HM TREASURY

BUDGET 2010

HC 61

June 2010

BUDGET 2010

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dated 22 June 2010

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Mark Hoban
Her Majesty's Treasury
22 June 2010

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The Economic and Fiscal Strategy Report and the Financial Statement and Budget Report contain the Government's assessment of the medium-term economic and budgetary position. They set out the Government's tax and spending plans, including those for public investment, in the context of its overall approach to social, economic and environmental objectives. After approval for the purposes of Section 5 the European Communities (Amendment) Act 1993, these reports wil form the basis of submissions to the European Commission under Article 99 (ex Article 103) and Article 104 (ex Article 104c) of the Treaty establishing the European Community.

Contents

Executive Summary

This Budget sets out a five-year plan to rebuild the British economy based on the Government's values of responsibility, freedom and fairness. It shows how the Government will carry out Britain's unavoidable deficit reduction plan in a way that strengthens and unites the country.

The British economy has become unbalanced. It has been too reliant on growth from a limited number of sectors and regions. Overcoming these challenges will require a new model of economic growth built on saving, investment and enterprise instead of debt. This Budget is the first step in transforming the economy and paving the way for sustainable, private sector led growth, balanced across regions and industries.

This Budget sets out the action the Government will take in three areas to rebalance the economy and provide the conditions for sustainable growth:

- **deficit reduction;**
- **enterprise; and**
- **fairness.**

Responsibility: deficit reduction

The most urgent task facing this country is to implement an accelerated plan to reduce the deficit. Reducing the deficit is a necessary precondition for sustained economic growth. To continue with the existing fiscal plans would put the recovery at risk, given the scale of the challenge. High levels of debt also put an unfair burden on future generations.

For the first time, the Government's fiscal policy decisions have been based on independent forecasts for the economy and public finances. The Office for Budget Responsibility (OBR), in its pre-Budget forecast[1], has confirmed that without further action to tackle the deficit:

- public sector net borrowing would remain at 4 per cent of GDP in five years time, having been above 5 per cent of GDP for six consecutive years, unprecedented in the post-war period;
- the structural deficit would be 2.8 per cent of GDP in 2014-15, while the structural current deficit would be 1.6 per cent; and
- debt would still be rising in 2014-15 to 74.4 per cent of GDP, with annual debt interest payments set to reach £67 billion in that year.

The Government has therefore set a forward-looking fiscal mandate to **achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period.** At this Budget, the end of the forecast period is 2015-16.

[1] *Office for Budget Responsibility pre-Budget forecast*, Office for Budget Responsibility, June 2010.

At this time of rapidly rising debt, the fiscal mandate will be supplemented by **a target for public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16**, ensuring that the public finances are restored to a sustainable path.

This Budget takes urgent action to eliminate the bulk of the structural deficit through **plans for additional consolidation of £40 billion per year by 2014-15.** These plans include:

- **£32 billion per year by 2014-15 from spending reductions.** This includes £30 billion of current spending reductions and no further reductions in capital spending beyond those already announced. **The Budget announces the Spending Review will be on 20 October 2010**;
- **as part of these spending reductions, the Budget announces £11 billion of welfare reform savings** designed to reward work and protect the most vulnerable, including adopting the Consumer Prices Index for the indexation of benefits, tax credits and public service pensions from April 2011. **The Budget also announces a two year freeze In public sector pay, except for those earning less than £21,000 a year;** and
- **£8 billion per year from net tax increases. This includes an increase in the main standard rate of Value Added Tax (VAT) to 20 per cent and the standard and higher rate of Insurance Premium Tax (IPT) to 6 per cent and 20 per cent from 4 January 2011.**

By 2014-15, 80 per cent of the additional consolidation measures set out in this Budget will be delivered through spending reductions.

The Budget and the plans the Government inherited represent a total consolidation of £113 billion per year by 2014-15 and £128 billion per year by 2015-16, of which £99 billion per year comes from spending reductions and £29 billion per year from net tax increases. By 2015-16, 77 per cent of the total consolidation will be delivered through spending reductions.

As a result of the action the Government is taking, the OBR projects in its Budget forecast that:

- public sector net borrowing will decline to 1.1 per cent of GDP in 2015-16;
- the structural current deficit will be eliminated by 2014-15, with a projected surplus of 0.8 per cent of GDP in 2015-16; and
- public sector net debt will peak at 70.3 per cent of GDP in 2013-14, before declining to 67.4 per cent of GDP in 2015-16.

The OBR's judgement is that the policies set out in this Budget are consistent with a greater than 50 per cent chance of achieving the Government's fiscal mandate and target for debt. The OBR's central forecasts also show the mandate and debt target being met a year early in 2014-15.

The first section of Chapter 1 describes the source of the imbalances in the UK economy and the scale of the economic and fiscal challenge the country faces. It sets out the Government's fiscal plans in more detail.

Freedom: enterprise

The second element to rebalancing the economy is creating the conditions for enterprise and sustainable growth. If growth is to be sustainable, it needs to be based on an expansion in the private sector, not the public sector, and businesses across all regions and industries need the right conditions to be able to grow.

This Budget sets out a plan to support business and restore the UK's diminished competitiveness. The Government will give businesses more freedom by reducing regulation and tax rates, while refocusing support towards infrastructure, the low-carbon economy, and regional development. This Budget announces:

- **a reduction in the main rate of corporation tax from 28 per cent to 24 per cent over the course of four financial years from April 2011, a reduction in the small profits rate to 20 per cent from April 2011, and a reduction in the main and special rate of capital allowances to 18 and 8 per cent respectively in April 2012;**
- **an increase in the Enterprise Finance Guarantee and the creation of a new Growth Capital Fund;**
- **a reversal of the most damaging part of the planned increase in employer National Insurance Contributions by raising the threshold by £21 a week above indexation in April 2011; and**
- **a Regional Growth Fund in 2011-12 and 2012-13 to support increases in business employment and growth, and a scheme in which new businesses in targeted areas will get a substantial reduction in their employer National Insurance Contributions (NICs).**

The second section of Chapter 1 outlines the Budget announcements in more detail.

Fairness

Underpinning the Goverment's approach is a commitment to fairness. The Government will ensure that every part of society makes a contribution to deficit reduction while supporting the most vulnerable, including children and pensioners. The Government will also seek to build over the long term a fair tax and benefit system that rewards work and promotes economic competitiveness.

The Budget sets out a vision for a refocusing of the tax and benefit framework. It announces measures to encourage people to take personal responsibility for their actions by rewarding those who work hard work and save responsibly for the future. In particular:

- **the personal allowance for under 65s will be increased by £1,000 in April 2011, with the gains limited to basic rate taxpayers.** The Government estimates that the 880,000 lowest income taxpayers will be removed from tax altogether;
- **capital gains tax will be increased to 28 per cent for higher and additional rate taxpayers, with an increase in the entrepreneurs' relief lifetime limit to £5 million;**
- **the Government will introduce a levy based on banks' balance sheets from 1 January 2011 intended to encourage banks to remove to less risky funding profiles. The Government will also take action on unacceptable bank bonuses; and**
- **the Government will work in partnership with local authorities in England to freeze council tax In 2011-12.**

As part of the welfare reforms referred to above, **the Budget announces reforms to the housing and disability benefit and tax credit system to make it fairer and more affordable.** These reforms will reduce dependency and promote work.

To help protect those who are most vulnerable and have the highest level of need, **the Budget announces that Child Benefit will be frozen for three years to help fund significant increases in the Child Tax Credit. The Budget also announces that the Basic State**

Pension will be uprated by a triple guarantee of earnings, prices or 2.5 per cent, whichever is highest, from April 2011.

As a result of the Budget measures the richest will contribute the most to deficit reduction, and the impact on child poverty in 2012-13 is statistically insignificant.

The third section of Chapter 1 outlines the Budget announcements in more detail.

The Budget sets out a comprehensive list of all measures and announcements in Chapter 2.

Annex A of the document presents an analysis of the impact of the Government's tax and welfare proposals on households.

Annex B sets out the debt management and financing framework.

Annex C to this document is the OBR's Budget forecast

Budget decisions and government spending and revenue

A summary of the fiscal impact of Budget policy decisions is set out in the table below. Chapter 2 provides more information on the fiscal impact of the Budget

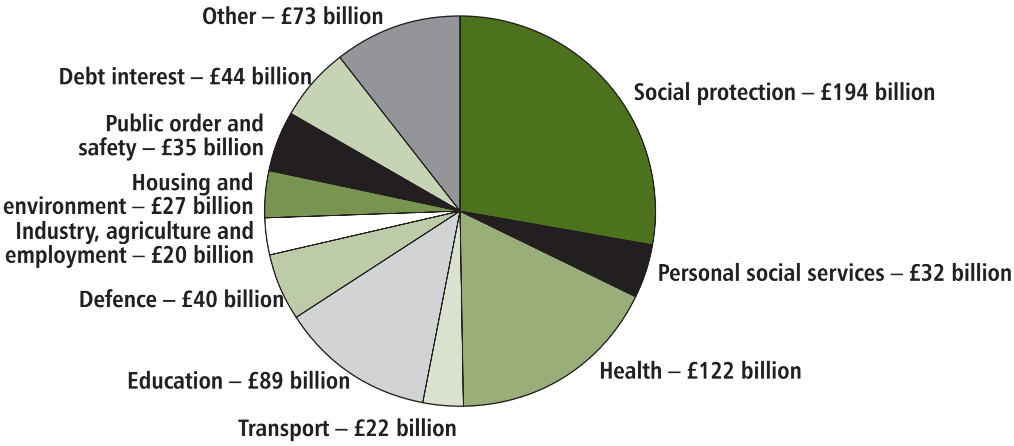
Table 1: Summary of the Budget policy decisions

	£ million				
	2010-11	**2011-12**	**2012-13**	**2013-14**	**2014-15**
Total tax policy decisions	**+2,830**	**+6,255**	**+6,950**	**+8,515**	**+8,230**
Spending measures announced at this Budget					
Changes to current spending	+3,465	+6,835	+15,230	+21,700	+29,780
Changes to capital spending	+1,780	+2,020	+2,070	+2,120	+2,160
Total spending policy decisions	**+5,245**	**+8,855**	**+17,300**	**+23,820**	**+31,940**
Of which specific welfare measures	*+385*	*+2,010*	*+4,710*	*+8,150*	*+11,040*
TOTAL POLICY DECISIONS	**+8,075**	**+15,110**	**+24,250**	**+32,335**	**+40,170**
Memo: debt interest savings as a result of policy decisions in spending review period	–	–820	+1,030	+1,810	+3,020
Memo: total policy decisions excluding debt interest savings	+8,075	+15,930	+23,220	+30,525	+37,150

Chart 1 presents public spending by main function. Total Managed Expenditure (TME) in 2010-11 is expected to be around £697 billion. TME is divided into Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME).

Chart 1: Government spending 2010-11

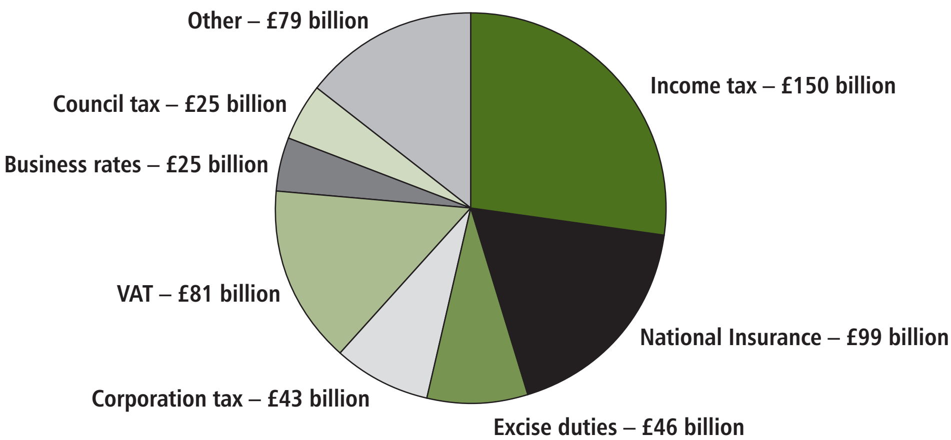
Total spending: £697 billion



Source: HM Treasury 2010-11 near-cash projections. The allocation of spending to functions is largely based on the United Nations' Classifications of the Functions of Government (COFOG). Other expenditure includes general public services (including international services); recreation, culture, and religion; public service pensions; plus spending yet to be allocated and some accounting adjustments. Social protection includes tax credit payments in excess of an individual's tax liability, which are now counted in AME, in line with OECD guidelines. Figures may not sum due to rounding.

Chart 2: Government receipts 2010-11

Total receipts: £548 billion



Source: Office for Budget Responsibility, 2010-11 estimates. Other receipts include capital taxes, stamp duties, vehicle excise duties and some other tax and non-tax receipts - for example, interest and dividends. Figures may not sum to total due to rounding.

Chart 2 shows the different sources of government revenue. Public sector current receipts are expected to be around £548 billion in 2010-11.

Budget Report

1 Budget Report

Deficit Reduction

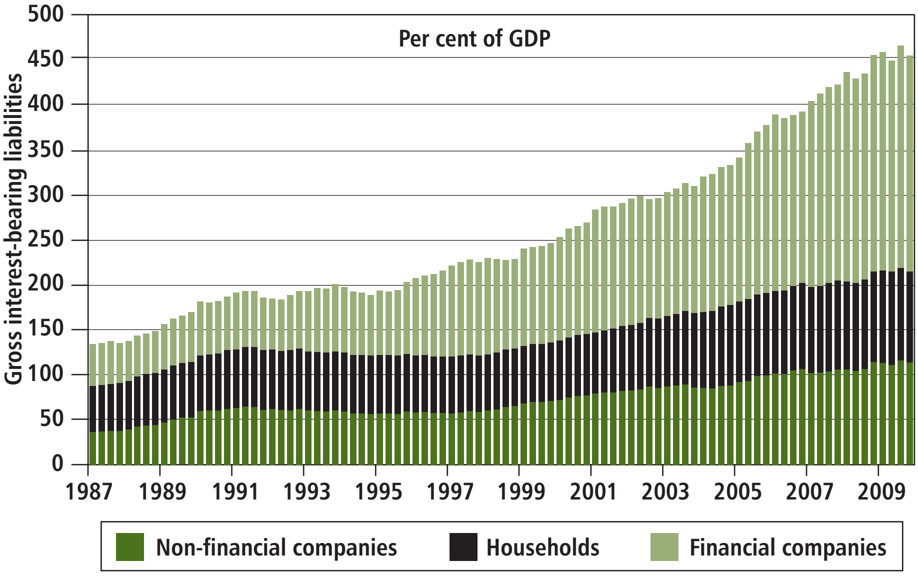
Rebalancing the UK economy

1.1 Over the past decade, economic growth in the UK has been driven by the accumulation of unsustainable levels of private sector debt and rising public sector debt. This pattern of unbalanced growth and excessive debt has helped create the exceptional economic and fiscal challenges that the Government must address, to restore the economy to sustainable, balanced and private sector-led growth.

Private sector debt

1.2 By 2008, the household saving ratio had fallen to the lowest level since the 1950s and household debt had risen to 100 per cent of GDP, as households borrowed heavily to purchase increasingly expensive property. Companies also took on rising levels of debt, reaching 110 per cent of GDP by 2008. Within the financial sector, the accumulation of debt was even greater. While rising debt was an international phenomenon, it was more pronounced in the UK than in most other countries. It has been estimated that the UK has become the most indebted country in the world.[1]

Chart 1.1: Private sector debt in the UK



Source: Office for National Statistics.

[1] *Debt and deleveraging: The global credit bubble and its economic consequences*, McKinsey Global Institute, January 2010.

Unbalanced growth

1.3 Increasing reliance on debt-financed consumer and government spending and on the financial sector drove growing imbalances in the UK economy, which were clear on many measures. According to the OECD, by 2007 the UK had the largest structural budget deficit in the G7.[2] The current account deficit was around 2¾ per cent of GDP in 2007, a figure that was flattered by a 2¼ per cent surplus on trade in financial services. Between 1997 and 2007, government consumption increased from 18 to 21 per cent of GDP, while business investment fell from 11¾ to 10 per cent of GDP. The recession has only compounded these imbalances, with government consumption accounting for 23½ per cent of GDP in 2009 and business investment falling over 25 per cent from its peak, to trough at just 8¼ per cent of GDP.

Financial crisis

1.4 Between 2002 and 2007 there was a near tripling of UK bank balance sheets[3] and the UK financial system had become one of the most highly leveraged in the world, more so than the US. As a result, the UK was particularly vulnerable to financial instability and was hit hard by the financial crisis. The loss of confidence and withdrawal of credit that followed precipitated the deepest and longest recession since the Second World War: output fell by more than 6 per cent according to the latest estimate from the Office for National Statistics (ONS).

Public sector imbalances

1.5 In the UK, a property boom and unsustainable profits and remuneration in the financial sector in the pre-crisis years drove rapid growth in tax receipts. The spending plans set out in the 2007 Comprehensive Spending Review were based on these unsustainable revenue streams. As tax receipts fell away during the crisis, the public sector was revealed to be living beyond its means. Public spending increased from 41 per cent of GDP in 2006-07 to 48 per cent of GDP in 2009-10, while tax receipts fell by 2 per cent of GDP over the same period. Revenue has averaged around 38 per cent of GDP over the past 20 years, not exceeding 40 per cent in that time. Chart 1.2 later in this chapter shows both the persistent gap between spending and revenue in the pre-crisis years, and the dramatic widening of that gap in the past two years. As a result, the overall budget deficit reached 11 per cent of GDP in 2009-10.

1.6 As Box 1.1 illustrates, the result has been to leave the UK with one of the largest fiscal challenges of any major economy, reinforcing the case for accelerated action to put the UK's public finances back on a sustainable footing.

[2] *OECD Economic Outlook No. 87*, OECD, May 2010.
[3] Speech by Mervyn King, Governor of the Bank of England, at the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House, 16 June 2010.

Box 1.1: The scale of the fiscal challenge

The fiscal challenge in the UK is, on some measures, larger than in any other advanced economy. In May, the International Monetary Fund (IMF) forecast that UK public borrowing would be the highest in the G20 in 2010;[a] it is also estimated that the UK's structural deficit will be the highest among all OECD countries[b] and the 27 EU Member States.[c] The rating agency Fitch has pointed out that *"the rise in public debt ratios [in the UK] since 2008 is faster than for any other 'AAA'-rated sovereign."*[d]

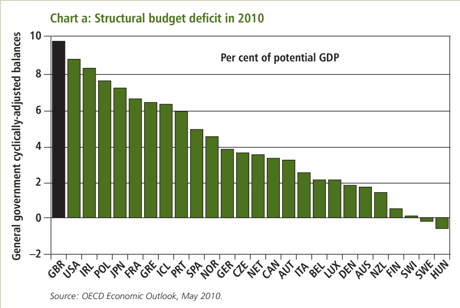


Chart a: Structural budget deficit in 2010

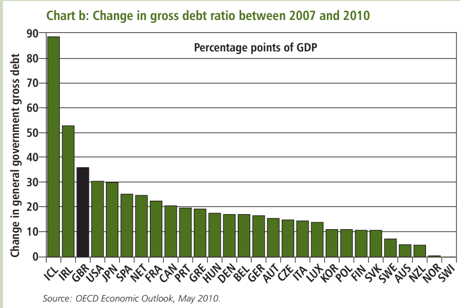


Chart b: Change in gross debt ratio between 2007 and 2010

While the fiscal position in the UK is very challenging, the financing environment has remained supportive and, among other factors, the new Government's fiscal credibility has already helped to keep long-term interest rates close to record lows, as shown in Chart c. Accelerated fiscal consolidation will help keep market interest rates lower for longer, supporting economic recovery and lowering the proportion of tax revenues devoted to debt service payments. The Government has set out a credible deficit reduction plan that should provide businesses with the confidence they need to plan and invest, supporting the necessary recovery in business investment.

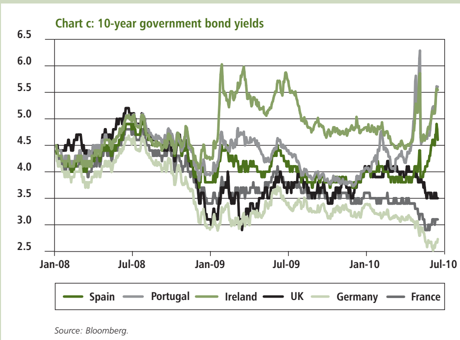


Chart c: 10-year government bond yields

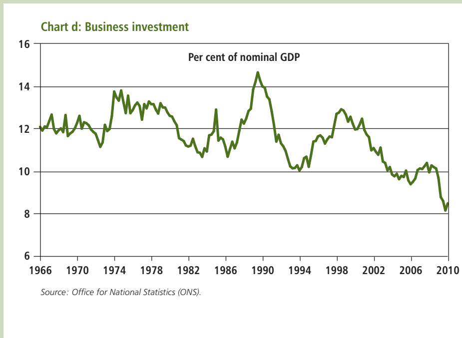


Chart d: Business investment

[a] *IMF Fiscal Monitor*, IMF, May 2010.

[b] *OECD Economic Outlook No.87*, May 2010.

[c] *European Commission Spring Forecast*, May 2010.

[d] *Special Report*, Fitch Ratings Agency, June 2010.

Role for Government

1.7 Government policy has an important role to play in minimising risks to the recovery and supporting rebalancing towards sustainable, private sector-led growth, including through:

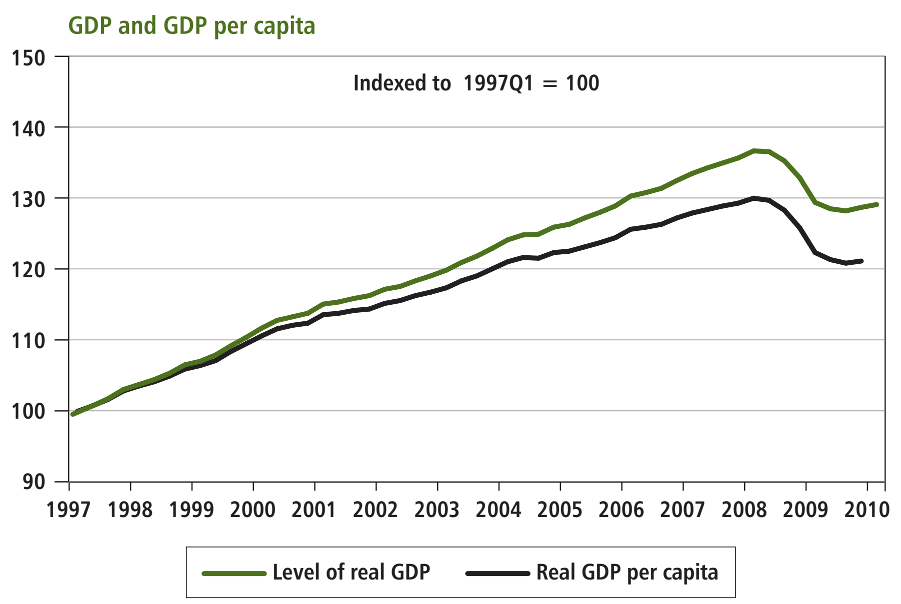
- an accelerated plan to reduce the deficit and place debt as a percentage of GDP on a downward path, which should underpin household, business and market confidence and provide the conditions for sustainable growth in the private sector; and

- action to prevent the build-up of systemic macroeconomic and financial risks, which will help ensure that the economy is no longer reliant on unsustainable, debt-financed activities.

