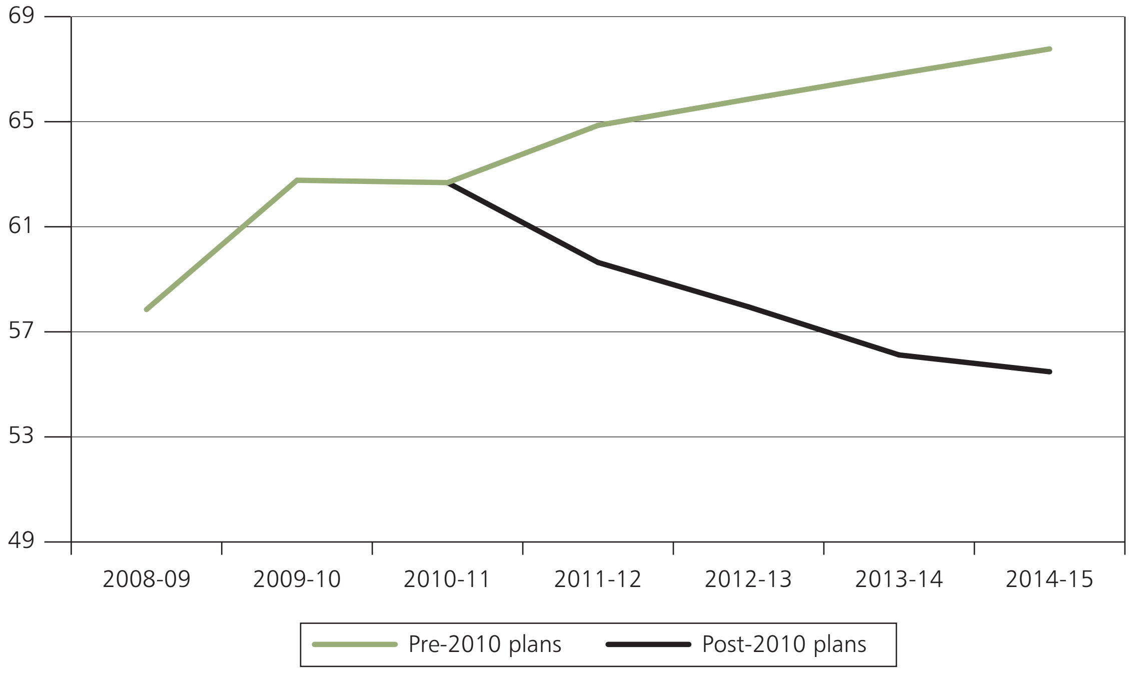
1.173 Nevertheless, in recognition of the impact that persistently high pump prices have on the cost of living, **Budget 2013 announces that the 1.89 pence per litre fuel duty increase that was planned for 1 September 2013 will be cancelled.** This means that fuel duty will have been frozen for nearly three and half years, the longest duty freeze for over 20 years.

1.174 In total, the Government's actions on fuel duty will have eased the burden on motorists by £21.5 billion over the Parliament to 2015-16. From April 2013, pump prices will be 13 pence per litre (ppl) lower than under the previous government's plans, and are forecast to be 18 ppl lower by the end of the Parliament. This means that it will cost the typical motorist £7 less to fill up their tank every time they visit the pump from April, and £10 less by the end of the Parliament. In addition, a small business could have saved £340 in total over the last two years and will continue to save at least £340 a year.[53]

1.175 As a direct result of this Government's actions, fuel duty is forecast to fall over this Parliament by 11 per cent in real terms. Had the Government implemented the fuel duty escalator, rates would have increased by 7 per cent as Chart 1.20 shows.

[53] Pump price and total saving for a private motorist driving a typical family car and business motorist driving a typical van by May 2015 assumes that fuel duty increases by RPI in September 2014. The final fuel duty rate will be confirmed in Budget 2014 according to the FFS.

Chart 1.20: Real terms fuel duty rates (pence per litre)



Notes: Pre-2010 plans based on the previous government's legislated increases and planned increases up to 2014-15. Post-2010 plans based on this Government's policy. Plans expressed in 2012-13 prices.