1.8 The Government's macroeconomic strategy will help provide a stable economic foundation for private sector growth. Measures to promote enterprise will reduce regulation and tax rates and refocus support towards infrastructure, the low-carbon economy, and regional development. Measures to create a fair tax system will reward work and promote economic competitiveness. The Government's policies in these areas are discussed in the enterprise and fairness sections of this chapter.

Box 1.2: Economic performance

There is widespread acknowledgement that GDP is not the ideal measure of well-being. GDP per capita is a better measure, as it reflects economic output per person. As shown on the chart below, GDP per capita has fallen below the level it reached in 2004. A recent Stiglitz, Sen and Fitoussi report makes recommendations on the measurement of both current well-being and sustainability, as well as changes needed to 'classical GDP', where the report notes: *"... perhaps had there been more awareness of the limitations of standard metrics, like GDP, there would have been less euphoria over economic performance in the years prior to the crisis; metrics which incorporated assessments of sustainability (e.g. increasing indebtedness) would have provided a more cautious view of economic performance.."* [a]



Source: Office for National Statistics.

The Government is committed to developing broader indicators of well-being and sustainability, with work currently underway to review how the Stiglitz, Sen and Fitoussi report should affect the sustainability and well-being indicators collected by Defra, and with the ONS and the Cabinet Office leading work on taking forward the report's agenda across the UK.

[a] *Report by the Commission on the measurement of economic performance and social progress*, Stiglitz, Sen and Fitoussi, 2009.

Macroeconomic strategy

1.9 Providing the right macroeconomic conditions will help correct the imbalance between the public and private sectors that built up over the past decade, underpinning a sustainable recovery that is more evenly balanced across regions and industries.

Fiscal policy framework

Role of fiscal consolidation

1.10 The current, historically high level of public borrowing risks undermining fairness, growth and economic stability in the UK. Borrowing must be brought under control and debt as a percentage of GDP must be placed on a downward path, as:

- reducing public sector borrowing will underpin private sector confidence and reduce competition for funds for private sector investment, supporting growth and job creation over the medium term;
- failure to address rising public sector debt in the UK risks pushing up long-term interest rates, which would affect not just the Government, but also families and businesses through the higher costs of loans and mortgages. The IMF has estimated that every ten percentage points of additional debt could raise interest rates by around ½ percentage point and reduce long-term economic growth by around ¼ percentage point.[4] Public spending on debt interest is unproductive and squeezes out spending on public services;
- reducing the deficit and so placing debt as a percentage of GDP on a downward path provides scope to absorb the impact of future economic shocks; and
- public borrowing is, in essence, taxation deferred, and it would be irresponsible and unfair to accumulate substantial debts to fund spending that benefits today's generation at the expense of subsequent generations.

Fiscal policy

1.11 This Budget sets out a comprehensive set of policies to bring the public finances back under control. It demonstrates the Government's determination to reduce public sector borrowing and debt, promoting domestic and international confidence in the sustainability of the public finances, including by:

- creating the new Office for Budget Responsibility (OBR), which introduces independence, greater transparency and credibility to the economic and fiscal forecasts on which fiscal policy is based;
- setting fiscal policy to restore the public finances to a sustainable position; and
- a clear and measurable fiscal mandate, which will guide fiscal policy decisions over the medium term.

The Office for Budget Responsibility

1.12 The Government's fiscal policy decisions will be based on independent forecasts for the economy and public finances, prepared by the OBR. The OBR has already transparently laid out the full scale of the fiscal challenge. The Chancellor has also asked the OBR to judge whether the Government's fiscal policy is consistent with a greater than 50 per cent chance of achieving the fiscal mandate. The establishment of the OBR places the UK at the forefront of

[4] *IMF Fiscal Monitor,* November 2009 and May 2010.

institutional reform internationally. The IMF has advocated the benefits of such a model.[5]

1.13 For this Budget, the OBR has operated on an interim basis. The Terms of Reference for the interim OBR were agreed on 8 June 2010 and published on the OBR's website.[6] The OBR will be put on a permanent footing once the necessary legislation has been enacted. The OBR's pre-Budget forecast was published on 14 June 2010.[7] Full details of the OBR's Budget forecast are provided in Annex C.

1.14 For this Budget, the National Audit Office (NAO) has examined the process by which the interim OBR's forecasts have been arrived at. The Comptroller and Auditor General's report confirms that, based on the NAO's criteria, *"the key economic and fiscal assumptions underpinning the interim Office for Budget Responsibility's forecasts have been independently arrived at."*[8]

Fiscal mandate

1.15 The Budget announces the Government's forward-looking fiscal mandate **to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period.** At this Budget, the end of the forecast period is 2015-16.

1.16 At this time of rapidly rising debt, the fiscal mandate will be supplemented by **a target for public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16,** ensuring that the public finances are restored to a sustainable path. The Government has asked the OBR to assess whether policy is consistent with a greater than 50 per cent chance of meeting the target for debt.

1.17 This fiscal mandate, supplemented by the target for debt, will guide fiscal policy decisions over the medium term, ensuring that the Government sets plans consistent with accelerating the reduction in the structural deficit so that debt as a percentage of GDP is restored to a sustainable, downward path. This will help reduce the risk of pushing up long-term interest rates and provide scope to absorb the impact of future economic shocks.

Design of mandate

1.18 The fiscal mandate is based on:

- the current balance, to protect the most productive public investment expenditure; and
- a cyclically-adjusted aggregate, to allow some fiscal flexibility at a time of economic uncertainty.

1.19 The fiscal mandate applies to the end of the five-year forecast period, set at this Budget as 2015-16. In the future, when the forecast period moves forward a year, the deficit target will continue to apply in the final year, so anchoring the Government's medium-term fiscal stance.

1.20 The forward-looking fiscal mandate addresses a key failing of the framework that was in place from 1997 to 2008: the formulation of the golden rule adopted during this period required the Government to balance the current budget over the economic cycle. This resulted in an approach that

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[5] *Code of good practices on fiscal transparency*, IMF, 2007.
[6] http://budgetresponsibility.independent.gov.uk.
[7] *Pre-Budget forecast,* Office for Budget Responsibility, June 2010.
[8] *Examination concerning the forecasts prepared by the interim Office for Budget Responsibility for the emergency Budget,* National Audit Office, June 2010.

proved too backward looking, especially at the end of the economic cycle, allowing persistent fiscal deficits when growth was strong, on the basis of past surpluses.

1.21 Under the framework in place from 1997 to 2008, the Government determined the dating of the economic cycle over which the golden rule applied, calling the credibility of the framework into question. The OBR will be responsible for key judgements relevant to achieving the fiscal mandate, in particular the cyclical position of the economy, which determines the structural position of the public finances.

1.22 The previous golden rule and sustainable investment rule were suspended following the financial crisis. The first replacement, the temporary operating rule, was criticised as insufficiently specific to guide the fiscal position back to sustainability. The second replacement, the Fiscal Responsibility Act 2010, was insufficiently rigorous – public sector net borrowing was only required to be 5½ per cent of GDP by 2013-14.

1.23 The Government's fiscal mandate requires that the cyclically-adjusted current budget be returned to balance over the five-year forecast period. The target for debt is a fixed requirement for debt as a percentage of GDP to be falling in 2015-16, which will not move forward with the five-year forecast period, ensuring that the public finances are restored to a sustainable path.

Future approach

1.24 The choices of a five-year rolling forecast period for the fiscal mandate, supplemented by the fixed date for the debt target, reflect the exceptional environment in which the Government must address the fiscal challenge. They are designed to ensure that fiscal consolidation is delivered over a realistic and credible timescale. 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.

Stability and Growth Pact

1.25 The Stability and Growth Pact (SGP) provides a framework for fiscal policy in the European Union. The Excessive Deficit Procedure of the SGP recommends the Government reduce the Treaty deficit below 3 per cent of GDP by 2014-15. The OBR's pre-Budget forecast showed the plans inherited by this Government leaving a Treaty deficit of 4.0 per cent of GDP in 2014-15. The plans set out in this Budget are consistent with reducing the Treaty deficit below 3 per cent of GDP by 2014-15 and placing the Treaty debt ratio on a downward path from 2013-14.

Macro-prudential policy framework

1.26 The recent crisis shows that price stability alone is not sufficient to ensure wider economic and financial stability. During the years preceding the crisis, there was no single body or organisation with responsibility for addressing the build-up of systemic risks in the financial sector. As outlined in the Chancellor's Mansion House speech of 16 June 2010,[9] the Government is therefore introducing a new system of regulation, which will give the Bank of England control of macro-prudential regulation and oversight of micro-

[9] Available at www.hm-treasury.gov.uk

prudential regulation. This new regulatory structure will ensure that there is clear responsibility for monitoring and acting upon the build-up of systemic risks. The Government has also established an independent commission on banking, chaired by Sir John Vickers. This commission will consider the structure of the UK banking sector and make recommendations to the Cabinet Committee on Banking Reform by the end of September 2011.

Monetary policy framework

1.27 While price stability has not proved sufficient for wider economic stability, it remains a necessary condition. The Government is therefore fully committed to maintaining price stability. **The Chancellor has decided that the independent Monetary Policy Committee (MPC) of the Bank of England will continue to target 2 per cent inflation, as measured by the 12-month increase in the Consumer Prices Index (CPI).**

Deficit reduction

Scale of the fiscal challenge

1.28 Compared with the March Budget forecast, the OBR estimates that a lower proportion of the UK's budget deficit results from the cyclical position of the economy and a greater proportion reflects an underlying structural deficit. The OBR's pre-Budget forecast estimated that the cyclically-adjusted or 'structural' deficit in 2010-11 was 0.6 per cent of GDP higher than estimated in the March Budget.

1.29 The OBR's pre-Budget forecast showed that, without further action to tackle the deficit:

- public sector net borrowing would remain at 4 per cent of GDP in five years time, having been above 5 per cent of GDP for six consecutive years, unprecedented in the post-war period;
- the structural deficit would be 2.8 per cent of GDP in 2014-15, while the structural current deficit would be 1.6 per cent; and
- debt would still be rising in 2014-15 to 74.4 per cent of GDP, with debt interest payments set to reach £67 billion in that year.

1.30 The OBR's pre-Budget forecast used market expectations for short-term and long-term interest rates. The OBR recognised that those market rates reflected investors' expectations about the measures to be introduced in the Budget and the possible response of the Monetary Policy Committee to further consolidation. As a result, the OBR made clear in its pre-Budget forecast, *"in present conditions the likely result is that these economic forecasts are biased upwards: to the extent that market expectations factor in tighter fiscal policy than assumed in these projections, then following the fiscal path assumed here would lead to higher interest rates and so lower economic activity than set out in this projection."*[10]

[10] *Pre-Budget forecast,* Office for Budget Responsibility, June 2010.

Approach to deficit reduction

Choice of levers

1.31 The Government's fiscal consolidation plans have been designed with growth and fairness in mind, as far as possible:

- protecting the most productive public investment expenditure;
- avoiding punitive increases in tax rates on capital and labour; and
- reforming the welfare system to reward work.

1.32 The greatest contribution to the Government's fiscal consolidation will come from public spending reductions, rather than tax increases. This approach is consistent with OECD and IMF research, which suggests that fiscal consolidation efforts that largely rely on spending restraint promote growth.[11] Tax measures can be an effective tool for reducing the deficit quickly, allowing for phased reductions in public spending. The Government's consolidation plans therefore involve a rising contribution from public spending over the forecast period.

Scale of consolidation

1.33 This Budget delivers additional consolidation on top of the plans set in the March Budget for the period to 2014-15, with additional spending reductions of £32 billion a year by 2014-15 and additional net tax increases of £8 billion. This results in plans for a total consolidation of £128 billion per year by 2015-16, consisting of total reductions in spending of £99 billion and a net increase in taxes of £29 billion.

1.34 Plans in the March Budget were for 71 per cent of the consolidation by 2014-15 to be delivered through lower spending. By 2014-15, 80 per cent of the additional consolidation measures set out in this Budget will be delivered through spending restraint. Taking the consolidation as a whole, 74 per cent of the total will now be delivered by lower spending in 2014-15, rising to 77 per cent in 2015-16. This is set out in Table 1.1.

Table 1.1: Total consolidation plans over the forecast period

	£ billion					
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Discretionary policy announced at Budget [1]	8.1	15	24	32	40	
Spending	5.2	9	17	24	32	
Tax	2.8	6	7	9	8	
Spending share of consolidation (per cent)	*65*	*59*	*71*	*74*	*80*	
Policy inherited by the Government	0.8	26	42	57	73	
Spending[2]	0.0	14	25	39	52	
Tax	0.8	11	17	18	21	
Spending share of consolidation (per cent)	*0*	*56*	*60*	*68*	*71*	
Total discretionary consolidation	8.9	41	66	90	113	128
Spending[3]	5.2	23	42	63	83	99
Tax	3.6	18	24	27	29	29
Spending share of consolidation (per cent)	*59*	*57*	*64*	*70*	*74*	*77*

[1] *Including savings in 2010-11 announced before Budget.*

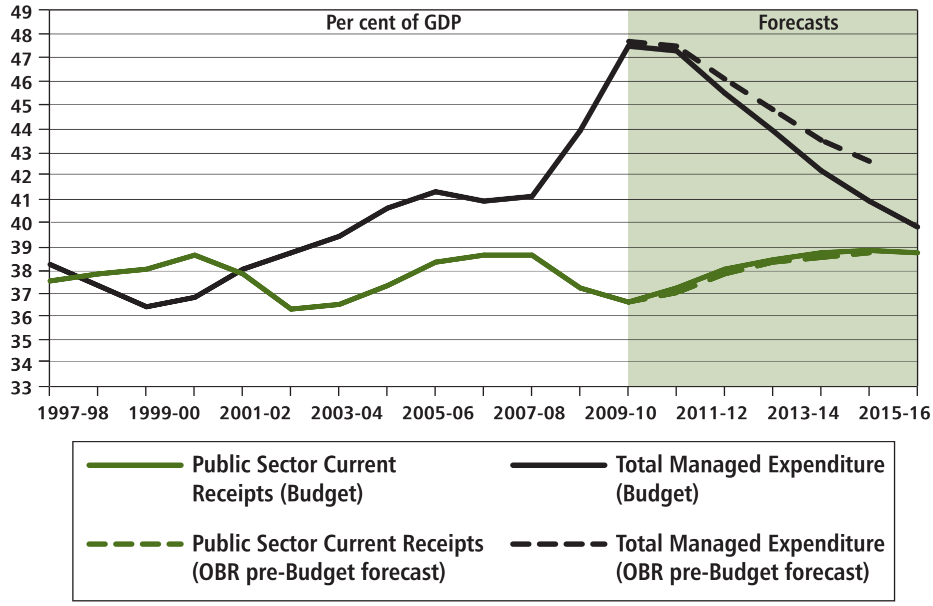
[2] *Spending reductions against baseline of growing DEL in line with general inflation in the economy, in line with Table 4.8 in the OBR pre-Budget forecast and AME as forecast at Budget, including estimated debt interest savings from 2011-12 onwards of £0.5bn, £2bn, £4bn and £7bn.*

[3] *Baseline as in footnote 2, but extended to 2015-16 using the same methodology, with estimated total debt interest saving of £16bn in 2015-16.*

[11] See *UK Article IV Consultation*, IMF, May 2009 and *Economic Outlook No.81*, OECD, June 2007.

1.35 Spending is projected to fall from 48 per cent of GDP to 40 per cent by 2015-16 and receipts are projected to rise from 37 to 39 per cent. Cyclically-adjusted public sector net borrowing will be reduced by 8.4 percentage points, from 8.7 per cent of GDP in 2009-10 to 0.3 per cent of GDP in 2015-16.

Chart 1.2: Receipts and expenditure



Source: Office for Budget Responsibility and Office for National Statistics.

Spending measures

1.36 The Government has already identified £6.2 billion of savings in 2010-11 and cancelled nearly £2 billion of projects approved since 1 January 2010. Further detail, and confirmation of Departmental Expenditure Limits (DELs) for 2010-11, is provided in Chapter 2.

The future path of public spending

1.37 The Budget announces the path of public spending for the period until 2015-16. The figures for Total Managed Expenditure (TME), public sector current expenditure (PSCE) and public sector gross investment (PSGI) are set out in Table 2.3 in Chapter 2. **In 2015-16, TME will grow in line with general inflation in the economy.**

1.38 The forthcoming Spending Review will, for the first time, set spending plans for the four years to 2014-15. Compared with departmental expenditure remaining constant in real terms and the OBR's pre-Budget forecast for Annually Managed Expenditure (AME), public expenditure will be £83 billion a year lower by 2014-15. £52 billion of these spending reductions were implied in projections that this Government inherited, but were not underpinned by specific plans for delivery. **This Budget announces:**

- **additional reductions in current spending totals of £30 billion a year by 2014-15; and**
- **no further cuts in capital spending totals beyond those announced as part of the £6.2 billion of savings in 2010-11, in order to protect the most productive public sector investment.**

The Spending Review process

- **This Budget announces that the 2010 Spending Review will be published on 20 October 2010.** An engagement programme will launch on 24 June 2010, giving public sector workers and members of the public an opportunity to feed in their ideas for how to reduce spending while protecting the quality of public services.

The Spending Review envelope

1.39 The Spending Review will set DELs for every department and for the devolved administrations.[12] It will also announce plans for any further savings and reforms in significant elements of AME, including social security, tax credits and public service pensions.[13] The Budget sets firm and fixed envelopes for the areas of current and capital spending included within the Spending Review. These are published in Table 2.3 in Chapter 2.

1.40 To promote transparency and understanding of the broad magnitude of spending changes, Table 2.3 presents indicative figures for the overall level of current and capital DEL spending in the years to 2015-16. These are based on the OBR's Budget forecast for AME, as set out in Annex C, which takes account of specific AME measures announced so far. Based on these implied DEL figures, and once the Government's commitments on protecting health and overseas aid are taken into account, other departments could see average real cuts to their budgets of around 25 per cent over the four years. This compares with the average real cuts of around 20 per cent for unprotected departments implied by the March Budget.[14] The final split between AME and DEL will be decided at the Spending Review, and any further AME savings will reduce the size of cuts to departmental budgets.

Budget spending measures

1.41 The Budget also announces significant measures on public sector pay and welfare reform that contribute to spending consolidation. Savings from these measures will help to protect the quality of public services as overall public spending is reduced.

1.42 The Government announces a two-year pay freeze for public sector workforces, except for workers earning less than £21,000 a year who will receive an increase of at least £250 per year in these years. This will save £3.3 billion a year by 2014-15. An independent commission chaired by John Hutton will undertake a fundamental, structural review of public service pension provision by Budget 2011 and consider the case for short-term savings in the Spending Review period, by September 2010.

1.43 Spending on social security and tax credits has increased by 45 per cent, around £60 billion, in real terms over the past 10 years. Welfare reform measures in this Budget reduce overall expenditure on social security, saving £11 billion in 2014-15. **The Government will adopt the CPI for the indexation of benefits, tax credits and public service pensions from April 2011. The Government will also introduce measures to control spending on tax credits, housing benefit and disability benefits.** Alongside these reforms, it is introducing measures to protect pensioners and low-income families with children. Further details are set out in the fairness

[12] For further information, see *The Spending Review Framework*, HM Treasury, June 2010.
[13] Central government debt interest, BBC domestic services, National Lottery and net expenditure transfers to EU institutions will be excluded from the Spending Review process, as they are either self-financing or not directly within Government control.
[14] This included commitments to protect resource spending on NHS, overseas aid, schools, 16-19 education, Sure Start, and police numbers.

section of this chapter. The Government is also reviewing how the CPI can be used for the indexation of taxes and duties while protecting revenues.

Tax measures

VAT and IPT

1.44 The Budget announces tax measures to reduce the deficit and reform the tax system:

- **the standard rate of Value Added Tax (VAT) will increase from 17.5 per cent to 20 per cent from 4 January 2011.** VAT is a sustainable source of revenue and is less distortionary than other major tax bases. The increase will raise £13.5 billion a year, on a scorecard basis, by 2014-15. Following this increase, the main rate of VAT will remain below the European Union average. This Budget makes no changes to the VAT zero rating for household essentials, nor to the reduced rate of VAT; and
- in line with the increase in the VAT rate, **the higher rate of Insurance Premium Tax (IPT) will increase on 4 January 2011, from 17.5 per cent to 20 per cent, while the standard rate will increase from 5 per cent to 6 per cent.** This will raise £0.5 billion a year by 2014-15.

Tax reform

1.45 As set out in more detail in the fairness and enterprise sections of this chapter, the Budget also announces wider changes to the tax system. These include reform and rebalancing of business taxes, including the introduction of a bank levy, and an increase to the personal allowance, in part financed by an increase in capital gains tax.

1.46 Taken together, the tax measures announced in this Budget rebalance the tax system to increase its overall economic efficiency, improve its sustainability and support a fair reduction in the deficit. In total, the net tax contribution in this Budget is £8 billion a year by 2014-15.

Economic and fiscal forecast

Economic forecast

1.47 Table 1.2 provides a summary of the OBR's Budget central economic forecast. Further detail is provided in Annex C.

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

	Percentage change on a year earlier, unless otherwise stated						
		Forecasts					
	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Gross domestic product (GDP)	-4.9	1.2	2.3	2.8	2.9	2.7	2.7
CPI inflation (Q4)	2.1	2.7	2.4	1.9	2.0	2.0	2.0

[1] *All growth rates in this table are rounded to the nearest 1 decimal place. This is not intended to convey a degree of unwarranted accuracy.*

Economic prospects

1.48 The OBR's Budget economic forecast is for a gradual recovery, as the legacy of unbalanced growth and excessive levels of debt continue to weigh on the economic outlook. The OBR forecasts the economy to rebalance, with net exports and business investment making a greater contribution to growth than in the recent past, and government spending making a negative contribution to growth as fiscal consolidation is implemented. This is a crucial part of the rebalancing of the economy that is required for a sustainable recovery. Box 1.3 further explains the impact that fiscal consolidation will have on the economy.