Source: HM Revenue and Customs analysis.

Alcohol duty

1.176 The Government is committed to supporting communities as well as individual households. The Government has already taken action to support community pubs through the reduction in both the small profits rate and the corporation tax rate, and regulatory changes to make it easier for pubs to play live music.

1.177 To provide further support to community pubs, **Budget 2013 announces that general beer duty will be reduced by 2 per cent from 25 March 2013. The Government will then cancel the escalator for beer duty next year and instead increase it by inflation thereafter.** Tax on average strength beer will be 1 penny lower after Budget 2013, saving beer drinkers 4 pence a pint in 2013-14 compared to the previous government's plans. Duty on high and low strength beer will also be adjusted to reduce the tax on a typical product by 1 penny a pint from 25 March 2013. The Government will shortly respond to its alcohol consultation, including with proposals to deal with deeply-discounted alcohol in supermarkets and other stores.

Supporting parents

Childcare

1.178 High quality, affordable childcare is essential to improving children's life chances and supporting parents who want to get back into work. The Government has already prioritised investing in early education, in particular for the most disadvantaged families, through:

- increasing the free entitlement to 15 hours a week of free early education for all three and four year olds; and
- extending 15 hours of free early education a week to 40 per cent of two year olds by 2014-15.

1.179 However, for some parents the high cost of childcare is still a significant disincentive to work. **The Government therefore announces a new Tax-Free Childcare Scheme for working families. The Government will provide 20 per cent of working families' childcare costs, up to £1,200 for each child.** This is equivalent to basic rate tax relief on childcare costs up to £6,000 a year. The scheme will ultimately be open to around 2.5 million working families in the UK. Households in which all parents work but do not receive support through tax credits (or Universal Credit, once it is established) will be eligible, so long as neither parent earns over £150,000 a year.

1.180 The Tax-Free Childcare Scheme offers support to more parents than the current Employer Supported Childcare (ESC) system, which is only available to some employees. The Government will therefore phase out ESC. Existing members of this scheme will be able to choose whether to remain on their current scheme or move to the new scheme (if they are eligible). The tax exemption available for workplace nurseries will remain.

1.181 This new system will be phased in from autumn 2015, partly funded by the phasing out of the ESC system. From the first year of operation, all children under five will be eligible. Disabled children up to age 16 will also be eligible, in line with existing ESC rules. The scheme will then build up over time to include children under 12.

1.182 The Government will also increase assistance for parents who receive childcare support through Universal Credit, which in due course will replace tax credits. Households eligible for tax credits already receive support for 70 per cent of their childcare costs up to a cap. **Budget 2013 announces that an additional £200 million will be provided to increase childcare support in Universal Credit.** This is equivalent to covering 85 per cent of childcare costs for households qualifying for the Universal Credit childcare element (where either a lone parent or both parents in a couple pay income tax). This will improve work incentives and ensure that it is worthwhile for low and middle income earners to work up to full-time hours. This additional £200 million is planned to be phased in from April 2016 as childcare support moves from tax credits into Universal Credit and it will be funded from within social security budgets at the time.

1.183 The Government will consult shortly on the detailed design and operation of the Tax-Free Childcare Scheme, including on how employers can continue to play a role in supporting their employees with childcare costs and to ensure it operates effectively with Universal Credit.

Children's savings

1.184 In November 2011, the Government introduced Junior ISA, a new tax-advantaged savings account for children under the age of 18. Children who have a Child Trust Fund (CTF) are currently ineligible for Junior ISA, although the Government has ensured that children with CTF accounts are not disadvantaged by increasing the CTF subscription limit to equal the Junior ISA limit (£3,600 in 2012-13 and £3,720 in 2013-14).

1.185 The Government wants to support parents by ensuring that there continues to be a clear and simple way to save for all children, and **will therefore consult on options for transferring savings held in CTFs into Junior ISA.**

Providing certainty on support for older people

1.186 The Government wants to give people clarity and security about what they can expect when they retire or reach old age. The current State Pension system is highly complicated and the existing social care funding system exposes individuals to catastrophic care costs, making it difficult for people to plan and prepare for their future. The Government has announced two major long-term reforms, the single-tier State Pension and social care funding reform, which together represent a comprehensive new deal for pensioners and people who want to plan and save for old age.