1.49 As set out by the OBR, significant uncertainties and risks to the outlook remain. Some of these uncertainties relate to their key forecast judgements, including their estimate of the underlying supply potential of the economy; developments in the euro area, credit and bank funding conditions also remain key risks to the UK outlook.

Box 1.3: Economic impact of fiscal consolidation

The overall economic impact of fiscal consolidation depends on the combination of:

- *direct and indirect effects*, from reduced public spending or increased taxation. These will tend to reduce demand growth in the short term; and
- *wider economic effects*, which depend on the reaction of the private sector and monetary policy to the changed fiscal environment. These will tend to boost demand growth, could improve the underlying performance of the economy and could even be sufficiently strong to outweigh the negative effects.

Wider economic effects include:

- *the reaction of the Monetary Policy Committee to tighter fiscal policy:* as the Governor of the Bank of England said in his Mansion House speech on 16 June 2010, *"...monetary policy must be set in the light of the fiscal tightening over the coming years... If prospects for growth were to weaken, the outlook for inflation would probably be lower and monetary policy could then respond."*[a] Monetary conditions are already expansionary, but further support could come from conditions remaining expansionary for longer than would otherwise have been the case;
- *the reaction of the bond market* to an accelerated and more credible fiscal consolidation plan could leave long-term interest rates lower for longer; and
- *the effect on private sector confidence and spending:* reassuring the private sector that concrete measures have been put in place to limit the rise in government debt could prompt households and companies to reduce precautionary saving, increasing consumption and investment relative to what they would have been otherwise.

A simple comparison of the pre-Budget and Budget forecasts produced by the OBR suggests that fiscal consolidation will negatively affect the economy in the short term. However, the OBR has stressed that *"it is potentially misleading to interpret the difference between the pre-Budget and Budget forecasts as the economic impact of the Budget measures."* The OBR note that interest rates would have been higher in the absence of the fiscal tightening announced in this Budget, and it has provided an illustrative calculation that long-term interest rates might have been 0.3 percentage points higher. Higher interest rates would negatively affect output and employment.

As the OBR makes clear, its forecasts are surrounded by a significant degree of risk and uncertainty. A key benefit of taking decisive action on fiscal consolidation is to reduce the risks associated with failing to correct the fiscal position, in particular that high levels of public debt could trigger a sudden loss of market confidence, leading to higher market interest rates. Since the end of March, the spread of government bond yields over German bunds has increased sharply in those countries where market concerns about fiscal credibility have heightened: by around 1½ percentage points on average in Spain, Portugal and Ireland. In the UK, the change has been close to zero. A simple comparison of forecasts would not reflect the significant economic benefit of reducing the risk of such adverse outcomes.

[a] Available at www.bankofengland.co.uk

Trend output

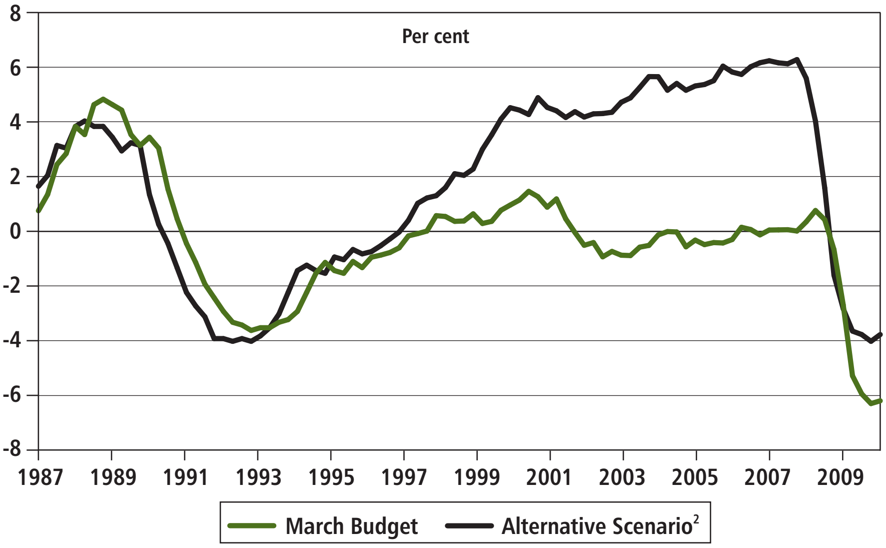
1.50 The OBR's forecast is based on the judgement that the current level of trend output is lower than assumed in the March Budget, and the negative output gap is therefore smaller. Their projection for trend growth is also lower, at around 2¼ per cent over the next three years, slowing to just over 2 per cent from 2014. That compares with 2¾ per cent a year assumed for the March Budget economy forecast and 2½ per cent underpinning the public finance projections.

Box 1.4: Output gap assessment

The depth of the recession means there is great uncertainty about what has happened to 'trend' or 'potential' output over the recent past. Previous official estimates assumed that the financial crisis had brought about a downward adjustment to potential output. In particular, the March Budget estimated that trend growth would average just under 1 per cent between mid-2007 and mid-2010, before reverting to a pre-crisis projection of 2¾ per cent. As shown by the chart below, this implied a negative output gap of just over 6 per cent at the end of 2009. The OBR's central judgement is that a range of indicators point to a smaller negative output gap of around 4 per cent at the end of 2009, and that the current level of trend output is therefore lower than assumed for the March Budget.

It is difficult to judge the extent to which the downward revision to trend output reflects economic changes *resulting* from the financial crisis, as opposed to those *revealed* by it. One possibility is that trend output has undergone a significant adjustment as a result of the recession, reflecting for example the impact of an increase in the cost of capital on the productive capital stock. An alternative view is that trend output growth was lower before the crisis. For example, over the past 50 years GDP growth in the UK has averaged a little over 2¼ per cent a year. Using the OBR judgement of a negative output gap of around 4 per cent at the end of 2009, and assuming a trend growth rate of around 2.3 per cent a year prior to this point, would imply that a large positive output gap had opened up in the years preceding the recession, reaching over 5 per cent by 2007. This would, in turn, imply that the structural position of the public finances prior to the crisis was worse than estimated at the time. This is illustrated in the chart.

Output gap[1] based on alternative trend growth assumptions



[1] *Actual output less trend output as a percentage of trend output. Non-oil GVA basis.*
[2] *Alternative scenario based on output gap of around –4 per cent at the end of 2009 and long-run average growth rate of 2.3 per cent.*

Source: HM Treasury.

Many external forecasters have assumed the crisis negatively affected trend output. Indicators of the cyclical position of the economy prior to the recession also point to a somewhat smaller output gap than implied by the alternative scenario. However, the previous Government's assumptions about trend growth before the crisis were at the upper end of external estimates and many commentators have suggested that the economy was further above trend by 2007 than was assumed in the March Budget. For example, the OECD has estimated that the UK economy was just under 2 per cent above trend in 2007, compared with the March Budget estimate of around ¼ per cent.

[a]*OECD Economic Outlook No.87*, OECD, May 2010.

Fiscal forecast

1.51 Table 1.3 provides a summary of the OBR's central forecast for the public finances. Further detail is provided in Annex C.

Table 1.3: Overview of OBR central fiscal forecast

.	Per cent of GDP							
	Outturn	Estimate	Forecasts					
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Deficit								
Public sector net borrowing	6.7	11.0	10.1	7.5	5.5	3.5	2.1	1.1
Surplus on current budget	-3.5	-7.5	-7.5	-5.7	-4.0	-2.3	-0.9	0.0
Cyclically-adjusted net borrowing	6.3	8.7	7.4	5.0	3.4	1.8	0.8	0.3
Cyclically-adjusted surplus on current budget	-3.1	-5.3	-4.8	-3.2	-1.9	-0.7	0.3	0.8
Total policy decisions [1]			*0.5*	*1.0*	*1.5*	*1.9*	*2.2*	
Treaty Deficit[2]	6.8	11.3	10.1	7.6	5.6	3.6	2.2	1.2
Debt								
Public sector net debt[3]	44.0	53.5	61.9	67.2	69.8	70.3	69.4	67.4
Treaty Debt ratio[4]	55.8	71.2	78.9	83.6	85.5	84.9	83.1	80.4
Memo: Output Gap (per cent of GDP)	*-1.0*	*-4.1*	*-3.7*	*-3.5*	*-2.8*	*-2.3*	*-1.6*	*-0.9*

[1] *Equivalent to the 'Total policy decisions' line in Table 2.1, which includes debt interest savings.*

[2] *General government net borrowing on a Maastricht basis.*

[3] *Debt at end March; GDP centred on end March.*

[4] *General government gross debt on a Maastricht basis.*

Impact on fiscal position

1.52 As a result of the action the Government is taking, the OBR projects that:

- public sector net borrowing will decline from its peak of 11.0 per cent of GDP in 2009-10 to 1.1 per cent of GDP in 2015-16;
- the cyclically-adjusted or 'structural' current deficit will be eliminated by 2014-15, two years earlier than planned in the March Budget, with a projected surplus of 0.3 per cent of GDP in that year, rising to 0.8 per cent of GDP in 2015-16; and
- public sector net debt will peak at 70.3 per cent of GDP in 2013-14, one year earlier than projected in the March Budget and around 4½ percentage points lower, before declining to 69.4 per cent of GDP in 2014-15 and 67.4 per cent of GDP in 2015-16.

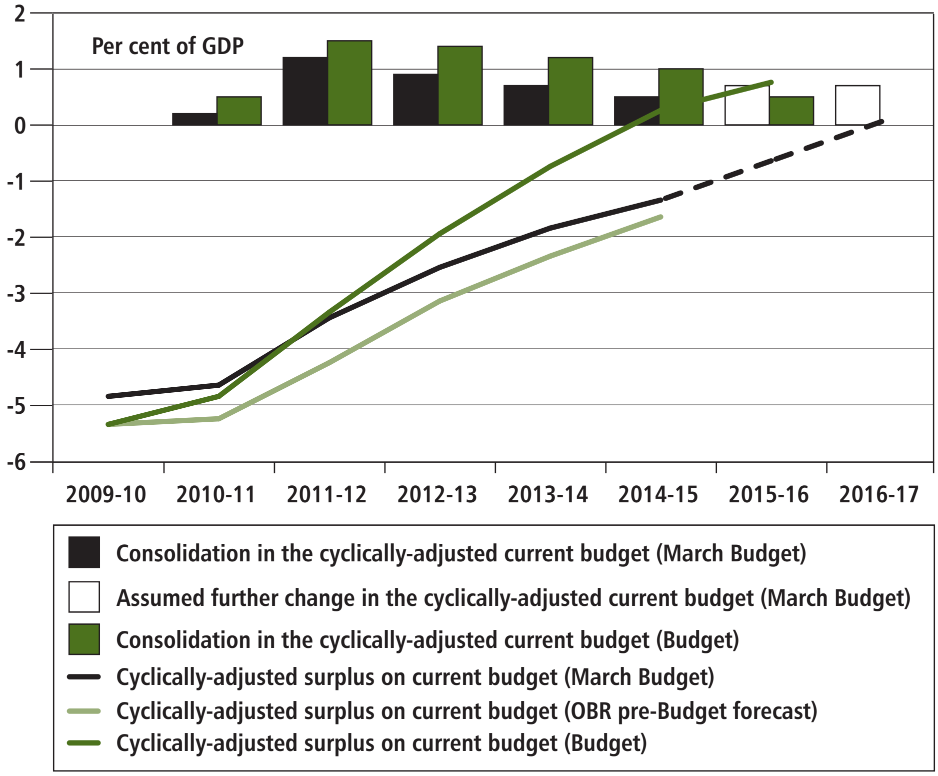
Performance against the mandate

1.53 As set out in Annex C, taking account of uncertainty, the OBR's judgement is that the policies set out in this Budget are consistent with a greater than 50 per cent chance of achieving the Government's fiscal mandate.

1.54 It is also the OBR's assessment that the Government's policies have a greater than 50 per cent chance of meeting the target for debt in 2015-16.

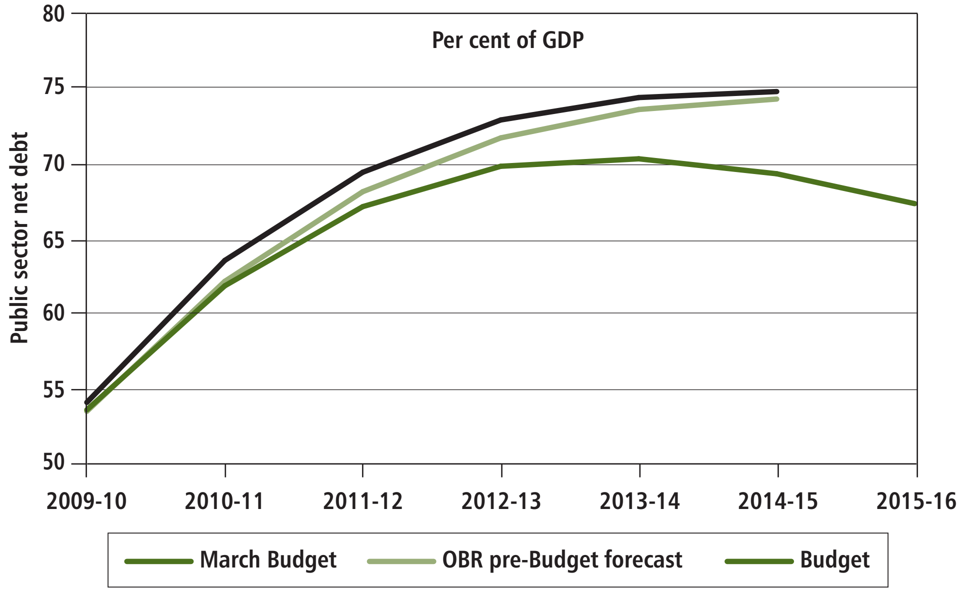
1.55 As the OBR have highlighted, all forecasts are subject to uncertainty, but this applies in particular to fiscal forecasts at the present time. Recognising this, the Government has set policy to achieve a surplus on the cyclically-adjusted current budget, so that moderate shocks can be absorbed should they arise. The OBR's central Budget forecast is for the fiscal mandate to be achieved in 2014-15, a year early. The forecast also shows the debt target being achieved a year early in 2014-15.

Chart 1.3: Consolidation in the cyclically-adjusted current budget



Source: Office for Budget Responsibility and HM Treasury.
Note: The March Budget forecast extended to 2014-15 and assumed further consolidation to 2016-17. This Budget forecasts to 2015-16.

Chart 1.4: Public sector net debt



Source: Office for Budget Responsibility and HM Treasury.

Historical and international context

1.56 Overall, the consolidation set out in this Budget reduces cyclically-adjusted public sector net borrowing by 8.4 per cent of GDP between 2009-10 and 2015-16. This is of a similar magnitude to the fiscal consolidation achieved: in the UK between 1993-94 and 1999-00, when the structural deficit was reduced by 6.5 per cent of GDP; in Sweden between 1993 and 1998, when the structural deficit was reduced by 9.4 per cent of GDP; and in

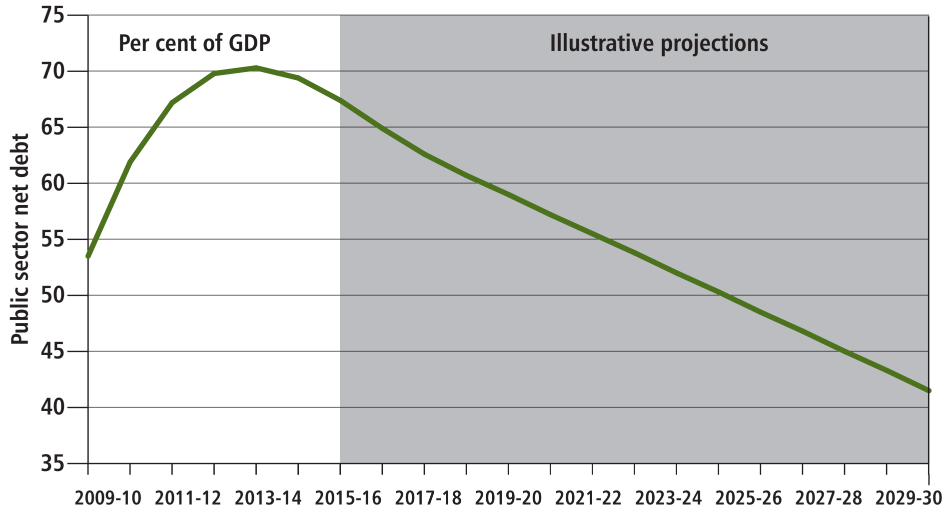
Canada between 1992 and 1999, when the structural deficit was reduced by 7.5 per cent of GDP.[15]

1.57 The Government's plans bring the UK into line with international agreements on the need for fiscal consolidation, including the June 2010 G20 Finance Ministers' conclusion that "*those countries with serious fiscal challenges need to accelerate the pace of consolidation*."[16] The path set for fiscal policy in this Budget is also consistent with the UK meeting its recommendation under the European Union's Excessive Deficit Procedure to reduce the Treaty deficit below 3 per cent of GDP in 2014-15. The Budget judgement will also restore the Treaty debt ratio to a downward path from 2013-14.

Illustrative long-term projection

1.58 Chart 1.5 shows illustrative projections for the profile of public sector net debt beyond the OBR's forecast horizon, using a set of neutral assumptions. The key assumptions are that policy neither loosens nor tightens further beyond the forecast horizon, and that interest rates and growth rates are equal. These projections are purely illustrative and do not provide a full account of long-term fiscal pressures. The interim OBR set out its initial assessment of the public sector balance sheet and fiscal sustainability, including assessing the impact of ageing, public service pensions and PFI contracts in their pre-Budget forecast report.[17]

Chart 1.5: Illustrative long-term projections



Source: Office for Budget Responsibility and HM Treasury.

[15] *IMF World Economic Outlook*, April 2010.
[16] Available at www.g20.org.
[17] See Chapter 5 of *Pre-Budget forecast*, Office for Budget Responsibility, June 2010.

Enterprise

1.59 Over recent years, the UK has become less competitive and the economy has become more dependent on growth in the public sector. The World Economic Forum's Global Competitiveness Index showed the UK's ranking falling from seventh to thirteenth place between 1997 and 2009-10.[18] If growth is to be balanced and sustainable, it needs to be based on an expansion in the private sector, not the public sector, and UK businesses need an environment which helps them compete in a global market place.

1.60 The measures in this Budget are intended to give businesses the confidence to invest for the long term, and to reduce the burden of tax and regulation. They aim to encourage firms to create new jobs and to help those out of work back into the labour market. Where small businesses continue to have problems accessing finance, measures in this Budget are designed to address this. This Budget also helps to create the right incentives for building a sustainable low-carbon economy, and for attracting private sector investment in the UK's infrastructure. This Budget seeks to make sure that all parts of the UK benefit from sustainable economic growth, especially those regions most dependent on public sector employment.

Competitiveness

Roadmap for corporate tax reform

1.61 The Government aims to create the most competitive corporate tax system in the G20. As a first step, this Budget announces a major package of reforms to reduce corporation tax rates. This Government will:

- **reduce the main rate of corporation tax from 28 per cent to 24 per cent over the course of four financial years from April 2011**. This will give the UK the lowest rate of corporation tax in the G7 and the fifth lowest rate in the G20;
- **reduce the small profits rate[19] to 20 per cent**, instead of the planned increase to 22 per cent, from April 2011;
- **reduce the capital allowances main rate from 20 per cent to 18 per cent, and the special rate from 10 per cent to 8 per cent from April 2012.** This will ensure allowances remain broadly aligned with economic depreciation rates. The manufacturing sector as a whole will pay less corporation tax as a result of the Government's reforms;
- **reduce the Annual Investment Allowance from £100,000 to £25,000 from April 2012.** It is expected that over 95 per cent of businesses will still have all their annual investment covered by this allowance;
- **reform Controlled Foreign Company (CFC) rules**, a key priority for UK multinationals. New CFC rules will be legislated in spring 2012 allowing time to consider carefully how to make the rules more competitive, to enhance long-term stability and to provide adequate protection of the UK tax base. **Consultation will take place over the summer on interim**

[18] *The Global Competitiveness Report 2009-2010*, World Economic Forum, September 2009 and *The Global Competitiveness Report 1997*, World Economic Forum, May 1997
[19] Formerly known as the small companies' rate.

improvements, to be legislated in spring 2011, to make the current rules easier to operate and where possible increase competitiveness;

- **move to a more territorial basis for taxing the profits of foreign branches**, and consult in summer 2010 on options for retaining foreign branch loss relief as part of this, reforming the rules in spring 2011; and
- **consult with business to review the taxation of intellectual property, the support R&D tax credits provide for innovation and the proposals of the Dyson Review.**[20]

1.62 The Government understands the importance of the whole corporate tax system to business and will set out a more detailed programme for reform in the autumn. This will allow it to take a considered approach to implementing tax reforms and to listen to the needs of business through greater consultation. The Government will provide greater certainty for business by committing to principles for corporate tax reforms. In particular, it intends to develop its view that in general a broad tax base, a low rate and a more territorial approach will improve competitiveness. **It will establish a business forum, chaired by the Exchequer Secretary to the Treasury, to consult with multinational businesses on the UK's tax competitiveness**, including the long-term aims of reform of the corporate tax system.

Bank levy

1.63 Alongside these reforms, **the Government will introduce a levy based on banks' balance sheets from 1 January 2011, intended to encourage banks to move to less risky funding profiles**. The Government believes that banks should make a fair contribution in respect of the potential risks they pose to the UK financial system and wider economy. Final details of the levy will be published later this year, following consultation. The levy will result in a rebalancing of the burden of taxation between banking and other sectors.

Tax policy making

1.64 Tax competitiveness is not just about rates and incidence of tax. Predictability, stability and simplicity are also important. **Alongside this Budget, the Government is publishing proposals to improve the way tax policy is made to support these objectives.**[21] **The Government also confirms its intention to create an independent Office of Tax Simplification and will announce further details shortly.**

Deregulation

1.65 The volume and complexity of regulation can damage UK competitiveness. The Government has announced that it will reduce regulatory costs by introducing a one-in-one-out system for new regulations. The Department for Business, Innovation and Skills will publish more detail in July 2010. The Government's plans for reducing burdens include:

- fundamentally reviewing all regulation scheduled for introduction over the coming year. **These regulations will not be implemented until they have been reviewed and re-agreed by the Reducing Regulation Committee;**
- imposing sunset clauses on regulations. **Regulations will cease to be law after seven years unless Parliament has confirmed they are**

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[20] *Ingenious Britain: Making the UK the leading high tech exporter in Europe*, James Dyson, March 2010

[21] *Tax policy making: a new approach*, HM Treasury and HMRC, June 2010

still necessary and proportionate, or they were explicitly set to have a longer timeframe;

- **requiring each relevant Department to start immediately a review of the employment laws for which they are responsible** to ensure maximum flexibility, protect fairness and promote competitiveness. Changes to employment law will be made as part the Government's one-in-one-out approach to regulatory reform; and
- working with European partners to ensure that new proposals for EU regulation are rigorously costed at an early stage, and that existing legislation is reviewed with the aim of reducing the burden on European businesses.

Employment and enterprise

National Insurance Contributions

1.66 The Government will promote employment by reducing the cost of retaining and hiring staff. The Government inherited plans for National Insurance rates to increase by 1 per cent in April 2011. **The negative effect of the employer rate rise will be largely reversed by increasing the threshold for employer National Insurance Contributions (NICs) by £21 a week above indexation.** As a result, the number of employees for whom employers pay no NICs will rise by 650,000. This will benefit a number of sectors, including manufacturing.

Business rates

1.67 Business rates can be a significant cost, particularly for smaller businesses. The Government has already legislated to freeze payments of certain significant backdated business rates bills until April 2011, including for businesses in ports. To resolve this issue, **it will bring forward legislation to cancel such bills for newly assessed properties that were split from a larger rateable property**. Legislation will also now be laid for a temporary increase in the level of small business rate relief, for one year from October 2010. It is estimated that over half a million businesses across England will benefit.

Procurement and SMEs

1.68 As part of introducing greater transparency in the way that it does business, the Government plans to promote small business procurement by publishing central Government tenders online and free of charge. This facility will be made available by the end of 2010.

Small business tax review

1.69 The Government remains committed to a review of IR35 and small business tax and will release further details shortly.

Business finance

1.70 Small and medium-sized enterprises (SMEs) are fundamental to the economic recovery and to tackling unemployment. However, some SMEs continue to have problems accessing the affordable finance they need. To address this, the Government is announcing measures to help SMEs access the funds that they need.

Bank lending to SMEs

1.71 The Government is clear that UK banks need to promote lending to SMEs. The banking industry has today published a new set of principles that the high street banks will follow when lending to SMEs. The Government will also be working with the banking industry on the disclosure of regional lending data.

Enterprise Finance Guarantee

1.72 The Enterprise Finance Guarantee (EFG) supports lending to viable small businesses that lack sufficient collateral or the financial track record to access a normal commercial loan. To ensure that more businesses have access to credit as the economy recovers, **the EFG facility for this year is being increased by £200 million to support additional lending of up to £700 million for small businesses until 31 March 2011. In addition, a processing target of 20 business days will be introduced for all major lenders participating in the EFG.** This will provide certainty for businesses about how long their applications will take to process.

SME non-bank finance

1.73 The Government will create the Growth Capital Fund. This is to address the Rowlands Review findings that, for some fast-growing SMEs, capital for growth is not being provided by the market and that this problem was exacerbated by the recession.[22] To support small businesses with high growth potential, a new Enterprise Capital Fund is being launched. This new Fund will form part of the existing £237 million programme of Enterprise Capital Funds and will provide an extra £37.5 million in equity finance. It will be funded through a £25 million Government contribution and £12.5 million in private co-investment.

Green Paper on business finance

1.74 The Government wants to ensure that the banking system and financial markets meet the needs of the economy over the long term. **This Budget therefore announces that the Government will publish a Green Paper on business finance before the summer recess.** The paper will consider the broad range of finance options for businesses of different sizes including bank lending, equity and corporate debt. It will invite views from business, investors and lenders on priorities and approaches to enhancing the access of credit-worthy businesses to appropriate sources of finance.

Low-carbon economy

1.75 Climate change is one of the most serious threats that the world faces. The Prime Minister has pledged to make this the greenest government ever, including reducing the Government's own emissions by 10 per cent between mid-May 2010 and mid-May 2011.

1.76 The Government is committed to playing its part in moving to a low-carbon economy. The transition will change the shape of industry, growth and jobs. As part of this, the UK needs £200 billion of investment to 2020 to provide secure low-carbon energy. This will require reform of the energy market and action to attract additional private sector funding.

Carbon price

1.77 Alongside wider market reforms, the Government will assess how the energy tax framework can provide the right incentives for investment. **In the autumn, the Government will publish proposals to reform the climate change levy in order to provide more certainty and support to the carbon price. Subject to consultation, the Government intends to bring forward relevant legislation in Finance Bill 2011.**

[22] *The Provision of Growth Capital to UK Small and Medium-Sized Enterprises*, BIS, November 2009

Green Investment Bank

1.78 The Government is also determined to address other barriers to investment in the low-carbon economy. **Following the Spending Review, the Government will put forward detailed proposals on the creation of a Green Investment Bank to help the UK meet the low-carbon investment challenge.** The Government is considering a wide range of options for the scope and structure of the Green Investment Bank. The options will be evaluated for effectiveness, fiscal affordability and transparency.

Green Deal for households

1.79 The Government will establish a Green Deal for households through legislation in the Energy Security and Green Economy Bill, to help individuals invest in home energy efficiency improvements that can pay for themselves from the savings in energy bills. These improvements provide substantial and cost-effective carbon reductions but the initial cost can be significant, especially for low-income households. The Government will also continue to work on green financial products to provide individuals with opportunities to invest in the infrastructure necessary to support the green economy.

1.80 These measures are expected to have positive environmental impacts by enabling investment in low-carbon infrastructure and technologies. The environmental impact of Budget measures will be assessed in more detail as proposals are developed.

Infrastructure

Infrastructure investment

1.81 The Government recognises the important role investment in infrastructure plays in supporting economic growth and UK competitiveness. As the Government acts to reduce the fiscal deficit, it will continue to encourage increased funding for infrastructure projects from the private sector. It will target public sector investment in infrastructure on those projects with the greatest economic benefit for which private sector capital is not available.

1.82 As set out in the deficit reduction section of this chapter, apart from the capital element of the £6.2 billion savings in 2010-11 (worth £2 billion a year until 2015-16), the Government will make no further cuts in public sector gross investment compared with the plans that it inherited. Instead it will undertake a fundamental review of all capital spending plans to ensure they are affordable and to identify the areas of spending that will achieve the greatest economic returns.

Infrastructure UK

1.83 This Budget confirms the establishment of Infrastructure UK (IUK) to lead work within HM Treasury to enable greater private sector investment in infrastructure, and improve the Government's long-term planning and delivery. In the autumn, the Government will publish a national infrastructure plan that will set out goals for UK infrastructure. This will include priority public and private sector investments and proposals for delivering and supporting investment on a cross-sector basis. IUK will also carry out an investigation into how to reduce the cost of delivery of civil engineering works for major infrastructure projects. This will be chaired by Terry Hill (Chair of Transport Market, Arup).

Digital infrastructure

1.84 The Government will not introduce a tax on landlines. Instead, it will drive private sector investment in superfast broadband by making regulatory changes to reduce the cost of roll-out. The Government will also fund three pilots to bring superfast broadband to hard-to-reach areas while working towards a universal broadband service at two Megabits per second. These will be funded by a portion of the Digital Switchover underspend within the TV licence fee.

UK oil and gas fiscal regime

1.85 The Government recognises the importance of a stable and fair UK oil and gas tax regime that provides certainty for businesses. It will take forward discussions with the industry to ensure the regime encourages continuing investment and the exploitation of remaining resources.

Growth in all parts of the UK

1.86 The Government is determined that all parts of the UK benefit from sustainable economic growth, and that the private sector recovery is particularly strong in areas that are currently overly dependent on the public sector. The difference in real gross value added per capita growth rates between the Greater South East[23] and all other English regions widened towards the end of the last decade, from 0.6 per cent (1989-2002) to 0.7 per cent (2002-2008).

Regional growth

1.87 The Government's strategy to support private sector enterprise in all parts of the UK aims:

- to encourage the creation of private sector jobs in regions reliant on public sector employment, through reducing the cost to new businesses of employing staff. **The Government will shortly announce details of a scheme to help new businesses in targeted areas of the UK that need it most. During a three year qualifying period, new businesses which start up in these areas will get a substantial reduction in their employer National Insurance Contributions (NICs).** Within the qualifying period, these employers will not have to pay the first £5,000 of Class 1 employer NICs due in the first twelve months of employment. This will apply for each of the first 10 employees hired in the first year of business and operate in selected countries and regions[24]. Subject to meeting the necessary legal requirements, **the scheme is intended to start no later than September 2010. Any new business set up from 22 June 2010 which meets the criteria set out in the forthcoming announcement will benefit from the scheme**; and
- to help areas and communities particularly affected by reductions in public spending make the transition to private sector-led growth and prosperity, **the Government will create a Regional Growth Fund in 2011-12 and 2012-13. This Fund will operate in England only and support increases in business employment and growth.** The Devolved Administrations will be encouraged to undertake similar action.

Northern Ireland

1.88 The Government will publish a consultation paper, in autumn 2010, on rebalancing the Northern Ireland economy. This will include examining proposals for economic enterprise zones, possible mechanisms for changing the corporation tax rate and other economic reform options. The Government will consult the Northern Ireland Executive fully as the paper is prepared.

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[23] London, the South East and the East of England.
[24] The measure would apply in Scotland, Northern Ireland and Wales, and the following English regions: the North West, North East, Yorkshire and Humber, West Midlands, East Midlands and South West.

Local enterprise partnerships

1.89 The Government will enable locally-elected leaders, working with business, to lead local economic development. As part of this change, Regional Development Agencies will be abolished through the Public Bodies Bill. **A White Paper later in the summer will set out details of these proposals. As part of this, the Government will:**

- **support the creation of strong local enterprise partnerships**, particularly those based around England's major cities and other natural economic areas, to enable improved coordination of public and private investment in transport, housing, skills, regeneration and other areas of economic development;
- **consider the most appropriate framework of incentives for local authorities to support growth**, including exploring options for business rate and council tax incentives, which would allow local authorities to reinvest the benefits of growth into local communities; and
- as part of the shift to a more locally driven planning regime, **promote the role for a simplified planning consents process in specific areas where there is potential or need for business growth, through use of Local Development Orders**.

Fairness

1.90 The Government is committed to creating a fair and responsible tax and benefit system that rewards work and promotes economic competitiveness.

1.91 To achieve these objectives the tax and benefit framework must incentivise work and tackle welfare dependency. More than five million households are currently dependent on benefits, and spending on social security and tax credits has increased by 45 per cent, around £60 billion, in real terms over the past 10 years.[25] Despite these levels of spending, performance in tackling poverty and inequality has stalled or deteriorated. The Government believes this is neither fair nor affordable. A fair and responsible benefit system supports those in most need, without creating dependency for those who would be better off in work. A fair tax system should reward work for those on lower incomes while ensuring that those on higher incomes pay their fair share of tax.

1.92 This Budget sets out immediate tax and benefit reforms to address these challenges. This Budget announces measures to: support low and middle-income earners; tackle welfare dependency and unaffordable spending; support the most vulnerable; and encourage personal responsibility. The measures set out in this Budget will reduce overall expenditure and tackle unfair payments while recognising the needs of pensioners and low-income families with children.

[25] Public Expenditure Statistical Analysis 1995-2010 and the June Budget for the 2009-10 outturns. The 10 years in question are 1999-2000 to 2009-10 and the figures are in 2010-11 prices using a GDP deflator.

Personal tax

Personal allowance

1.93 The Government is committed to increasing support for lower and middle income earners and improving the rewards to work, and has a long term objective to raise the personal allowance to £10,000 with real terms progress towards that goal every year. This Budget announces **that the personal allowance for under 65s will be increased by £1,000 to £7,475 in 2011-12.** As a result, the Government estimates that the 880,000 lowest income taxpayers will be removed from tax altogether, and 23 million taxpayers will benefit by up to £170 per year.[26]

1.94 To ensure that support will be focused on those on low and middle incomes the Government will reduce the level of the basic rate limit. The National Insurance Upper Earnings/Profit Limit will also be reduced to keep it aligned with the income tax higher rate threshold. Based on current Retail Prices Index (RPI) forecasts the basic rate limit will be reduced by £2,500 and the higher rate threshold by £1,650 below plans the Government inherited. Exact figures will be confirmed in the autumn. These changes will mean that higher rate-taxpayers will not benefit from this measure.

Basic rate limit

1.95 To help fund increases in the personal allowance, and ensure that those on higher incomes pay their fair share, **the basic rate limit for income tax will be frozen in 2013-14**.

Capital gains tax

1.96 As set out in the Coalition Agreement, to partly fund the increase to the personal allowance, increase fairness and reduce tax avoidance the Government will reform capital gains tax to align it more closely with income tax rates. Effective from 23 June 2010, **capital gains tax will rise from 18 to 28 per cent for those with total income and taxable gains above the higher rate threshold**. This strikes the right balance between fairness and international competitiveness. A substantial part of the revenue from this measure comes from higher income tax receipts as the incentive to convert income into capital gains is reduced. Basic rate taxpayers will continue to pay an 18 per cent rate on their gains. **The 10 per cent capital gains tax rate for entrepreneurial business activities will be extended from the first £2 million to the first £5 million of qualifying gains made over a lifetime. The Government confirms that the annual exempt amount for capital gains tax will continue to rise in line with inflation and will remain at £10,100 for 2010-11.**

50p rate of income tax

1.97 The 50p rate of income tax took effect from April 2010 and will remain in place for the time being.

Taxation of non-domiciled individuals

1.98 As announced in the Coalition Agreement, **the Government will review the taxation of non-domiciled individuals**. This will assess whether changes can be made to the current rules to ensure that non-domiciled individuals make a fair contribution to reducing the deficit, in return for greater certainty and stability for those bringing skills and investment to the UK.

Bank bonuses

1.99 In addition to introducing a bank levy, the Government is taking action to tackle unacceptable bank bonuses. The Independent Commission on

[26] Estimates calculated using HMRC Personal Tax Model, based on 2007-08 Survey of Personal Incomes data projected to 2011-12 and modelling assumptions.

Banking will look at structural and non-structural measures to reform the banking system and promote competition. The Government will also consult on a remuneration disclosure scheme and, working with international partners, will explore the costs and benefits of a Financial Activities Tax on profits and remuneration. The Government has also asked the Financial Services Authority as part of its forthcoming review of its Remuneration Code to:

- **consider imposing more stringent requirements on the deferral and award of variable pay;**
- **examine mechanisms for strengthening the link between performance and remuneration to ensure that incentives are aligned with the long-term performance of the firm; and**
- **consider how to vary capital requirements to offset risk in remuneration practices.**

The benefit and tax credit system

1.100 The Government is committed to reforming the working age benefit and tax credit system so that it is fair and affordable. The Government's reforms will reduce benefit dependency and promote work, while protecting those who are most vulnerable and have the highest level of need.

Lone parent conditionality

1.101 To support more lone parents into employment, **those with their youngest child over five will be moved onto Jobseekers Allowance rather than Income Support from 2011-12**. The Government estimates that this could move up to 15,000 lone parents into employment which will help reduce child poverty.[27] The Government does not think that lone parents with children under school age should be required to seek work.

Housing Benefit

1.102 Housing Benefit is often criticised as making excessively generous payments that damage work incentives. To address this, the Government will remove payments that trap benefit claimants in poverty instead of providing incentives to work as well as being unfair to the millions of families on low income who do not depend on welfare. **The Government will introduce a package of reforms to Housing Benefit from April 2011 onwards. This includes changing the percentile of market rents used to calculate Local Housing Allowance rates, and uprating these rates by CPI from 2013-14, capping the maximum Local Housing Allowance payable for each property size, time-limiting the receipt of full Housing Benefit for claimants who can be expected to look for work, and restricting Housing Benefit for working age claimants in the social rented sector who are occupying a larger property than their household size warrants.**

Disability Living Allowance

1.103 The Government will reform the Disability Living Allowance (DLA) to ensure support is targeted on those with the highest medical need. **The Government will introduce the use of objective medical assessments for all DLA claimants from 2013-14** to ensure payments are only made for as long as a claimant needs them.

[27] Estimate calculated using DWP benefits stock-flow model, based on 2006-09 data from the Work and Pensions Longitudinal Study, Family and Children's Study, New Deal for Lone Parents statistics, and the DWP Destinations Survey.

Tax credits and Child Benefit

1.104 This Budget announces a number of reforms to tax credits, to ensure support is targeted on those most in need by reducing unaffordable support for higher earners, and to simplify the system. As part of this package **the Government will reduce tax credit eligibility for families with household income above £40,000 from April 2011 and make further changes to this threshold in 2012-13 to focus tax credits on lower income families**. **The Government will also increase the rate at which tax credits are withdrawn once household incomes rise.** The Government will freeze Child Benefit to help fund significant above indexation increases in the Child Tax Credit which is better targeted on low-income families. This means that support will be better targeted at low-income families with children and that this Budget will have no measurable impact on child poverty in the next two years.[28] In the meantime, the Government has also asked Frank Field to lead an independent review on poverty which, among other things, will make recommendations on potential action to tackle the underlying causes of poverty and enhance life chances, consistent with the Government's fiscal strategy.

Maternity payments

1.105 From April 2011 the Government will restrict eligibility to the Sure Start Maternity Grant to the first child only and abolish the Health in Pregnancy Grant from January 2011. Mothers that are already pregnant should not be affected.

Indexation

1.106 The Government will use the CPI for the price indexation of benefits and tax credits from April 2011. The CPI provides a more appropriate measure of benefit and pension recipients' inflation experiences than RPI, because it excludes the majority of housing costs faced by homeowners (low income households are subsidised separately through Housing Benefit, and the majority of pensioners own their home outright), and differences in calculation mean it may be considered a better representation of the way consumers change their consumption patterns in response to price changes. This will also ensure consistency with the measure of inflation used by the Bank of England. **This change will also apply to public service pensions through the statutory link to the indexation of the Second State Pension. The Government is also reviewing how the CPI can be used for the indexation of taxes and duties while protecting revenues.**

State pensions and benefits

1.107 In the last Parliament, the basic State Pension was uprated by the higher of prices or 2.5 per cent. **This Government will uprate the basic State Pension by a triple guarantee of earnings, prices or 2.5 per cent, whichever is highest, from April 2011.** CPI will be used as the measure of prices in the triple guarantee, as for other benefits and tax credits. However, to ensure the value of a basic State Pension is at least as generous as under the previous uprating rules, **the Government will increase the basic State Pension in April 2011 by at least the equivalent of RPI**. To ensure the lowest income pensioners benefit from the triple guarantee, **the standard minimum income guarantee in Pension Credit will increase in April 2011 by the cash rise in a full basic State Pension**.

1.108 The Government has also committed to protect key benefits for older people, including Winter Fuel Payments, free off-peak local bus travel, eye

[28] Estimate calculated using the HM Treasury's tax and benefit microsimulation model, based on 2007-08 Family Resource Survey data projected to 2011-12 and 2012-13.

tests and prescriptions for those aged over the female State Pension Age, and free television licences for those aged over 75.

State Pension Age

1.109 Given the challenges posed by an ageing society, **the Government will review when the State Pension Age will rise to 66**. This will be supported by a call for evidence to be launched shortly. The review will be conducted quickly in recognition of the urgent need to press ahead with implementing these changes fairly. The Government will also consider future increases to the State Pension Age and how best to manage the ongoing challenges posed by increasing longevity. To ensure that those who wish to work beyond 65 are able to, **the Government will consult shortly on how it will quickly phase out the Default Retirement Age from April 2011**.

Housing costs

Council tax

1.110 The Government will work in partnership with local authorities in England to implement a council tax freeze in 2011-12.

Stamp duty land tax

1.111 As announced in the Coalition Agreement, the Government will review the stamp duty land tax relief for first time buyers taking into account its impact on affordability and value for money.

Support for Mortgage Interest

1.112 The rate at which Support for Mortgage Interest (SMI) is paid is set at 1.58 percentage points above the Bank of England Base rate, and it has been frozen at 6.08 per cent since late 2008 although interest rates have fallen significantly. To put SMI on a more sustainable footing and to better reflect mortgage costs, **SMI will be paid at the level of the Bank of England's published Average Mortgage Rate from October 2010**.

Savings and pensions

1.113 As part of its commitment to achieving a more balanced economy, the Government is committed to creating the conditions to support higher savings. For individuals and families the Government wishes to encourage financial responsibility, and saving for retirement, through well targeted and affordable support.

Financial healthcheck

1.114 The Government has asked the Consumer Financial Education Body to develop a new annual family financial healthcheck. This will be introduced in spring 2011 as part of the national financial advice service.

ISAs

1.115 It is estimated that over 20 million people currently hold an ISA.[29] **The Government confirms that it will index link the annual ISA subscription limit from 2011-12**.

Child Trust Fund & Saving Gateway

1.116 The Government announced on 24 May 2010 its intention to reduce and then stop Government contributions to Child Trust Funds. The Government also announces that **the Saving Gateway is not affordable given the need to reduce the deficit. It will therefore not be introduced in July 2010**.

Annuitisation by age 75

1.117 The Government will end the existing rules that create an effective obligation to purchase an annuity by age 75 from April

[29] HMRC estimate based on information supplied by financial institutions from April 2007 to March 2008.

2011 to enable individuals to make more flexible use of their pension savings. The Government will shortly launch a consultation on the detail of this change and will introduce transitional measures for those yet to secure a retirement income who will reach 75 in the meantime.

Pensions tax relief

1.118 The Government will continue with plans it inherited to raise revenues from restricting pensions tax relief. The Government is committed to protecting the public finances by introducing reforms that raise no less revenue than existing plans. However, it believes that the approach legislated for in Finance Act 2010 could have unwelcome consequences for pension saving, bring significant complexity to the tax system, and damage UK business and competitiveness. An alternative approach involving reform of existing allowances, principally of a significantly reduced annual allowance, might better meet the Governments objectives. Provisional analysis suggests that an annual allowance in the range of £30,000 to £45,000 would raise the necessary yield. The Government wishes to engage employers, pension schemes, experts and other interested parties to determine the best design of a regime.

Excise duties

1.119 The Government is committed to fair excise duties that contribute to deficit reduction while also encouraging personal responsibility.

Alcohol duty

1.120 The Government confirms the across the board increase in cider duty rates of 10 per cent above inflation announced in the March Budget will be reversed from 30 June 2010. Secondary legislation will be introduced shortly to increase tax on cheap, strong ciders. The Government will also review alcohol taxation and pricing and will report in the autumn. There will be no increases in the rate of duty on beer, wine or spirits at this Budget but the Government will continue with the plans it inherited to increase the rates by 2 per cent above inflation each year to 2014-15.

Fair fuel stabiliser

1.121 The Chancellor has asked the Office for Budget Responsibility to undertake an assessment over the summer of the effect of oil price fluctuations on the public finances. Informed by this assessment, the Government will examine options for the design of a fair fuel stabiliser.