Single-tier State Pension

1.187 In January 2013, the Government set out its plans for the single-tier State Pension, as a cost-neutral reform set above the basic level of means-tested support. **Budget 2013 confirms that the single-tier State Pension will begin in 2016-17.**

1.188 The current State Pension system is highly complicated. The majority of individuals do not know what pension they will get from the state and the level of means-testing discourages people to save for their retirement. Introducing the single tier for newly-retired pensioners in 2016-17 will bring clarity and confidence to the State Pension system. This will provide a firm foundation to support people who want to take responsibility for their retirement income by saving, particularly alongside automatic enrolment (the Government's recent workplace pensions reform). The single tier will particularly benefit women, the low paid and the self-employed, who have tended to build up low amounts of Additional State Pension under the current system. Compared to the current system, by 2040, around 1.25 million of the lowest income pensioners will have higher retirement incomes.

1.189 A necessary consequence of the single-tier State Pension system is the closure of the State Second Pension, because everyone will have access to the same single-tier State Pension. **As a result, Budget 2013 confirms that from 2016-17 the ability for members of a defined benefit occupational pension scheme to 'contract out' of the State Second Pension will end.** They and their employers will therefore no longer be entitled to pay a lower NICs rate.

1.190 To alleviate the impact on private sector employers, the Government has committed to legislating for a statutory override, which will allow private sector employers to cover the costs of additional NICs payments through changes to contribution rates or benefits for their existing pension schemes.

1.191 For employees, single tier will make the State Pension system fairer by ensuring that, from 2016-17 onwards, everyone except for the self-employed will pay the same rates of NICs and build up access to the same single-tier State Pension. This means that those who are contracted out in 2016-17 will contribute more in National Insurance, and in return they will get a more generous State Pension.

1.192 The effects of the single tier introduction will vary between individuals, but 90 per cent of employees affected by the end of contracting-out who reach State Pension age in the first 20 years after the single tier's introduction will be better off over their lifetimes. An individual who is 40 years old when single tier is introduced in 2016 would contribute an extra £6,000 of NICs before reaching State Pension age in 2043. But they would gain £24,000 in extra State Pension over the course of their retirement. An individual who is 30 years old when single tier is introduced in 2016 would contribute an extra £7,000 in NICs before reaching State Pension age in 2054. But they would gain £18,000 in extra State Pension over their retirement.[54]

1.193 None of the additional employee and private sector employer NICs will be used for net revenue-raising. Overall, the Budget constitutes a net reduction in taxation for non-wealthy households, and a net reduction in NICs for private sector employers.

Social care funding reform

1.194 Drawing on the Dilnot Commission's recommendations, the Government has announced that it will introduce a cap on reasonable care costs. This will give a level of financial protection to those with the greatest care and support needs. In addition, the residential care means test will be extended to give more people access to financial support for their residential care costs.

[54] For an individual contracted-out over their whole career, with average life expectancy and median earnings (2012-13 earnings terms rounded to the nearest £1,000).

Taken together, these reforms should help an extra 100,000 people who would not receive any support under the current system. The reforms will help people who want to work hard and save for old age, by providing peace of mind that the savings they want to leave to their children will not be at risk of being wiped out by catastrophic care costs.

1.195 The Government has made clear that it would not implement these reforms without finding a way to pay for them. The Government has set out that the higher employer NICs revenue that arises from the end of contracting-out for members of defined benefit occupational pension schemes will help cover the costs of social care reform for the duration of the next Parliament. As the single-tier State Pension will begin in 2016-17, **Budget 2013 announces that the Government will introduce a £72,000 cap on reasonable care costs and extend the means test from April 2016.**

1.196 The new social care cap will protect the assets of those who face the highest social care costs, and will particularly benefit older people who have worked and saved all their lives to build up assets. As announced in February 2013, the Government will freeze the inheritance tax threshold for three years until April 2018, providing a simple and fair way of ensuring that those with the largest estates, who are more likely to benefit from social care reform, help to fund it. The Government has set out that the inheritance tax freeze will contribute to the costs of social care reform in the next Parliament.