Remote rural areas

1.122 Reflecting the Coalition commitment to investigate measures to help with fuel costs in remote rural areas, **the Government is considering the case for introducing a fuel duty discount in remote rural areas. This includes possible pilot schemes in Scotland.**

Air transport

1.123 The Government will explore changes to the aviation tax system, including switching from a per-passenger to a per-plane duty, which could encourage fuller planes. Major changes will be subject to public consultation.

Tax compliance

1.124 The Government is committed to maximising tax compliance by delivering a tax system that is predictable, stable and simple. The Government has published proposals to improve the way in which tax policy is made and delivered.[30]

1.125 In support of this approach, the Government will make every effort to improve tax compliance and protect revenues. **This year, HMRC will use debt collection agencies to collect £140 million of additional tax revenue from existing tax debts**.

Tax avoidance

1.126 The Government is committed to tackling tax avoidance and intends to develop strategic responses to address long-standing avoidance risks. Further details on specific measures can be found in Chapter 2. As part of this work, **the Government will examine whether, as one element of strengthened defences, there is a case for developing a General Anti-Avoidance Rule**.

[30] *Tax policy making: a new approach*, HM Treasury and HMRC, June 2010

2 Budget policy decisions

2.1 Chapter 1 explains how the measures and other decisions announced in this Budget advance the Government's long-term goals. This chapter summarises measures and decisions announced since the Government took office, with their estimated effect on government revenues and spending to 2014-15. This chapter has three sections:

- Section 2a sets out the cost or yield of all Budget decisions with a fiscal impact (Table 2.1) and provides a brief description of the main Budget measures[1], including measures announced since 11 May 2010;
- Section 2b sets out measures that were announced in the March 2010 Budget or earlier that have not yet come into effect, and which the Government confirms will be implemented. The effect of these measures on the public finances is summarised in Table 2.4; and
- Section 2c sets out information on the Civil List.

Section 2a – Budget policy decisions

2.2 Budget policy decisions are taken on tax measures, national insurance contributions (NICs) measures, measures that affect Annually Managed Expenditure (AME), and changes to Departmental Expenditure Limits (DEL). Measures that are financed from existing DEL provisions are not included. Measures that impact on the next spending review period when departmental budgets have not been set will be absorbed within the Government's spending envelope for 2011-12 onwards.

2.3 On 14 June 2010, the Office for Budget Responsibility (OBR) published an independent forecast of the public finances and the economy, incorporating all policy measures introduced or announced by the previous Government. Alongside the Budget, the OBR have published a further forecast incorporating policy measures announced at the Budget. To produce the Budget forecast, the OBR has scrutinised the Government's assessment of the direct cost or yield of Budget policy decisions that affect the economy and public finance forecasts and has made an assessment of the indirect effects of Budget measures on the economy.

[1] The number in brackets after each measure refers to the line in Table 2.1 or Table 2.4 where its costs or yield is shown.

Table 2.1: Budget policy decisions[1]

		£ million				
		2010-11	2011-12	2012-13	2013-14	2014-15
Tax measures announced at this Budget						
	1. Deficit Reduction					
1	VAT: increase main rate to 20% from 4 January 2011	+2,850	+12,100	+12,500	+12,950	+13,450
2	Insurance Premium Tax: increase standard rate to 6% and higher rate to 20% from 4 January 2011	+115	+455	+445	+455	+455
	2. Enterprise and growth					
3	Corporation Tax: decrease to 27% in 2011-12, 26% in 2012-13, 25% in 2013-14 and 24% from 2014-15 [2]	–10	–400	–1,200	–2,100	–2,700
4	Small Profits Rate: decrease to 20% from 2011-12	0	–100	–1,000	–1,300	–1,400
5	Capital allowances: decrease main rate to 18% and special rate to 8% from 2012-13	0	0	+1,000	+1,900	+1,800
6	Annual Investment Allowance: decrease to £25,000 from 2012-13	0	0	+100	+1,200	+1,000
7	Video games tax relief: not introduce	0	+40	+50	+50	+50
8	Bank Levy: introduce from January 2011	0	+1,150	+2,320	+2,500	+2,400
9	Business rates: backdated bills in 2011-12[3]	+30	–70	–15	–15	–15
10	Employer NICs: relief for new businesses in targeted regions	–50	–320	–390	–180	0
11	Employer NICs: increase threshold in 2011-12	0	–3,130	–3,150	–3,510	–3,720
	3. Fair taxes					
12	Personal allowance: increase by £1,000 in 2011-12, with adjustments to basic rate limit and upper earnings limit	0	–3,490	–3,700	–3,770	–3,910
13	Basic rate limit: freeze in 2013-14	0	0	0	+320	+740
14	Capital Gains Tax: increase rate for higher rate taxpayers to 28% and increase Entrepreneurs' Relief to £5 million from 23 June 2010	0	+725	+825	+850	+925
15	Council Tax: reduction to receipts due to a one year freeze in 2011-12[4]	0	–625	–630	–635	–640
16	Landline duty: not introduce	–90	–175	–175	–175	–175
17	Cider duty: reverse increase	–10	–15	–15	–15	–20
18	Furnished holiday lettings: reverse plans to repeal existing rules	–5	–30	–15	–10	–10
19	Managed payment plans: not introduce	0	+140	0	0	0
	Total tax policy decisions	**+2,830**	**+6,255**	**+6,950**	**+8,515**	**+8,230**
Spending measures announced at this Budget[5]						
20	Changes to current spending	+3,465	+6,835	+15,230	+21,700	+29,780
21	Changes to capital spending	+1,780	+2,020	+2,070	+2,120	+2,160
	Total spending policy decisions	**+5,245**	**+8,855**	**+17,300**	**+23,820**	**+31,940**
	Of which specific welfare measures	**+385**	**+2,010**	**+4,710**	**+8,150**	**+11,040**
22	Benefits, tax credits and public service pensions: switch to CPI indexation from 2011-12[6]	0	+1,170	+2,240	+3,900	+5,840
23	Disability Living Allowance: reform gateway from 2013-14	0	0	0	+360	+1,075
24	Lone parent benefits: extend conditionality to those with children aged 5 and above from October 2011	0	0	+50	+150	+180
25	Health in Pregnancy Grant: abolish	+40	+150	+150	+150	+150
26	Sure Start Maternity Grant: apply to first child only from 2011-12	0	+75	+75	+75	+75
27	Support for Mortgage Interest: set payments at the average mortgage rate from October 2010	+15	–75	–10	+40	+65
28	Saving Gateway: not introduce in July 2010	+10	0	+75	+110	+115
	Housing Benefit reforms:	0	+220	+600	+1,640	+1,765
29	*Local Housing Allowance: set at the 30th percentile of local rents from 2011-12*	0	+65	+365	+415	+425
30	*Deductions for non-dependents: reverse previous freezes on uprating and maintaining link with prices from 2011-12*	0	+125	+225	+320	+340
31	*Social sector: limit working age entitlements to reflect size of family from 2013-14*	0	0	0	+490	+490
32	*Switch to CPI indexation for Local Housing Allowance from 2013-14*	0	0	0	+300	+390
33	*Reduce awards to 90% after 12 months for claimants of Jobseekers Allowance*	0	0	0	+100	+110
34	*Additional bedroom for carers from 2011-12*	0	–15	–15	–15	–15
35	*Local Housing Allowance: caps on maximum rates for each property size, with 4-bed limit from 2011-12*	0	+55	+65	+70	+65
36	*Additional Discretionary Housing Payments from 2011-12*	0	–10	–40	–40	–40

	Tax credit reforms:	0	+1,180	+2,860	+3,110	+3,220
37	*Tax credits second income threshold: reduce to £40,000 from 2011-12*	0	+140	+145	+155	+145
38	*First and second withdrawal rates: increase to 41% from 2011-12*	0	+640	+710	+730	+765
39	*Child Tax Credit: taper the family element immediately after the child element from 2012-13*	0	0	+510	+515	+480
40	*Child Tax Credit: remove the baby element from 2011-12*	0	+295	+275	+270	+275
41	*Working Tax Credit: remove the 50 plus element from 2012-13*	0	0	+35	+40	+40
42	*Child Tax Credit: reverse the supplement for children aged one and two from 2012-13*	0	0	+180	+180	+180
43	*Reduce the income disregard from £25,000 to £10,000 for two years in 2011-12 then to £5,000 from 2013-14*	0	+105	+140	+340	+420
44	*Introduce an income disregard of £2,500 for falls in income from 2012-13*	0	0	+550	+560	+585
45	*New claims and changes of circumstances: reduce backdating from 3 months to 1 month from 2012-13*	0	0	+315	+320	+330
46	Child Tax Credit: increase the child element by £150 in 2011-12 and £60 in 2012-13 above indexation	0	–1,200	–1,845	–1,930	–1,995
47	Child Benefit: freeze rates for three years from 2011-12	0	+365	+695	+940	+975
48	Basic State Pension: introduce triple guarantee from 2011-12	0	0	–195	–420	–450
49	Pension Credit Minimum Income guarantee: matching basic State Pension cash increase in 2011-12	0	–415	–535	–535	–535
50	Child Trust Funds: phased abolition of Government contributions from 2010-11	+320	+540	+550	+560	+560
	TOTAL POLICY DECISIONS	**+8,075**	**+15,110**	**+24,250**	**+32,335**	**+40,170**
	Memo: debt interest savings in the next Spending Review period as a result of policy decisions	–	–820	+1,030	+1,810	+3,020
	Memo: total policy decisions excluding debt interest savings	+8,075	+15,930	+23,220	+30,525	+37,150

1 Costings reflect latest Budget 2010 economic forecast and assumptions.

2 In 2015-16 the cost will rise to £3.6 billion.

3 The 2010-11 figure results from reallocation of funding to the following year.

4 This costing is net of expected changes to council tax benefit.

5 These measures include the impact of the 2010-11 in-year savings, including capital savings from changes to Child Trust Funds. There are no further cuts to capital totals. Current savings include debt interest savings.

6 The Basic State Pension will be increased by the equivalent of RPI in 2011-12.

Box 2.1 Transparency of policy costings

This Budget increases the level of transparency around the policy costings shown in Table 2.1 consistent with the Governments commitment to increase transparency in public life. The methodology underlying the calculation of the fiscal impact of each Budget policy decision is set out in detail in the supplementary document *Budget 2010 policy costings,* published alongside this Budget.

The number of years presented in Table 2.1 has been extended to show five full years through to 2014-15.

Annex A of the *Budget 2010 policy costings* supplementary document explains in detail the underlying indexation assumption for each tax and benefit, including pre-announcements.

Public spending

Comprehensive Spending Review 2007 Departmental Expenditure Limits

2.4 The allocation of Departmental Expenditure Limits (DEL) for 2008-09, 2009-10 and 2010-11 is shown in Table 2.2. In line with previous practice, resource and capital DEL reflects the latest available information and includes an allowance for shortfall reflecting likely underspends against departmental provisions.

2.5 The DEL budgets shown in Table 2.2 reflect:

- policy decisions contained in this Budget;
- reductions to 2010-11 DEL budgets as a result of the £6.2 billion savings package;
- technical classification changes arising from the implementation of the Alignment (or 'Clear Line of Sight') project. These classification changes, which are largely a consequence of removing transactions previously recorded as non-cash from the DEL boundary, have the effect of reducing DEL in all years. However, the adjustments have no impact on the purchasing power of departments or the planned level of expenditure, nor do they impact on the fiscal aggregates; and
- other classification or budgetary changes, which have no impact on National Accounts definitions.

Waste and inefficiency

£6.2billion savings

2.6 The Government will deliver £6.2 billion of savings in 2010-11 to start to tackle the budget deficit and to bear down on waste and inefficiency across the public sector.

Efficiency and Reform Group

2.7 The Efficiency and Reform Group (ERG) has been set up within the Cabinet Office drawing on expertise within Government. It will support departments in renegotiating contracts and will oversee an immediate freeze on unnecessary spending on consultancy, advertising and new ICT spend over £1 million.

Table 2.2: Departmental Expenditure Limits - resource and capital budgets

	£ billion					
	Departmental Expenditure Limits			Impact of Alignment Project classification changes[1]		
	Outturn 2008-09	Estimate 2009-10	Plans 2010-11	Outturn 2008-09	Estimate 2009-10	Plans 2010-11
Resource DEL						
Education	46.8	49.6	50.9	0.0	0.1	0.0
Health	90.3	97.6	101.5	-2.0	-2.1	-2.6
of which: NHS England	88.8	96.0	99.5	-2.0	-2.1	-2.6
Transport	5.8	7.0	6.4	0.5	0.1	-0.4
CLG Communities	4.1	4.3	3.8	-0.1	-0.2	-0.1
CLG Local Government	24.7	25.5	26.0	0.0	0.0	0.0
Business, Innovation and Skills	17.9	19.2	19.2	-0.2	-0.3	-0.1
Home Office	9.2	9.5	9.4	0.0	0.0	0.0
Justice	9.2	9.6	9.1	0.1	-0.3	-0.3
Law Officers' Departments	0.7	0.7	0.7	0.0	0.0	0.0
Defence	32.6	35.2	36.0	-4.1	-3.9	-4.3
Foreign and Commonwealth Office	2.0	2.2	2.0	-0.1	-0.1	-0.1
International Development	4.8	5.3	6.1	0.0	-0.1	-0.1
Energy and Climate Change	0.3	1.2	1.2	-0.1	0.0	0.0
Environment, Food and Rural Affairs	2.4	2.5	2.4	-0.2	-0.1	-0.1
Culture, Media and Sport	1.5	1.6	1.5	-0.1	-0.2	-0.1
Work and Pensions	7.9	9.1	8.8	0.0	0.0	0.0
Scotland	24.1	25.1	25.7	-0.5	-0.5	-0.5
Wales	12.8	13.6	13.9	-0.1	-0.3	-0.2
Northern Ireland Executive	7.9	8.8	8.6	-0.1	-0.2	-0.1
Northern Ireland Office	1.2	1.1	1.2	-0.2	-0.1	0.0
Chancellor's Departments	4.5	4.5	4.1	0.0	-0.1	-0.1
Cabinet Office	2.0	2.2	2.3	-0.1	-0.1	-0.1
Independent Bodies	0.8	0.8	1.0	0.0	-0.1	0.0
Modernisation Funding	0.0	0.0	0.2	0.0	0.0	0.0
Reserve	0.0	0.0	0.6	0.0	0.0	0.0
Allowance for shortfall	0.0	-1.4	0.0	0.0	0.0	0.0
Total resource DEL	**313.5**	**334.8**	**342.7**	**-7.2**	**-8.4**	**-9.1**
Capital DEL						
Education	5.5	7.5	6.7	0.0	0.0	0.0
Health	4.4	5.4	4.9	0.0	0.0	0.0
of which: NHS England	4.2	5.2	4.7	0.0	0.0	0.0
Transport	7.3	8.3	7.2	0.0	0.0	0.0
CLG Communities	7.1	9.2	6.2	0.0	0.1	0.0
CLG Local Government	0.1	0.2	0.0	0.0	0.0	0.0
Business, Innovation and Skills	2.1	3.0	2.0	0.0	0.0	0.0
Home Office	0.8	1.0	0.8	0.0	0.0	0.0
Justice	0.9	0.9	0.6	0.0	0.0	0.0
Law Officers' Departments	0.0	0.0	0.0	0.0	0.0	0.0
Defence	9.0	9.2	10.1	0.3	0.0	0.0
Foreign and Commonwealth Office	0.2	0.2	0.2	0.0	0.0	0.0
International Development	0.9	1.3	1.6	0.0	0.0	0.0
Energy and Climate Change	1.7	1.9	1.9	0.0	0.0	0.0
Environment, Food and Rural Affairs	0.6	0.7	0.5	0.0	0.0	0.0
Culture, Media and Sport	0.8	0.6	0.5	0.0	0.0	0.0
Work and Pensions	0.1	0.3	0.2	0.0	0.0	0.0
Scotland	3.3	3.9	3.2	0.0	0.0	0.0
Wales	1.6	1.9	1.7	0.0	0.0	0.0
Northern Ireland Executive	1.2	1.2	1.1	0.0	0.0	0.0
Northern Ireland Office	0.1	0.1	0.1	0.0	0.0	0.0
Chancellor's Departments	0.3	0.4	0.3	0.0	0.0	0.0
Cabinet Office	0.4	0.5	0.3	0.0	0.0	0.0
Independent Bodies	0.0	0.0	0.1	0.0	0.0	0.0
Reserve	0.0	0.0	1.5	0.0	0.0	0.0
Allowance for shortfall	0.0	-1.2	0.0	0.0	0.0	0.0
Total capital DEL	**48.5**	**56.6**	**51.6**	**0.3**	**0.1**	**0.0**
Depreciation	11.6	13.3	14.3	0.0	0.0	-0.6
Total Departmental Expenditure Limits	**350.4**	**378.0**	**380.0**	**-6.9**	**-8.5**	**-8.4**

Note: The budgetary transfers from the Northern Ireland Office to the Northern Ireland Executive arising from the devolution of policing and justice powers are to be effected in Supplementary Estimates, and therefore are not reflected in this table.

[1] *For further details on the Alignment (or "Clear Line of Sight") Project, please see paragraph 2.6.*

Review of spending commitments

Spending re-approvals **2.8** All significant items of spending inherited by the Government, which were agreed between 1 January 2010 and the election, have now been reviewed. Of these items, 12 have been cancelled, which carry a total lifetime cost of nearly £2 billion. A further 12, that would have cost £8.5 billion over their lifetime, have been suspended to be considered at the Spending Review.

Review of EYF commitments and DEL Reserve **2.9** The Government inherited very substantial commitments whose funding was dependent on underspending this year through the End of Year Flexibility system or additional funding from the Reserve. This level of underspending is not expected to materialise and the Government is reviewing EYF commitments.

Asset sales

Asset sales **2.10** In addition to launching the sale of High Speed 1, as part of a wider programme of asset commercialisation over the next 12 months the Government will:

- facilitate a capital injection into the Royal Mail Group;
- resolve the future of the Tote in a way that secures value for the taxpayer while recognising the support the Tote currently provides the racing industry;
- announce its decision on selling part of the student loan portfolio, including looking at the options for early repayment for individuals, in light of Lord Browne's review of higher education finance;
- release the 800MHz and 2.6GHz spectrum to support super-fast mobile services. A decision on the approach will be made before recess; and
- explore with other shareholders the options for a potential sale process in NATS.

2.11 At the conclusion of the Spending Review, decisions will be made on the future capacity at the Dartford Crossing, and the possibilities for letting out a concession.

The Spending Envelope and Spending Review

Path of spending **2.12** Table 2.3 sets out the path for Total Managed Expenditure (TME), Public Sector Current Expenditure (PSCE) and Public Sector Gross Investment (PSGI) to 2015-16. TME will fall in real terms by 4 per cent over the period; PSCE will fall by 1 per cent; and PSGI will fall by 31 per cent. (20) (21)

Spending Review **2.13** The Spending Review will be published on 20 October 2010 and will set out spending plans for the years 2011-12 to 2014-15.

2.14 Table 2.3 shows the fixed envelopes for the current and capital spending included within the Spending Review. The final allocation between DEL and AME – and the allocation of DEL between departments – will be set at the Spending Review.

2.15 As set out in the Spending Review Framework[2], published on 8 June 2010, the Government will evaluate spending programmes against tough criteria on ensuring value for money. This will ensure a clear focus on prioritising resources to meet the Government's objectives within tighter budgets.

2.16 Capital DEL allocations will be made on the basis of a fundamental review of spending plans, which will identify the areas of spending that will achieve the greatest economic returns.

2.17 The Government's national engagement programme will give public sector workers and members of the public an opportunity to feed in their ideas for reducing spending. An online event will launch on the 24 June 2010 inviting public sector workers to submit their suggestions. Following this, members of the public will be asked to submit their ideas online. The Government will take forward the most promising ideas as part of the Spending Review process.

Table 2.3: Total Managed Expenditure

	£ billion							
	Outturn	Estimate		Forecasts				
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
CURRENT EXPENDITURE								
Resource Annually Managed Expenditure	251.3	265.8	294.6	308.0	323.1	337.4	355.0	371.4
Implied Resource Departmental Expenditure Limits[1,2]	313.5	334.8	342.7	343.1	341.4	341.2	337.7	340.0
Public sector current expenditure	**564.7**	**600.6**	**637.3**	**651.1**	**664.5**	**678.6**	**692.7**	**711.4**
CAPITAL EXPENDITURE								
Capital Annually Managed Expenditure	16.6	12.1	7.8	7.3	6.9	6.3	6.2	5.2
Implied Capital Departmental Expenditure Limits[1,2]	48.5	56.6	51.6	41.4	39.6	37.0	38.7	40.8
Public sector gross investment	**65.1**	**68.7**	**59.5**	**48.7**	**46.5**	**43.3**	**44.9**	**46.1**
Less public sector depreciation	-18.7	-19.7	-20.6	-21.6	-22.5	-23.4	-24.3	-25.2
Public sector net investment	**46.4**	**49.0**	**38.9**	**27.2**	**24.0**	**19.9**	**20.6**	**20.9**
TOTAL MANAGED EXPENDITURE[3]	**629.8**	**669.3**	**696.8**	**699.8**	**711.0**	**722.0**	**737.5**	**757.5**
Spending Envelope for Spending Review 2010				639.6	644.7	649.3	658.7	
Of which:								
Resource spending envelope				591.6	598.9	606.7	614.5	
Capital spending envelope				48.0	45.8	42.6	44.1	

[1] *Incorporates changes from the Alignment (or "Clear Line of Sight") Project, please see paragraph 2.6.*

[2] *Implied DEL numbers from 2011-12 onwards. Calculated as the difference between Resource AME and PSCE in the case of Resource DEL, and between Capital AME and PSNI in the case of Capital DEL.*

[3] *TME is equal to the sum of PSCE and PSGI, on a basis which excludes temporary effects of financial interventions.*

Public sector pay and pensions

Public sector pay

2.18 A two year pay freeze will be introduced from 2011-12 for public sector workforces, except for those earning £21,000 or less, who will receive an increase of at least £250 a year. This will save £3.3 billion a year by 2014-15.

2.19 Pay will also be frozen in 2010-11 for civil servants who are yet to agree a legally binding pay deal, except for those earning £21,000 or less, who will receive at least £250 a year. These civil servants will then exit the freeze ahead of other groups.

[2] The Spending Review framework (Cm 7872), June 2010, is available at www.hm-treasury.gov.uk

Public service pensions 2.20 An independent commission chaired by John Hutton, formerly Secretary of State for Work and Pensions, will undertake a fundamental structural review of public service pension provision by Budget 2011 and consider the case for short-term savings in the Spending Review period by September 2010.

Other measures

Euro preparations 2.21 The Government has clearly stated that it will not join or prepare to join the euro in this Parliament. Government departments have been instructed to cease all work relating to euro preparations and not to spend money on euro compatibility in procurement. Staff engaged in this work are being transferred to other duties.

Personal tax and benefits

Income tax personal allowances 2.22 The personal allowance for under 65s will increase by £1,000 to £7,475 in 2011-12, with a corresponding decrease in the levels at which the 40 per cent higher rate of tax and the two per cent rate of NICs are paid, to ensure that the majority of higher rate taxpayers will pay the same total level of tax and National Insurance Contributions as previously planned. (12)

Basic rate limit 2.23 The basic rate limit for income tax will be frozen in 2013-14. (13)

Employer NICS 2.24 The secondary NICs threshold will be increased by £21 per week in addition to indexation from April 2011. (11)

PAYE 2.25 The Pay As You Earn (PAYE) system is a fundamental part of the UK tax system. The Government wishes to explore how it could be improved in order to reduce costs and make the system easier for employers and HMRC to administer. As an initial step, the Government intends to consult with employers and payroll providers on mechanisms that could support more frequent or real time PAYE data.

Managed Payment Plans 2.26 The Government will defer implementation of Managed Payment Plans, which would allow taxpayers to pay self-assessed income tax and corporation tax in a series of monthly instalments either side of the theoretical due date. (Budget 2009) (19)

Pensions tax – annual allowance 2.27 The Government will restrict the generosity of pensions tax relief. The Government is committed to protecting the public finances by introducing reforms that raise no less revenue than has already been accounted for in the public finances over the forecast period, and in steady-state in subsequent years. It believes an alternative approach to the high income excess relief charge legislated for in Finance Act 2010, involving reform of existing allowances, principally a significantly reduced annual allowance, might better meet the Government's objectives. Provisional analysis suggests that an annual allowance in the range of £30,000 of £45,000 would raise the necessary yield. The Government intends to introduce legislation in the Finance Bill after the Budget to bring in powers to repeal the measure legislated for in Finance Act 2010. (j) (k)

Tax rules for foster carers 2.28 The capital allowance rules for foster carers will be amended to ensure that they operate consistently and as intended for all carers. Legislation will be in the Finance Bill introduced in the autumn and will take effect from Royal Assent.

Interest: deduction of tax **2.29** Legislation will be in the Finance Bill introduced in the autumn to provide HMRC with a power to make regulations to amend the rules on the collection of income tax deducted at source from interest and similar payments.

Non-domiciled individuals **2.30** As announced in the Coalition Agreement, the Government will review the taxation of non-domiciled individuals.

Expenses paid to MPs **2.31** Legislation will be in the Finance Bill introduced after the Budget to address the tax and NICs consequences of the new expenses scheme for Members of Parliament. It will consolidate existing tax and NICs treatments following the introduction of the Parliamentary Standards Act 2009 and the provision in that act for expenses to be administered by the Independent Parliamentary Standards Authority rather than the House Authorities. The legislation will take effect for income tax purposes from 7 May 2010.

Tax credits and benefits

Benefits uprating **2.32** From April 2011, the Consumer Prices Index (CPI) will be used for the indexation of all benefits, tax credits and public service pensions. (22)

State Pension **2.33** From April 2011, the basic State Pension will be uprated by a triple guarantee of earnings, prices or 2.5 per cent, whichever is highest. CPI will be used as the measure of prices in the triple guarantee but the basic State Pension will be uprated by the equivalent of RPI in April 2011. (48)

2.34 The Government will review the date at which the State Pension Age rises to 66. This will be supported by a call for evidence.

Default Retirement Age **2.35** The Government will consult shortly on how it will quickly phase out the Default Retirement Age from April 2011.

Pension Credit **2.36** In April 2011, the standard minimum income guarantee in Pension Credit will increase by the cash rise in a full basic State Pension. (49)

Tax credits **2.37** From April 2011, the second income threshold for the family element of the Child Tax Credit will reduce from £50,000 to £40,000 and from April 2012, the family element of the Child Tax Credit will be withdrawn immediately after the child element. (37) (39)

2.38 From April 2011, the first and second withdrawal rates for tax credits will increase to 41 per cent. (38)

2.39 From April 2011, the baby element will be removed from the Child Tax Credit and from April 2012, the 50 plus element will be removed from the Working Tax Credit. (40) (41)

2.40 In April 2011, the child element of the Child Tax Credit will increase by £150 above CPI indexation and in April 2012 it will increase by £60 above indexation. (46)

2.41 The Government will not introduce the £4 supplement in the Child Tax Credit for each child aged one and two from April 2012, which was announced at the March 2010 Budget. (42)

2.42 From April 2011, the level of in-year rises of income that will be disregarded from calculations of tax credit entitlement will decrease from £25,000 to £10,000 and from April 2013, this will be decreased further to £5,000. (43)

2.43 From April 2012, the period for which a tax credit claim and certain changes of circumstances can be backdated will be reduced from three months to one month. (45)

2.44 From April 2012, a disregard of £2,500 will be introduced in the tax credits system for in-year falls in income. (44)

Maternity payments

2.45 From January 2011, the Health in Pregnancy Grant will be abolished. (25)

2.46 From April 2011, payment of a SureStart Maternity Grant will be restricted to a first child (or children where the first is a multiple birth). (26)

Child Benefit

2.47 The rates of Child Benefit for the first and subsequent children will be frozen for three years from April 2011. (47)

Child Trust Funds

2.48 As announced on 24 May 2010, the Government will reduce and then stop Government contributions to Child Trust Funds. (50)

Support for Mortgage Interest

2.49 From October 2010, the standard interest rate used to calculate Support for Mortgage Interest payments will be set at a level equal to the Bank of England's published monthly Average Mortgage Rate. (27)

Housing Benefit

2.50 From October 2011, Local Housing Allowance rates will be set at the 30th percentile of local rents. (29)

2.51 Deductions for non-dependents will be uprated in April 2011 on the basis of prices. This will reverse the freeze in these rates since 2001-02. (30)

2.52 From 2013-14, Local Housing Allowance rates will be uprated in line with CPI. (32)

2.53 From April 2013, housing entitlements for working age people in the social sector will reflect family size. (31)

2.54 Housing Benefit awards will be reduced to 90 per cent of the initial award after 12 months for claimants receiving Jobseekers Allowance. This will be introduced in April 2013. (33)

2.55 From April 2011, Housing Benefit claimants with a disability and a non-resident carer will be entitled to funding for an extra bedroom. (34)

2.56 From April 2011, Local Housing Allowance Rates will be capped at £250 per week for a one bedroom property, £290 per week for a two bedroom property, £340 per week for a three bedroom property and £400 per week for four bedrooms or more. (35)

2.57 The Government contribution to Discretionary Housing Payments will be increased by £10 million in 2011-12 and £40 million in each year from 2012-13. (36)

Disability benefits

2.58 From 2013-14, an objective medical assessment will be introduced for Disability Living Allowance. (23)

Lone parents **2.59** From October 2011, lone parents whose youngest child is aged 5 or above will be eligible for Jobseekers Allowance rather than Income Support, and existing customers will be transferred from Income Support to Jobseekers Allowance from April 2012. (24)

Other measures

Annuitisation by age 75 **2.60** The existing rules that create an effective obligation to purchase an annuity by age 75 will end from April 2011. A consultation on the detail of this change will be launched shortly. Legislation for transitional arrangements will be in the Finance Bill introduced after the Budget for those yet to secure an income who will reach 75 in the meantime.

Saving Gateway **2.61** The Government will not introduce the Saving Gateway in July 2010. (28)

Annual family financial healthcheck **2.62** The Government has asked the Consumer Financial Education Body to develop an annual family financial healthcheck, which will be delivered as part of the new national financial advice service. The healthcheck will be launched in spring 2011.

Capital, assets and property

Capital gains tax reform **2.63** Effective from 23 June 2010, capital gains tax will rise from 18 to 28 per cent for those with total taxable gains and income above the higher rate threshold. Basic rate taxpayers will continue to pay an 18 per cent rate on their gains. Legislation will be in the Finance Bill introduced after the Budget. (14)

2.64 Effective from 23 June 2010, the lifetime limit for entrepreneurs relief will be extended from £2 million to £5 million. Legislation will be in the Finance Bill introduced after the Budget. (14)

2.65 The Annual Exempt Amount for capital gains tax will remain at £10,100 for 2010-11 and will continue to rise in line with inflation.

Stamp duty land tax **2.66** The Government will review the effectiveness of the stamp duty land tax relief for first time buyers.

Business and financial services

Corporate tax reform **2.67** The Government has set out the roadmap for corporate tax reform, with further details to follow in the autumn.

2.68 The main rate of corporation tax will be reduced from 28 per cent to 24 per cent over four years. A one per cent reduction will be implemented from 1 April 2011. Legislation will be in the Finance Bill introduced after the Budget, with further reductions in subsequent Finance Bills. (3)

2.69 The small profits rate of corporation tax will be reduced from 21 per cent to 20 per cent with effect from 1 April 2011, rather than rising to 22 per cent as inherited by the Government. (4)

2.70 The Government will move to a more territorial basis for taxing the profits of foreign branches, and will consult in summer on options for retaining foreign branch loss relief as part of this. The Government plans to reform the rules in Finance Bill 2011.

2.71 The Government is committed to reforming the Controlled Foreign Company (CFC) rules and will consult on interim improvements to the current rules to be introduced in Finance Bill 2011.

2.72 The Government will consult with business in autumn 2010 to review the taxation of Intellectual Property and the support R&D tax credits provide for innovation. (t)

2.73 The Government is committed to simplifying the capital gains rules for groups of companies to a Finance Bill 2011 timetable.

Small business tax review

2.74 The Government remains committed to a review of IR35 and small business tax and will release further details shortly.

Capital allowances

2.75 From April 2012, the rate of capital allowances on the general pool of plant and machinery will be reduced from 20 per cent to 18 per cent, and the rate of allowance on the special rate pool of plant and machinery will be reduced from 10 per cent to 8 per cent. (5)

2.76 The Annual Investment Allowance will be reduced from £100,000 to £25,000 from April 2012. (6)

Video games tax relief

2.77 The Government will not introduce the tax relief for the UK video games industry. (7)

Bank levy

2.78 A bank levy based on banks' balance sheets will be introduced, following consultation, effective from 1 January 2011. It is proposed that the levy will be set at a rate of 0.07 per cent, with a lower initial rate of 0.04 per cent in 2011. (8)

Bank remuneration

2.79 The Government will explore the costs and benefits of a Financial Activities Tax. The Government has asked the FSA to consider a number of factors in its forthcoming review of its Remuneration Code. Alongside this the Government will consult on a remuneration disclosure regime.

Independent commission on banking

2.80 As announced on 16 June 2010, the Government has established an independent commission on banking, chaired by Sir John Vickers.

Asset management

2.81 The Government will hold discussions with industry and formal consultations on a range of issues concerning the asset management sector, including UCITS IV[3] implementation, introducing a tax transparent contractual fund vehicle, taxation of Investment Trust Companies and Funds Investing in Non-Reporting Funds (FINROF) regulations, and Stamp Duty Reserve Tax (SDRT) Schedule 19 in the context of investments in underlying funds.

Backdated business rates

2.82 Legislation will be introduced to cancel backdated business rates bills eligible for the 8-year schedule of payments scheme, for newly assessed properties that were split from a larger rateable property. (9)

[3] Undertakings for Collective Trusts in Transferrable Securities directive.

Insurance Premium Tax

2.83 With effect from 4 January 2011, the standard rate of Insurance Premium Tax (IPT) will increase to 6 per cent and the higher rate of IPT will increase to 20 per cent. Legislation will be in the Finance Bill introduced after the Budget. (2)

Life insurance – deficiency relief

2.84 The Government will not extend life insurance deficiency relief to the additional rates of tax. Instead the deficiency relief rules will continue as at present and will reduce tax due on income subject to the higher rate and dividend upper rate of tax only.

Furnished holiday lettings

2.85 The proposal inherited by the Government to repeal the special tax rules for furnished holiday lettings will not be implemented. Instead, the Government will consult over the summer on a proposal to ensure the tax rules meet EU legal requirements in a fiscally responsible way, by changing the eligibility thresholds and restricting the use of loss relief. Any changes will take effect from April 2011, and in the meantime the current rules continue to apply for the 2010-11 tax year. (18)

Better regulation

2.86 Regulation previously scheduled for introduction over the coming year will not be introduced unless it has been reviewed and re-agreed by the Reducing Regulation Committee. Sunset clauses will be applied to new regulation so they end after seven years unless Parliament has confirmed they are still necessary. Budget announces that departments will immediately start to review employment law as committed to in the coalition agreement. The Government will influence the EU to adopt its new approach.

Business finance

2.87 A new Enterprise Capital Fund of £37.5 million will be introduced to provide additional equity finance for small businesses.

2.88 The Enterprise Finance Guarantee will be increased to provide £200m in additional lending for small businesses until 31 March 2011.

2.89 The Government will publish a Green Paper on business finance before the summer recess.

Value Added Tax

Value Added Tax

2.90 The standard rate of VAT will increase from 17.5 per cent to 20 per cent with effect from 4 January 2011 and anti-forestalling legislation will be introduced, effective from 22 June 2010. Legislation will be in the Finance Bill introduced after the Budget. (1)

2.91 Rates under the flat rate scheme for small businesses will be increased from 4 January 2011, to reflect this change in the standard rate.

2.92 The threshold for businesses to be obliged to make VAT payments on account (currently an annual VAT liability of £2million) will be increased to maintain the status quo of the scheme. The Government will legislate for this next year.

2.93 The effective rate of five per cent for imported works of art, certain antiques, collections and collectors pieces will be maintained by changing the percentage of the value on which standard rate VAT is payable.

Shared services **2.94** Recognising the efficiencies that can be achieved by organisations such as charities sharing services and the potential VAT barrier that exists, the Government has started discussions with charities and other affected sectors to consider options for implementing the EU cost sharing exemption. It will continue those discussions and launch a formal consultation in the autumn.

Excise duties

Alcohol duty **2.95** The Government will reverse the increase in cider rates of 10 per cent above inflation, from 30 June 2010, which was previously announced in the March 2010 Budget. This will bring it in line with increases to other alcohol rates. (17)

2.96 The Government will review the taxation and pricing of alcohol to ensure it tackles binge drinking without unfairly penalising responsible drinkers, pubs and important local industries.

Tobacco duty **2.97** Technical changes will be made in the Finance Bill introduced in the autumn to the definition of cigarettes to take account of the recently revised EU tobacco directive.

Landline duty **2.98** The proposal inherited by the Government for a landline duty will not be implemented. (16)

National Lottery **2.99** As announced in the Coalition Agreement, the Government will review the taxation of the National Lottery.

Environment and transport

Fair fuel stabiliser **2.100** The Chancellor has asked the Office for Budget Responsibility to undertake an assessment over the summer of the effect of oil price fluctuations on the public finances. Informed by this assessment, the Government will examine options for the design of a fair fuel stabiliser.

Rural fuel duty **2.101** Reflecting the coalition commitment to investigate measures to help with fuel costs in remote rural areas, the Government is considering the case for introducing a fuel duty discount in remote rural areas. This includes possible pilot schemes in Scotland.

Carbon price **2.102** In the autumn, the Government will publish proposals to reform the climate change levy in order to provide more certainty and support to the carbon price. Subject to consultation, the Government intends to bring forward relevant legislation in Finance Bill 2011.

Charities

Charitable giving **2.103** The Government will continue to explore with voluntary sector representatives ways to improve the Gift Aid system and encourage charitable giving.

Substantial donors **2.104** The Government will replace the current rules on substantial charity donors and HMRC will consult informally on draft clauses in the summer, with a view to publishing final legislation in the autumn.

Local, regional and devolved administrations

Council tax **2.105** The Government will work in partnership with local authorities to implement a freeze in council tax in England in 2011-12. The Government will clarify in due course the terms under which local authorities that commit to freeze or reduce their council tax will be compensated. (15)

Local authority prudential borrowing **2.106** To ensure the fiscal risks around local authority borrowing decisions are better understood, the Government will monitor lending from the Public Works Loans Board more closely, and consider the approach taken in Scotland to increase transparency around borrowing undertaken more than two years in advance of expenditure.

Scotland **2.107** The Government reaffirms its commitment to implement the proposals of the Calman Commission in Scotland. The Government will also review the control and use of accumulated and future revenues from the Fossil Fuel Levy in Scotland.

Northern Ireland **2.108** The Government will publish a consultation paper in autumn 2010, on rebalancing the Northern Ireland economy. This will include options to promote enterprise in Northern Ireland and will examine mechanisms for changing the corporation tax rate as well as economic and public service reform.

Regional growth **2.109** To support private sector enterprise and investment in those regions that are particularly reliant on the public sector Government will:

- announce a three year scheme to exempt new businesses in targeted areas from up to £5,000 of class 1 employer National Insurance Contributions payments, for each of their first ten employees hired in their first year of business. Subject to meeting the necessary legal requirements, the Government aims to have the scheme established by September 2010. Any qualifying new business set up from today will also benefit; (10)
- create a Regional Growth Fund to fund regional capital projects in 2011-12 and 2012-13; and
- the Government will publish a White Paper later in the summer setting out its plans for a new approach to sub-national growth.

Tax compliance

Accounting derecognition **2.110** Legislation will be in the Finance Bill introduced after the Budget, with effect from Budget day, to prevent avoidance of corporation tax using accounting 'derecognition' rules in relation to loans and derivatives.

Alternative Investment Funds **2.111** Legislation will be introduced, with effect from Budget day, to prevent tax avoidance involving the creation for corporate investors of a credit for UK tax where no UK tax has been paid.

Financial securities **2.112** The Government will now consult on introducing a power for HMRC to require financial security where PAYE & NICs are at serious risk of non payment, rather than legislate in the upcoming Finance Bill as announced at the March 2010 Budget. (ac)

Life insurance **2.113** An anti-avoidance rule that applies when a transfer of business sidesteps the rules for non-profit funds with unrecognised profits will be legislated for in the Finance Bill introduced after the Budget. Additionally, legislation will be in the Finance Bill introduced in the autumn to modify the tax rules that apply to Overseas Life Insurance Companies and the application of the transfer of business rules when non-profit business is transferred to a non-EEA country.

GAAR **2.114** The Government will engage informally with interested parties to explore whether there is a case for developing a General Anti-Avoidance Rule (GAAR). This will be part of wider work on improvements to the tax policy making process.[4]

IHT on trusts **2.115** The Government will consult on bringing Inheritance tax (IHT) on trusts within the Disclosure of Tax Avoidance Schemes regime.

Stamp duty land tax **2.116** The Government will examine whether changes to the rules on stamp duty land tax on high value property transactions are needed to prevent avoidance in this area.

Section 2b – Measures announced at the March 2010 Budget or earlier

2.117 This section sets out measures announced by the previous Government at the March 2010 Budget or earlier that have not yet come into effect, and which the Government confirms will be implemented and legislated for. The fiscal event at which each policy was initially announced is in brackets.

2.118 The Government will publish a Finance Bill after the Budget to ensure swift Royal Assent for its key priorities. Given the exceptional circumstances this year, and in order to clear inherited measures in a manner consistent with proper Parliamentary scrutiny, a further Finance Bill will be introduced in the autumn. This Bill will be published in draft for comment in July and will contain those measures as specified in this chapter.

2.119 Table 2.4 shows the cost or yield of all measures announced at the March 2010 Budget or earlier which take effect from April 2011 or later. These numbers were incorporated into the pre-Budget forecast published by the OBR on 14 June 2010. Where the Government is not proceeding with a previous announcement, Table 2.1 shows the impact on the public finances.

[4] *Tax policy making: a new approach*, HM Treasury June 2010.