Equitable Life

1.197 Budget 2013 announces that the Government will make an ex-gratia payment of £5,000 to those policyholders who bought their Equitable Life With-Profits Annuity before 1 September 1992, and are living at the time of this announcement. A further £5,000 will be available to those policyholders who meet the above criteria and are in receipt of Pension Credit. These one-off payments are in recognition of the resulting pressures this very elderly group face, having not received the income they hoped for from their Equitable Life annuity. Payments will be made in 2014-15 or earlier if possible.

Affordable public spending

1.198 Budget 2013 maintains the Government's policy of setting clear and credible consolidation plans by fixing the envelope for Total Managed Expenditure in 2015-16. The Government confirms that health, schools and ODA will be protected in 2015-16. These protections will be of greatest benefit to households on lower incomes, who benefit from health and school spending by around £2,700 a year more than those on the highest incomes.[55]

An affordable welfare system

1.199 Welfare spending must remain affordable, help those who need it most and provide the right incentives for people to work. Welfare spending rose by 20 per cent in real terms in the decade before the financial crisis, leaving reduced resources available for other public services.[56] Reforming the welfare system will not only put welfare spending on a more sustainable footing, but will also reduce pressures on public services.

1.200 As previously announced, a package of welfare reforms will be implemented from April 2013 which will meet these key objectives. It includes:

- the introduction of Universal Credit, the biggest change to the welfare system in a generation which will ensure that it always pays to be in work;
- the Household Benefit Cap, which will ensure no family will receive more on benefits than the average family in work;

[55] Based on comparison of income quintiles one and two against quintile five, HM Treasury analysis.
[56] Public sector net social benefits, Office for National Statistics.

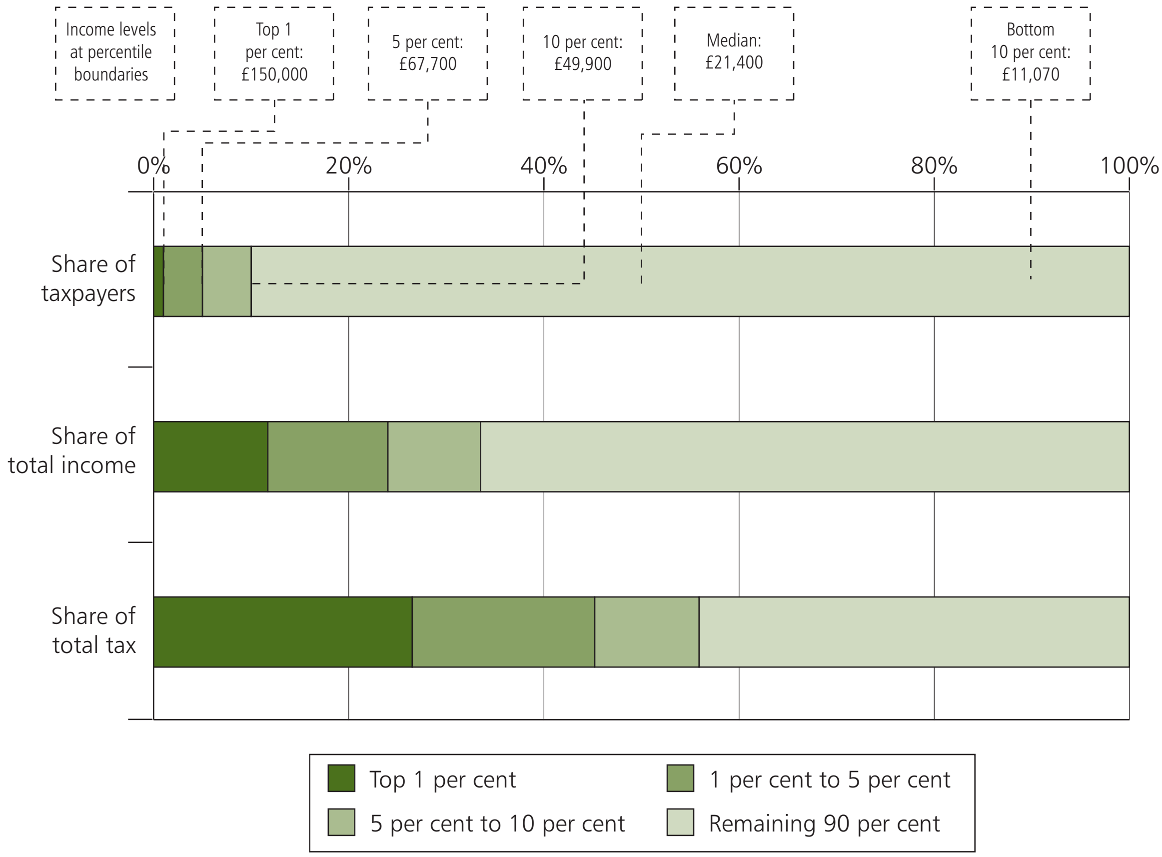
- the phased introduction of Personal Independence Payments to replace working-age Disability Living Allowance, which will ensure a more accurate assessment of needs so that support is reaching those who need it most;
- uprating a wide range of benefits and tax credits by 1 per cent in each of the next three years, as announced at Autumn Statement 2012. This recognises that benefits have risen faster than average earnings in recent years, while protecting the most vulnerable; and
- a number of measures to help reduce the £23 billion cost of Housing Benefit, while increasing fairness and efficiency in the system.