Table 2.4: Measures announced in the March 2010 Budget or earlier which take effect from April 2011 or later[1]

			(+ve is an Exchequer yield)			
		Head	2011-12	2012-13	2013-14	2014-15
	Measures announced in the March 2010 Budget or earlier					
a	Freeze higher rate threshold in 2012-13	Tax	0	+380	+850	+800
b	Freeze basic rate limit in 2011-12	Tax	+410	+850	+870	+960
c	Align the NICs primary threshold with baseline personal allowance from 2011-12	Tax	-1,510	-1,650	-1,800	-1,830
d	Increase NICs primary threshold in 2011-12	Tax	-1,420	-1,440	-1,590	-1,610
e	Increase main employee NICs rate by 1% from 2011-12	Tax	+3,660	+3,780	+3,990	+4,210
f	Increase additional employee NICs rate by 1% from 2011-12	Tax	+580	+610	+640	+680
g	Increase employer NICs rate by 1% from 2011-12	Tax	+4,500	+4,670	+4,940	+5,210
h	Increase main self-employed NICs rate by 1% from 2011-12	Tax	+240	+250	+250	+270
i	Increase additional self-employed NICs rate by 1% from 2011-12	Tax	+40	+40	+40	+40
j	Freeze pensions lifetime and annual allowance from 2011-12 for 5 years	Tax	+400	+450	+500	+500
k	Pensions tax: restrict tax relief[2]	Tax	+200	+3,500	+3,600	+4,600
l	Auto-enrolment: slower introduction	Tax	0	+100	+700	+1,600
m	Individual savings account: indexation from 2011-12	Tax	*	-5	-20	-50
n	SDLT: properties over £1m from 2011-12	Tax	+60	+220	+270	+310
o	Inheritance tax: freeze threshold from 2011-12 to 2014-15	Tax	+45	+135	+235	+345
p	Salary sacrifice: workplace canteens from 2011-12	Tax	+110	+110	+110	+110
q	Seafarers' Earning Deduction	Tax	-5	-5	-5	-5
r	Alcohol duty: increase in rates in 2013-14 and 2014-15	Tax	0	0	+205	+425
s	Fuel duty: increase in rates in 2014-15	Tax	0	0	0	+425
t	Patent Box from 2013-14[3]	Tax	0	0	-500	-800
u	Venture Capital Schemes: State Aid changes	Tax	-20	-30	-40	-40
v	Landfill tax: increase in 2014-15	Tax	0	0	0	+65
w	Climate change levy: reduction of relief from 2011-12	Tax	+50	+50	+50	+50
x	Company car tax: extend bands from 2012-13	Tax	0	+120	+120	+125
y	Company car tax: changes to bands and abolition of cap from 2011-12	Tax	+85	+75	+70	+65
z	Vehicle excise duty: additional exceptional rates from 2011-12	Tax	*	*	*	*
aa	EU Emissions Trading Scheme auctions: amendments from 2011-12	Tax	-10	0	0	0
ab	Aggregates levy rate: increase from 2011-12	Tax	+5	+5	+5	+5
ac	Extend financial securities from 2011-12	Tax	*	+5	+5	+5
ad	Childcare: employer supported childcare tax relief from 2011-12[4]	Tax/Spend	0	0	0	0
ae	Working tax credit: extend eligibility for over 60's from 2011-12	Spend	-20	-20	-20	-20

*Negligible

[1] *Costings reflect latest Budget 2010 economic forecast and assumptions.*

[2] *See chapter one for further details on the Governments plans for restricting pensions tax relief.*

[3] *The costs of this measure will rise to £1.1 billion in steady state.*

[4] *Employer supported childcare tax relief measure used to fund expansion of free childcare for 2 year olds.*

Income tax and NICs **2.120** The Government has inherited a number of measures which made changes to income tax and NICs rates and thresholds in 2011-12 and 2012-13. In 2011-12, these would have increased the personal allowance for under 65s by £130 below indexation and frozen the basic rate limit. The measures announced in this Budget now supercede these decisions (see paragraphs 2.22 and 2.23). In addition, as previously announced in 2011-12, the NICs primary threshold will increase and NICs rates will be increased by one per cent (2009 Pre-Budget Report). In 2012-13 the higher rate threshold (the level at which 40 per cent tax begins to be paid) will be frozen (2009 Pre-Budget Report). (a-i)

Working Tax Credit **2.121** From April 2011, people aged over 60 will qualify for Working Tax Credit if they work at least 16 hours a week, rather than 30 as currently. (March 2010 Budget) (ae)

Workplace canteens **2.122** Legislation was included in Finance Act 2010 to restrict the tax exemption for workplace canteens by removing the exemption when used in conjunction with salary sacrifice or flexible benefit arrangements. This will take effect from April 2011. (2009 Pre-Budget Report) (p)

Employer-Supported Childcare **2.123** From April 2011, the weekly amount that parents joining an Employer-Supported Childcare scheme will be able to claim exempt of income tax and disregarded of NICs will remain at £55 for basic rate taxpayers, but will be reduced to £28 and £22 per week for higher and additional rate taxpayers respectively. All current users will continue to enjoy the same exemption and disregards beyond April 2011. (2009 Pre-Budget Report) (ad)

Auto-enrolment **2.124** The Government is supportive of auto-enrolment. It has committed to reviewing private pension reforms and will be announcing details of a review shortly. (l)

Stamp duty land tax **2.125** An additional five per cent rate of stamp duty land tax will take effect for residential transactions worth over £1 million from 6 April 2011. (March 2010 Budget) (n)

Inheritance tax **2.126** The inheritance tax allowance will be frozen at its 2010-11 level of £325,000 until 2014-15. (March 2010 Budget). (o)

EU Emission Trading System **2.127** The Government intends to include nitrous oxide gases from nitric acid production in the EU Emission Trading System from 2011. (March 2010 Budget) (aa)

Landfill tax **2.128** The standard rate of landfill tax will increase by £8 per tonne each year from 1 April 2011 until at least 2014. There will be a floor under the standard rate at £80 per tonne, so that the rate will not fall below £80 per tonne from April 2014 until at least 2020. (March 2010 Budget) (v)

2.129 New qualifying criteria for lower rated wastes will be legislated in the Finance Bill introduced in the autumn, to come into effect on 1 April 2011. (March 2010 Budget)

Aggregates levy **2.130** The rate of aggregates levy will increase from £2.00 per tonne to £2.10 per tonne on 1 April 2011. (March 2010 Budget) (ab)

2.131 The Government is seeking EU State aid approval to extend the Aggregates Levy Credit Scheme in Northern Ireland for a further ten years from 31 March 2011. Legislation will be in the Finance Bill introduced in the autumn. (March 2010 Budget)

Climate change levy

2.132 From 1 April 2011, the discount from the climate change levy obtained by participating in a climate change agreement will be reduced from 80 to 65 per cent. (2009 Pre-Budget Report) (v)

2.133 The rates of climate change levy will be raised in line with inflation on 1 April 2011. (March 2010 Budget)

Fuel duty

2.134 Under plans the Government has inherited, fuel duty is scheduled to rise by one pence per litre above indexation in April 2014. (s)

Company car tax

2.135 The Government will reform company tax so that it continues to provide an incentive to purchase the lowest emitting vehicles on the market. From April 2011, the basic threshold for the 15 per cent band of company car tax will be reduced by 5 grams of carbon dioxide emitted per kilometre (g CO_2 per km), so that this band applies to cars emitting between 121 and 129g CO_2 per km. The percentage of list price subject to tax will continue to increase by one percentage point with every 5g CO_2 per km increase in emissions, to a maximum of 35 per cent. The cap on car list prices used to calculate the taxable benefit arising from company cars will also be abolished on this date, as will discounts for early uptake Euro 4-standard diesel cars, higher-emitting hybrid cars and alternative fuel company cars. (Budget 2009) (x)

2.136 From April 2012, the 10 per cent band for cars emitting 120g CO_2 per km or less will be removed, and the system of bands will be extended so that they increase by one percentage point with every 5g CO_2 per km increase in emissions, from 10 per cent. This 10 per cent band will apply to cars that emit 99g of CO_2 per km or less. (2009 Pre-Budget Report) (w)

Zero-carbon goods vehicles

2.137 Legislation will be in the Finance Bill introduced in the autumn for an enhanced capital allowance for zero-carbon goods vehicles. This will apply to vehicles purchased from April 2010, and will be in place for five years. (March 2010 Budget)

HGV VED

2.138 From April 2011, exceptional rates of vehicle excise duty will be introduced for certain heavy goods vehicles, to ensure consistency with EU regulations. The number and value of exceptional rates will be announced after the necessary exchange rate data becomes available in October. Legislation will be in the Finance Bill introduced in the autumn. (March 2010 Budget) (y)

Alcohol duty

2.139 The Government will continue with the plans it inherited to increase alcohol duty rates by two per cent above inflation each year to 2014-15. (r)

R&D tax credits IP conditions

2.140 Legislation will be in the Finance Bill introduced in the autumn to abolish the condition requiring that any intellectual property (IP) deriving from the R&D undertaken by a company which is a small or medium enterprise (SME) be owned by the company making the claim. Legislation will be effective for any expenditure incurred in an accounting period ending on or after 9 December 2009. (2009 Pre-Budget Report)

Seafarers earnings deduction

2.141 Seafarers earnings deduction will be extended to EU/EEA resident seafarers from April 2011. Legislation will be in the Finance Bill introduced in the autumn. (2009 Pre-Budget Report) (q)

Venture Capital Schemes

2.142 Legislation will be in the Finance Bill introduced in the autumn to implement changes required as a condition for the State aid approval of the Enterprise Investment Scheme (EIS), Venture Capital Trusts (VCTs) and Enterprise Management Incentives (EMI). The changes will generally have effect from a date to be appointed, with the exception of the eligible shares changes for VCTs, which will not affect monies raised by the VCT before that date. (2009 Pre-Budget Report) (u)

UK oil and gas fiscal regime

2.143 Secondary legislation will be introduced as soon as possible to extend the scope of the Ultra High Pressure High Temperature field allowance. (2009 Pre Budget Report)

2.144 Legislation will be in the Finance Bill introduced in the autumn to enable chargeable gains reinvestment relief to apply when a group company makes the reinvestment. (March 2010 Budget)

2.145 Other changes to the UK oil and gas fiscal regime previously announced will be legislated for in 2011. (2009 Pre Budget Report)

Consortium relief

2.146 Those aspects of corporation tax group relief rules that cover consortium relief will be amended to allow EU and EEA-resident companies engaged in UK consortia to pass on relief for the losses of those consortia to their UK-resident group companies. At the same time, the Government is strengthening rules designed to ensure that access to consortium relief is given only in proper proportion to the member company's involvement in the consortium. Legislation will be in the Finance Bill introduced in the autumn and both changes will have effect from the day on which draft legislation is published. (March 2010 Budget)

Capital distributions

2.147 Legislation will be in the Finance Bill introduced in the autumn to end uncertainty over the treatment of certain company distributions. Following a detailed review of distributions law, it was found that the prevailing practice of treating most distributions as income for corporation tax purposes (and not subject to the chargeable gains rules) was not correct. The legislation will restore previous expectations about the way distributions are taxed.

Shared lives carers

2.148 Legislation will be in the Finance Bill introduced in the autumn to extend foster care relief to shared lives carers, and to extend the income tax exemption for adopters to guardians, with effect from April 2010. This legislation will also ensure that from 9 December 2009, there will have been no loss of capital gains tax private residence relief where adult placement carers use part of their home exclusively for the accommodation of an adult in care. (2009 Pre-Budget Report and March 2010 Budget)

Associated company rules

2.149 With effect from 1 April 2011, legislation will be introduced in Finance Bill 2011 to reform and simplify the associated company rules as they apply to the small profits rate of corporation tax. (March 2010 Budget)

Small business rate relief

2.150 The level of small business rate relief in England will be temporarily increased for one year, from 1 October 2010, giving full relief for eligible businesses occupying premises with a rateable value of up to £6,000 and tapering relief to £12,000. (March 2010 Budget)

Savings and assets **2.151** From 2011-12 the Individual Savings Account (ISA) subscription limits will be indexed. (March 2010 Budget) (m)

2.152 Changes will be made to pensions tax legislation in the Finance Bill introduced in the autumn to enable the National Employment Savings Trust (NEST) to register as a pension scheme for tax purposes. Further legislation will be introduced in Finance Bill 2011 to remove tax charges on late contributions following auto-enrolment and to amend the tax rules on unauthorised borrowing by registered pension schemes. (March 2010 Budget)

Trusts **2.153** From 6 April 2010, where a settlor is liable to income tax on trust income at a lower rate of tax than that paid by the trustees, the settlor must pay this refund back to the trustees. These repayments will be disregarded for inheritance tax purposes. Legislation will be in the Finance Bill introduced in the autumn. (March 2010 Budget)

2.154 Legislation will be in the Finance Bill introduced in the autumn, which will apply retrospectively to 6 April 2006, to help trusts specifically set up to compensate asbestos victims, but which have been unable to access tax efficient structures for the benefit of victims. (March 2010 Budget)

Debt cap **2.155** Legislation will be in the Finance Bill introduced in the autumn to make changes to the worldwide debt cap. (March 2010 Budget)

UK-REITs **2.156** Changes will be made in the Finance Bill introduced in the autumn to allow UK-REITs to issue optional stock dividends as part of their property income distribution requirement. (March 2010 Budget)

Film tax credit **2.157** Legislation will be in the Finance Bill introduced in the autumn to correct an unintended anomaly affecting the amount of tax credit claimable where films are produced over more than one accounting period. Legislation will be effective for accounting periods ending on or after 9 December 2009. (2009 Pre-Budget Report)

Growth Capital Fund **2.158** The Government confirms that it will proceed with the establishment of a Growth Capital Fund to provide growth capital in the £2-10 million range to fast-growing SMEs currently not served by the market. (2009 Pre-Budget Report)

VAT measures **2.159** From 31 January 2011, VAT will be applied at the standard rate to certain postal services provided by the Universal Service Provider (Royal Mail), restricting the exemption to those services which Royal Mail is obliged to provide. The zero rating for passenger transport services will also be updated to reflect the status of the provider of a passenger transport service made in conjunction with postal services. Legislation will be in the Finance Bill introduced in the autumn. (March 2010 Budget)

2.160 The scope of the zero rate for aircraft will be amended in the Finance Bill introduced in the autumn, from one based on the aircraft's weight and usage to one based on the status of the customer, with the zero rate applying to aircraft bought by airlines operating for reward chiefly on international routes. As a minor change from the previous announcement, this will now take place from 1 January 2011. (March 2010 Budget)

2.161 From 1 January 2011, the scope of the VAT special rules for natural gas (which simplify the VAT treatment for businesses making wholesale supplies of gas) will be adjusted, and the rules (which also apply to electricity) will be extended to include heating and cooling networks. Legislation will be in the Finance Bill introduced in the autumn. (March 2010 Budget)

2.162 Legislation will be in the Finance Bill introduced in the autumn to protect revenues tied up in "Lennartz" schemes in existence at 22 January 2010, where the assets are used partly for business and partly for non-business purposes. From 1 January 2011, the use of Lennartz arrangements for certain assets (land and property, ships and aircraft) used partly for business and partly for private purposes will be withdrawn. (March 2010 Budget)

Tax compliance

2.163 Legislation will be in the Finance Bill introduced in the autumn to complete the harmonisation of interest charged by HMRC across different tax regimes. (March 2010 Budget)

2.164 Legislation will be in the Finance Bill introduced in the autumn to modernise compliance checking powers for excise duties. (March 2010 Budget)

2.165 Legislation will be in the Finance Bill introduced in the autumn to complete the modernisation of HMRC's late filing and late payment penalty regimes. (March 2010 Budget)

2.166 Legislation will be in the Finance Bill introduced in the autumn to deal with claims to recover overpaid stamp duty land tax and petroleum revenue tax. (March 2010 Budget)

2.167 The March 2010 Budget announced action to tackle arrangements using trusts and other vehicles to reward employees which seek to avoid, defer or reduce liabilities of employees and directors to income tax and NICs or to avoid restrictions on pensions tax relief. Legislation will take effect from April 2011. The Government confirms that Employer Financed Retirement Benefit Schemes (EFRBS) are within the scope of this measure. (March 2010 Budget)

Section 2c – The Civil List

2.168 The Civil List is paid from the Consolidated Fund each year to enable The Queen to discharge Her duties as Head of State. It meets the central staff costs and running expenses of Her Majesty's official Household.

2.169 Under the Civil List Act 1972, the Royal Trustees – that is, the Prime Minister, the Chancellor and the Queen's Treasurer – must report on Civil List expenditure at least every ten years (see HC140). In addition, the Royal Household now publishes annual accounts, professionally audited for the Treasury.

2.170 The report shows that the Royal Household has been a careful housekeeper since the last report of 2000. That report left the annual payments of the Civil List unchanged at £7.9 million a year and envisaged that these would be supplemented by drawings from the Civil List Reserve which had been built up since 1990. The Civil List Reserve will be down to £8 million by the end of 2010.

2.171 The Royal Trustees' Report details the expenditure of Civil List funds over the decade since 2000. It also shows the plans for 2011, as below. Expenditure will be slightly lower with no change in Civil List funding.

Table 2.5: Civil list (estimated and planned)

	2010[1]	2011[2]
Costs		
Basic expenditure	14.5	14.5
Net capital expenditure	0.2	0.2
Pension lump sum payment[3]	0.4	–
Transfers of expenditure now planned	–	0.2
	15.1	**14.9**
Financed by		
Civil List	7.9	7.9
Drawing from Civil List Reserve	7.2	7.0
	15.1	**14.9**
Civil List Reserve at the end of the year	**8.0**	**1.0**

[1] *Figures for 2010 are actuals to April 2010 and reforecasts for the remainder of the year*

[2] *Estimates*

[3] *The pension lump sum payment is to accelerate funding of the pension scheme deficit*

2.172 Beyond 2011, the Government intends to develop a new consolidated means of supporting The Queen in Her public duties. The current arrangements for supporting the Royal Household, established in 1972, need to be replaced. There will be a simple modern means to provide consolidated finance for The Queen's future expenses as head of state in an efficient, dignified and accountable fashion.

2.173 The Government also intends a significant improvement in accountability. At the moment, the Permanent Secretary to the Treasury has responsibility for the audit of the Civil List. These accounts are already published. From 2012, the Comptroller and Auditor General will operate as audit contractor and the accounts will be laid before the House. Civil List expenditure will be subject to the same audit scrutiny as any Government department – including, if it so decides, by the Public Accounts Committee.

A Impact of tax and welfare changes on households

Transparent policy making

A.1 The document, *Tax policy making: a new approach*, published at Budget, sets out the Government's commitment to improving tax policy making. It is vital that all policy decisions are properly scrutinised. This requires greater transparency about the impact of changes and this chapter is intended to help interested parties understand the impact on households of tax and welfare proposals. For future fiscal events the Government will consider how best to present the impact of changes on households consistent with these aims of transparency.

Impact of direct tax and tax credit changes

A.2 This section sets out the impact on individuals of the personal tax changes announced in this Budget; and on families of the tax credit changes announced in this Budget. The examples in the tables below are necessarily simplified, however they serve as a guide to changes in tax paid and tax credits received at different income levels.

A.3 The amounts set out in the tables below are based on the OBR's latest independent projections for CPI and RPI and the actual amounts will vary depending on actual levels of CPI and RPI over the relevant periods.

Income tax and National Insurance Contributions

A.4 Table A1 below shows income tax and National Insurance Contributions (NICs) paid for individuals under the age of 65 at different income levels. It shows the amount currently being paid; the amount that would have been paid in 2011-12 under the plans this Government has inherited; and the amount that will be paid in 2011-12 and 2012-13 following the changes announced in this Budget.

Table A1: Illustrative examples of income tax and National Insurance paid per year, by income level

Gross Income (£)	2010-11 (£)	2011-12 at March 2010 Budget (£)	2011-12 after this Budget (£)	2012-13 after this Budget (£)
10,000	1,175	1,010	840	760
20,000	4,275	4,210	4,040	3,960
30,000	7,375	7,410	7,240	7,160
40,000	10,475	10,610	10,440	10,360
50,000	14,190	14,410	14,405	14,315
75,000	24,440	24,910	24,905	24,815
100,000	34,690	35,410	35,405	35,315
150,000	57,780	59,060	59,395	59,410

Calculations based on individual aged 65 or under paying employee NICs (not contracted out). Gross income refers to pay only before the personal allowance is deducted (i.e. all gross income is subject to income tax and class 1 NICs). Calculations assume no other allowances or deductions. NICs calculations on an annual basis using equivalent annual thresholds.

Source: HM Revenue and Customs

Tax credits

A.5 Table A2 below shows the changes to tax credits received for a family with one child over the age of one and no childcare costs at different levels of family income. It shows the amount of tax credits they are currently entitled to receive; the amount they would have received in 2011-12 under the plans this Government has inherited; and the amount they will receive in 2011-12 and 2012-13 following the changes announced in this Budget.

Table A2: Illustrative examples of a family's tax credit entitlement per year, by income levels

Family Income (£)	2010-11 (£)	2011-12 at March 2010 Budget (£)	2011-12 after this Budget (£)	2012-13 after this Budget (£)
0	2,850	2,945	3,065	3,200
5,000[1]	6,660	6,865	6,990	7,235
10,000	6,060	6,285	6,340	6,610
15,000	4,110	4,335	4,290	4,560
20,000	2,160	2,385	2,240	2,510
25,000	545	545	545	460
30,000	545	545	545	–
40,000	545	545	545	–
50,000	545	545	–	–

1 Assumes not entitled to 30 hour element
Calculations are based on a family with one child over the age of one, with no entitlement to baby, childcare or disability elements
2 Families receiving tax credits are most likely to have one child.
Source: HM Revenue and Customs

The combined impact of changes on households

A.6 There are a number of different ways of assessing the combined impacts of tax, tax credits and benefit changes on households. For example, impacts can be shown in absolute cash terms or as a percentage of income. The advantage of the former approach is that it can show how much of the change is borne along the income distribution; the advantage of the latter approach is that it shows how the change will impact on households relative to their overall income or expenditure.

A.7 It is also possible to show impacts across the income or expenditure distribution. Traditionally analysis of tax and benefit changes on households has been measured against the income distribution as in Charts A1 and A2 below. This is particularly relevant when assessing the impacts of changes in direct taxes, tax credits and benefits which change the net income of a household; or for analysis of the short-term impacts of a policy.

A.8 However, the Office for National Statistics and others suggest that analysis of the income distribution can be potentially misleading when analysing the impact of expenditure taxes. Among the reasons for this is that for some households, predominantly in the bottom decile, expenditure exceeds current income.[1] This could be because some households – typically those containing students, self-employed and unemployed individuals – experience temporary periods of low income and fund their expenditure from savings or borrowing.[2] Because such households are smoothing their lifetime consumption, expenditure may be a better indicator of their standard of living.[3]

A.9 There are advantages and disadvantages to each of these approaches and for transparency the impact on households using all these approaches are included in this chapter.

Methodology

A.10 The impacts shown in this section are simulated using HM Treasury's tax and benefit model and assume 100 per cent take up of tax credits and benefits. The policies that can be modelled account for around two-thirds of benefits and tax credits changes and the majority of direct and indirect tax announcements.[4] A full list of the measures that can be modelled together with a methodological explanation is set out in the data sources document.[5] This does not include the impact of plans this Government has inherited to restrict the generosity of pensions tax relief.

A.11 Income and expenditure deciles divide households into 10 equally sized groups. As households with more adults and children require higher levels of household income and expenditure to achieve the same standard of living, an internationally recognised process called equivalisation has been used to ensure households are compared on an equal basis.[6] The income and expenditure levels on the horizontal axis of this chart shows the lower income or expenditure bound for a couple household with no children to be in the relevant income or expenditure decile. These income or expenditure levels will vary for different household types.

A.12 The impact of measures is shown for April 2012 given the staged implementation of the tax credit changes. It shows the impact of changes in comparison to what the tax and benefit system looks like currently in the absence of changes occuring in 2012.

[1] *The effects of taxes and benefits on household income*, 2008-09, Office for National Statistics, June 2010.
[2] *An expenditure based analysis of the redistribution of household income*, Office for National Statistics, March 2010.
[3] *The distributional effect of the Pre-Budget Report 2008*, Institute for Fiscal Studies, December 2008.
[4] This includes the impact of CPI indexation of tax credits and benefits; changes to tax credit rates and thresholds; and the abolition of some tax credit elements.
[5] Not all policy announcements can be modelled due to data constraints.
[6] Equivalisation is explained in more detail in the data sources document.