1.201 By the end of April 2013, the Government will have implemented measures to deliver over 90 per cent of the total savings expected from reforms to the welfare system announced to date. As set out earlier in this chapter, to help manage spending pressures the Government will strengthen the spending framework to improve control of AME, including areas of welfare expenditure.

A fair contribution from individuals and businesses

1.202 The Government is committed to a fair tax system in which those with the most contribute the most. As set out in Chart 1.21, over a quarter of all income tax is paid by just 1 per cent of taxpayers, with the top 5 per cent paying around half of all income tax.

Chart 1.21: Population, income and income tax share of individuals in 2012-13



Notes: Data expressed in terms of non-equivalised gross income of individual taxpayers; projected estimates.

Source: HM Revenue and Customs personal tax statistics.

1.203 Since 2010, the Government has raised taxes on the rich in every Budget: Budget 2010 increased higher rate capital gains tax; Budget 2011 tackled avoidance through disguised remuneration; Budget 2012 raised stamp duty on high-value homes; Autumn Statement 2012 took action to reduce the cost of pensions tax relief; and Budget 2013 announces further measures that tackle offshore tax evasion by high earners. The revenue raised from these measures will offset many times over the small cost of just over £100 million from the reduction in the additional rate of income tax from 50 per cent to 45 per cent.

Tackling tax evasion and avoidance

1.204 The vast majority of individuals and businesses pay their fair share of tax. Budget 2013 takes action against those who do not by announcing a significant crackdown on offshore tax evasion, tax avoidance and aggressive tax planning in four key areas:

- offshore tax evasion;
- avoidance of employment taxes;
- tax avoidance schemes; and
- corporation tax.

1.205 Collectively, these announcements will raise over £4.6 billion in new revenue over the next five years and protect against the loss of billions of pounds of revenue through the immediate closure of 10 loopholes. Further detail on these loophole closures is included in Chapter 2.

Offshore tax evasion

1.206 Following the Autumn Statement 2012 announcement that the Government would look to conclude further agreements based on its groundbreaking agreement with the US, the Isle of Man, Guernsey and Jersey have agreed to enter automatic tax information exchange agreements with the UK. These agreements will significantly increase the amount of information on potentially taxable income that is automatically exchanged, in order to further clamp down on tax evasion. HMRC has also put disclosure facilities in place to allow investors with accounts in the Isle of Man, Guernsey or Jersey to settle their past tax affairs in advance of the information being automatically exchanged. These agreements are expected to raise over £1 billion over the next five years.

1.207 The Government will look to sign similar agreements with other jurisdictions and is already in discussions with the Overseas Territories. Those, like the Crown Dependencies, who demonstrate their commitment to transparency and to tackling tax evasion will see their reputations enhanced. This forms a key part of the Government's offshore evasion strategy, published alongside Budget 2013 by HMRC's new centre of excellence on offshore evasion.

Avoidance of employment taxes

1.208 The Government is committed to reforming areas of the tax system where avoidance behaviour is widespread or where there are opportunities to level the playing field in the tax treatment of compliant and non-compliant businesses. Following Budget 2011 reforms to combat disguised remuneration, and the success of the Employee Benefit Trust Settlement Opportunity which has brought in over £600 million in the last 18 months, Budget 2013 announces new action to tackle avoidance of employment taxes.

1.209 The misuse of the partnership rules has been a feature of many avoidance schemes closed down in recent years, and the Government announced on 5 December 2012 that HMRC would consider the taxation of partnerships. As a result of this work, **the Government will consult on measures to:**

- **remove the presumption of self-employment for limited liability partnership (LLP) partners, to tackle the disguising of employment relationships through LLPs;** and
- **counter the artificial allocation of profits to partners (in both LLPs and other partnerships) to achieve a tax advantage.**

1.210 Autumn Statement 2012 also announced that HMRC would review the use of offshore employment intermediaries. As a result of that review, **the Government will strengthen obligations to ensure the correct income tax and NICs are paid by offshore employment intermediaries,** with consultation on the details. As part of its ongoing compliance work, HMRC will continue to gather evidence about other forms of employment tax avoidance in order to inform future policy and operational decisions.

Tax avoidance schemes

1.211 The Government is taking further action to tackle tax avoidance schemes:

- the UK's first General Anti-Abuse Rule will be introduced in Finance Bill 2013 to provide a significant new deterrent to abusive avoidance schemes and strengthen HMRC's means of tackling them;
- **the Government will shortly consult on new proposals to target the promoters of tax avoidance schemes, intending to tackle both the supply and demand of these schemes.** HMRC will consult on new "naming and shaming" proposals alongside a range of targeted disclosure requirements and associated penalties;
- **the Government will act on the warning made at Budget 2012 to introduce retrospective legislation to address aggressive Stamp Duty Land Tax avoidance schemes.** This action will tackle schemes exploiting 'transfer of rights' rules;
- **suppliers bidding for contracts will be required to declare specified non-compliance with tax obligations,** allowing government departments to exclude bidders that have not been compliant. The Government will review the effectiveness of the policy within a year and amend the rules if necessary to secure compliance; and
- a progress report on tackling avoidance and evasion is being published alongside Budget 2013.

Corporation tax

1.212 Alongside reforms to increase the competitiveness of the tax system, the Government is determined to take steps to ensure that domestic and multinational companies pay their fair share of tax and do not engage in aggressive tax planning. The Government has been at the forefront of the calls for collective action to strengthen international tax standards.

1.213 At the G20 meeting of Finance Ministers and Central Bank Governors in Moscow in February 2013, the OECD presented a report on *Addressing Base Erosion and Profit Shifting* which underlined the importance of international cooperation in tackling these issues.[57] The OECD has identified three main clusters of work: a review of ways to counter base erosion, looking at how to determine tax jurisdiction in particular in relation to the development of the digital economy, and an examination of how the transfer pricing rules allocate profits between different countries. The UK will use its involvement in these groups to work towards reform of

[57] *Addressing Base Erosion and Profit Shifting*, Organisation for Economic Co-operation and Development, February 2013.

the international tax standards. These issues will be examined by the OECD, which will present a comprehensive action plan to the G20 in July 2013.

1.214 The Government will take immediate action to prevent the growing practice of 'loss buying', where companies pass the potential to gain access to corporation tax loss relief to unconnected third parties. The Government will introduce new rules to prevent such behaviour in the future and raise just over £1 billion in new revenue as a result.

Tax debt collection

1.215 The Government announces that it will enable HMRC to increase the amount of tax debt collected via the Pay As You Earn system from individuals on higher incomes. The Government will consult on how this process will be designed. The Government will also introduce operational measures to increase HMRC's efficiency in collecting tax debts and make it easier for people to pay off a tax debt.