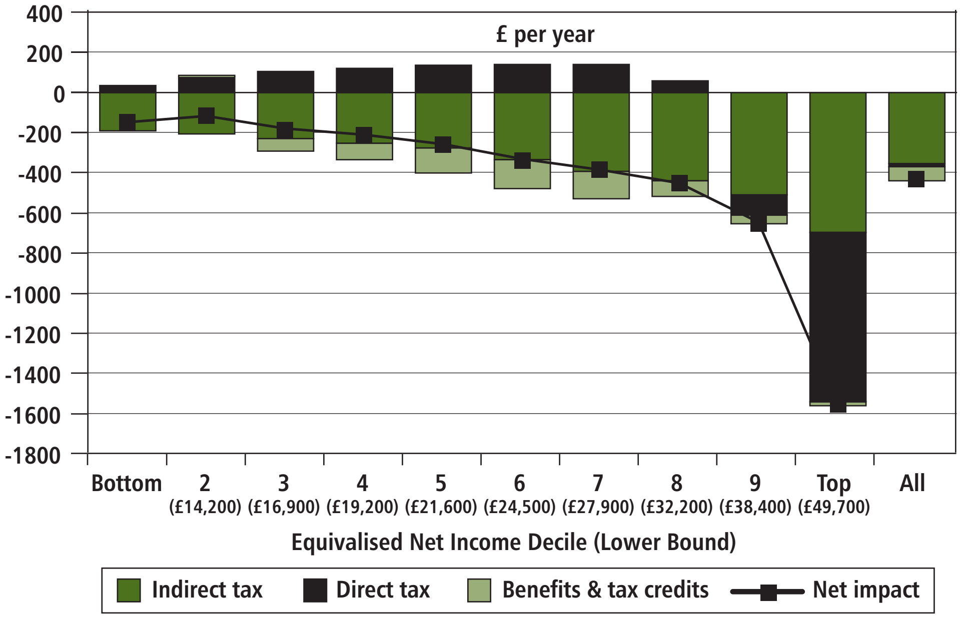
Analysis by income distribution

A.13 The impact of direct tax, indirect tax, and benefit and tax credit changes as an absolute amount by income decile is shown in Chart A1. The top decile see the largest absolute losses, losing more than twice as much as the ninth decile, and more than ten times as much as the bottom decile. On average the first three deciles experience the lowest losses.

A.14 All but the top two deciles will see gains from direct taxes. For the top deciles, gains from the increase from the personal allowance will be offset by the NICs rise announced at the 2009 Pre-Budget Report and the March 2010 Budget. Households in the bottom two deciles are on average gainers from modelled changes to benefits and tax credits.

A.15 The increase in the standard rate of VAT is the most significant change to indirect taxes. The analysis assumes that indirect tax changes are passed to the consumer in full, although in practice some retailers may decide to absorb the increase rather than increase prices for consumers.[7]

Chart A1: Impact of all measures in cash terms (£ per year) by income distribution (2012-13)

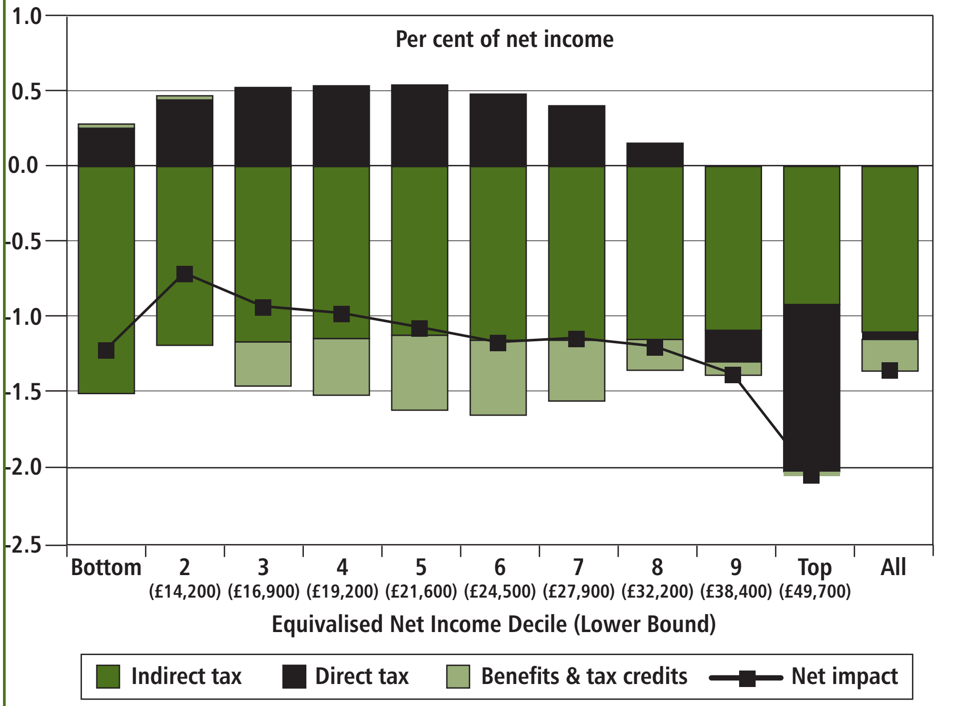


Source: HM Treasury tax and benefit micro-simulation model.

A.16 Chart A2 shows the overall impact as a per cent of net income to be more evenly spread across the income distribution. Impacts on households from VAT account for around 1.0 per cent of net income, although this is smaller on average for the top 10 per cent of households, and greatest for the bottom 10 per cent of households. However, as discussed above the impact of indirect taxes may be better illustrated by Charts A3 and A4 which show the impact of indirect taxes by expenditure decile. Households in the bottom income decile are spread across the expenditure distribution, though concentrated in the bottom three expenditure deciles. This reflects the fact that some households may be funding expenditure through savings or borrowing.

[7] In contrast, the OBR's economic forecast assumes two-thirds pass-through of VAT to consumers initially (with further adjustments in the following year) which would reduce the immediate impact on households. Further, the OBR have assumed that the economic impact will dissipate over the forecast period due to wider economic effects (see Annex C for further details).

Chart A2: Impact of all measures as a per cent of net income by income distribution (2012-13)

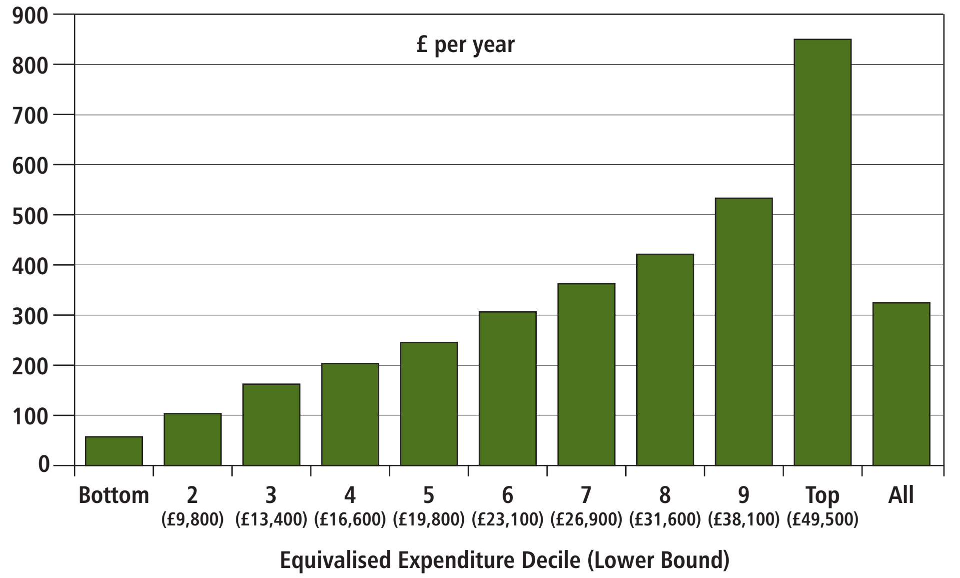


Source: HM Treasury tax and benefit micro-simulation model.

Analysis of expenditure distribution

A.17 The impact of the changes to VAT and duties by expenditure distribution is shown in Chart A3. The changes in VAT and duty rates are progressive on this basis. This is in part because goods not charged at the standard rate of VAT, such as food, domestic fuel and children's clothes, account for a higher proportion of expenditure for lower spending households. Chart A3 shows that the top expenditure decile will lose almost 15 times more, in absolute terms, than the bottom expenditure decile from changes in indirect taxes.

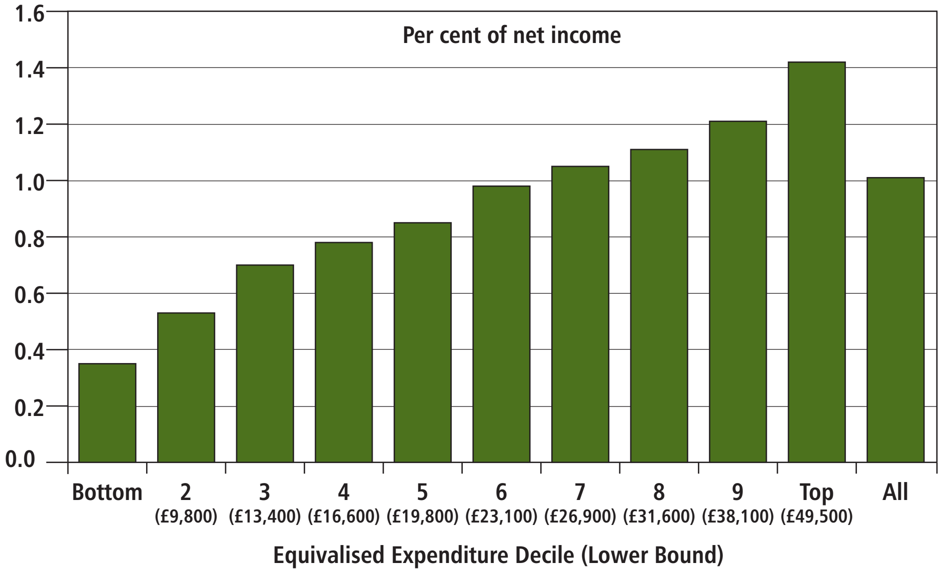
Chart A3: Additional tax due to indirect tax Budget changes in cash terms (£) by expenditure distribution (2012-13)



Source: HM Treasury tax and benefit micro-simulation model.

A.18 Chart A4 confirms the pattern seen in Chart A3 but as a percentage of income. This is in order to demonstrate the impact on household income.

Chart A4: Impact of indirect tax Budget changes as a per cent of net income by expenditure distribution (2012-13)



Source: HM Treasury tax and benefit micro-simulation model.

Marginal deduction rates

A.19 Marginal deduction rates (MDRs) show how much of each additional pound of earnings is lost due to taxes and the withdrawal of benefits or tax credits. To better illustrate how direct tax, tax credits and benefit changes affect MDRs, the following table shows the position in 2010-11, the impact in 2011-12 of the plans this Government has inherited, and the further impact in 2011-12 of measures included in this Budget for specific families. Increases in the number of families in each category in 2011-12 at the March 2010 Budget are due to the 1 per cent increase to NICs. There are slight changes to each category after this Budget as a result to an increase in the tax credit taper. Families facing withdrawal of tax credits and paying income tax and NICs see their MDRs rise in 2011-12 from 70 to 71 per cent as a result of the NICs increase; and from 71 to 73 per cent as a result of the changes to the tax credit taper. As part of a wider look at how impacts on households are modelled HM Treasury will be undertaking a review of the methodology used to produce this table and future estimates may change.

Table A3: The effect of Government reforms on high marginal deduction rates

Marginal Deduction Rates[1]	2010-11	2011-12 at March 2010 Budget	2011-12 after this Budget
Over 100 per cent	0	0	0
Over 90 per cent	70,000	110,000	130,000
Over 80 per cent	270,000	335,000	330,000
Over 70 per cent	330,000	1,680,000	1,710,000
Over 60 per cent	1,895,000	1,895,000	1,935,000

[1] Marginal deduction rates are for working heads of families in receipt of income-related benefits or tax credits where at least one person works 16 hours or more a week, and the head of the family is not receiving pensioner or disability premia.

Note: Figures are cumulative. Estimates for the 2011-12 tax benefit system are calibrated to tax credit statistics for April 2010, and earlier data for housing and council tax benefits.

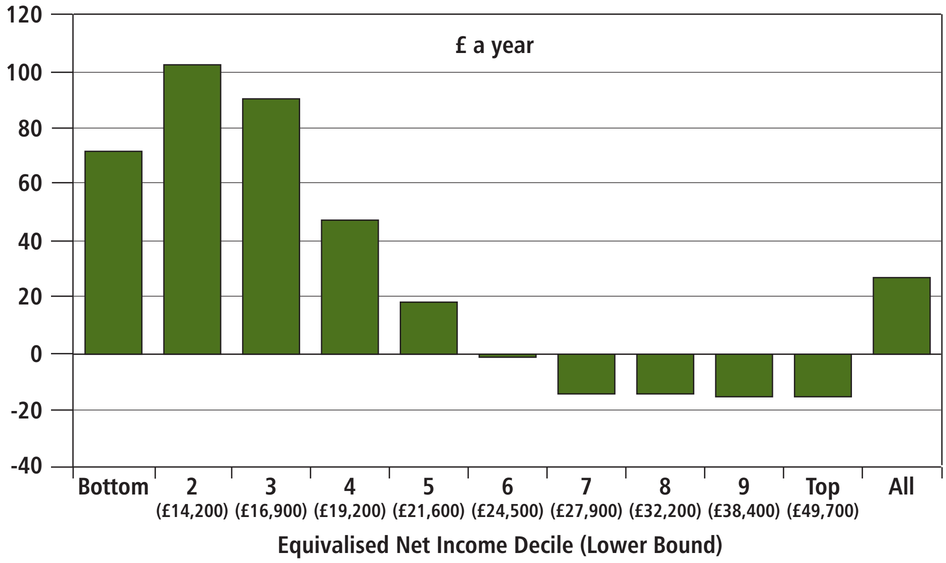
Source: HM Treasury

Impact of freezing Child Benefit and increases to the Child Tax Credit

A.20 This Budget includes measures to reduce welfare spending, alongside other reforms to reduce the deficit. Steps have been taken to protect low income families with children from the impact of these changes, by freezing the rate of Child Benefit to partly fund above indexation increases to the Child Tax Credit. This ensures that the overall impact of all modelled Budget changes on child poverty in 2012-13 is statistically insignificant.[8]

A.21 Chart A5 shows the impact of holding rates of Child Benefit constant and funding above indexation increases to the Child Tax Credit, as an absolute amount. In combination these measures have a progressive impact.

Chart A5: Impact of Child Benefit freeze and above indexation increase in Child Tax Credit in April 2012 in cash terms (£ a year), by income decile

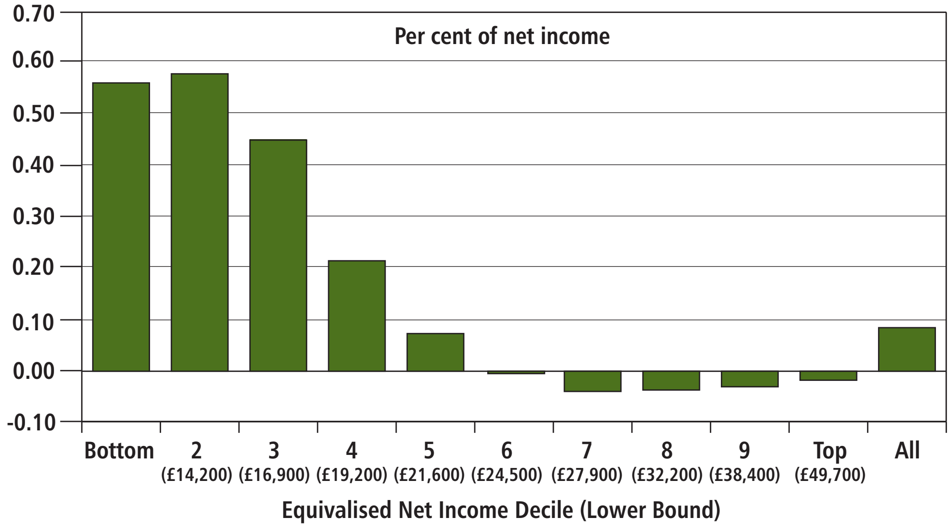


Source: HM Treasury tax and benefit micro-simulation model.

A.22 Chart A6 shows that the pattern shown in Chart A5 above in absolute terms also holds in relative terms.

[8] Estimates calculated using HM Treasury tax and benefit micro-simulation model.

Chart A6: Impact of Child Benefit freeze and above indexation increase in Child Tax Credit in April 2012 as a per cent of net income, by income decile



Source: HM Treasury tax and benefit micro-simulation model.

Basic State Pension

A.23 The Government is supporting pensioner incomes by reforming the uprating rules for the basic State Pension. The changes, including the introduction of the triple guarantee, will benefit over 11 million pensioners in the UK. The standard minimum income guarantee in Pension Credit will have an above indexation increase in April 2011 to ensure the lowest income pensioners benefit from the basic State Pension's triple guarantee.

B Financing

Debt management objective

B.1 The Government's debt management objective is:

"to minimise, over the long term, the costs of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the aims of monetary policy".

B.2 The debt management policy objective is achieved by:

- pursuing an issuance policy that is open, transparent and predictable;
- issuing gilts that achieve a benchmark premium;
- adjusting the maturity and nature of the Government's debt portfolio, primarily by means of the maturity and composition of debt issuance and potentially by other market operations including switch auctions, conversion offers and buy-backs;
- developing a liquid and efficient gilt market; and
- offering cost-effective savings instruments to the retail sector through National Savings and Investments (NS&I).

B.3 HM Treasury has overall responsibility for meeting the debt management policy objective but has delegated operational responsibility for debt management to its agents:

- the Debt Management Office (DMO) undertakes borrowing in sterling through issuance of government bonds and short-term debt instruments in the wholesale market;
- NS&I undertakes retail borrowing through sales of retail savings products; and
- the Bank of England undertakes borrowing in foreign currencies through the issuance of foreign currency denominated government bonds.

Financing framework

B.4 The Government intends to continue to finance the central government net cash requirement (CGNCR) using the framework that was established in the 1995 Debt Management Review. The Government aims to finance its net cash requirement plus maturing debt and any financing required for additional net foreign currency reserves through the issuance of debt. All such debt issuance will take place within a set maturity structure. Auctions remain the primary means of gilt issuance but will be supported by a supplementary issuance programme comprising syndication and mini-tenders.

Maturity and composition of debt issuance

B.5 In order to determine the maturity and composition of debt issuance, the Government needs to take account of a number of factors including:

- investors' demand for gilts;
- the Government's own appetite for risk, both nominal and real;
- the shape of both the nominal and real yield curves and the expected effect of issuance policy; and
- changes to the stock of Treasury bills and other short-term instruments.

Net cash requirement

B.6 The CGNCR measures the cash required by central government to finance its operations and is the key fiscal aggregate for debt management purposes. It forms the basis of the net financing requirement (NFR) as set out in Table B3.

B.7 The Public Sector Net Borrowing (PSNB) forecast has been produced by the interim Office for Budget Responsibility (OBR) and is set out in Annex C. Table B1 shows HM Treasury's reconciliation between PSNB and CGNCR which is achieved by: changing the scope from the whole of the public sector to central government only; moving from the accruals based net borrowing measure to the cash-based CGNCR; and accounting for lending within the public sector.

Table B1: Reconciliation of PSNB and CGNCR

	£ billion						
	Estimate	Forecasts					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Public sector net borrowing	**154.7**	**149**	**116**	**89**	**60**	**37**	**20**
minus Local authorities net borrowing	2.6	6	4	3	3	3	2
minus Public corporations net borrowing[1]	-3.3	0	-1	-1	-2	-2	-3
Central government net borrowing	**155.4**	**144**	**113**	**87**	**59**	**37**	**21**
Financial transactions	28.5	5	5	2	2	2	5
Accruals adjustments	13.8	-5	1	-2	3	-5	-6
Central government net cash requirement ("own account")	**197.7**	**144**	**119**	**88**	**63**	**34**	**20**
Net lending within the public sector	1.1	2	2	2	2	2	2
Central government net cash requirement	**198.9**	**146**	**121**	**90**	**65**	**35**	**21**

Note: Totals may not sum due to rounding.

[1] This includes removing the temporary effects of financial interventions.

B.8 The movement from PSNB to central government net borrowing (CGNB) requires the removal of the contributions of local authorities and public corporations. The negative numbers for public corporations reflect the fact that this sub-sector is generally a net saver.

B.9 The difference between CGNB and the CGNCR arises from either timing differences or from the impact of financial transactions involving cash. Timing differences arise because net borrowing is an accruals measure whereas the CGNCR is cash based. The measures are reconciled via accruals adjustments. Exchanges of financial assets involving cash are not net borrowing because they do not change the net liabilities position of the public sector, but the cash impact is captured in the CGNCR.

B.10 The methods used to forecast financial transactions and accruals adjustments are:

- the relatively small accruals adjustments on receipts and expenditure are produced by the modelling of the public finances more generally;
- for regular financial transactions for which the size and timing of the transaction are reasonably certain – for example, the repayment of loans to the financial sector and student loans repayments – an estimate based on the latest available information is included in the forecast; and
- potential financial transactions for which firm plans are not in place are not included in the forecast.

B.11 The transactions described above produce an estimate of the cash that central government needs to fund its own operations (the CGNCR ("own account")). In addition, central government lends money to local authorities and public corporations. The adjustment for the net effect of this impact produces the CGNCR.

B.12 In most years, the CGNCR and PSNB are similar. The measures have differed by more than usual in 2008-09 and 2009-10 reflecting the cash implications of the financial sector interventions. As shown in Table B2, these items were significant in 2008-09 and 2009-10 but are forecast to be much smaller in future years in which the only impact results from the repayment of loans.

Table B2: Financial interventions and Bank of England schemes - impact on CGNCR

	£ billion			
	Outturn	Estimate	Forecasts	
	2008-09	2009-10	2010-11	2011-12
Total[1]	**74.5**	**34.1**	**-1.6**	**-3.2**
Loans	20.6	11.0	-1.2	-3.3
Equity injections (net acquisition (	30.8	23.0	0.0	0.0
Depositor compensation	23.1	0.2	-0.4	0.0

Note: Totals may not sum due to rounding.

[1] *Total effect of financial interventions and Bank of England schemes on the diffference between PSNB and CGNCR.*

B.13 Box B1 sets out an update of the costs of financial sector interventions.

Box B1: Estimates of the costs of financial sector interventions

The eventual direct fiscal cost from the support provided by the previous Government to the financial sector will be dependent on a number of factors including the eventual sale price achieved for the shares in Royal Bank of Scotland (RBS) and Lloyds Banking Group (LBG). It is possible to estimate the final cost on the basis of current market prices and, where these are not available, on an assessment of the fees and risks associated with each scheme. Using the latest market prices, the cost of the financial sector interventions, net of fees and other income, is estimated at £2 billion. This estimate is based on:

- the current market value of the Government's shareholdings in RBS and LBG which implies a cost of £7 billion on these investments net of the value of the Dividend Access Share in RBS and fees received during the recapitalisation and for the provision of contingent capital;
- the Asset Protection Agency's central expectation that there will be a net benefit to the taxpayer of at least £5 billion from the Asset Protection Scheme; and
- the expectation that the aggregate costs of all other interventions will not be material after fees, other income and recoveries are taken into account.

The estimate reflects the potential direct costs of the Government's support provided to the financial sector and does not include the much more significant wider costs of the financial crisis to the economy as a whole.

Revisions to the Net Financing Requirement in 2010-11

B.14 In line with the new fiscal forecasts set out in this Budget, the financing arithmetic for 2010-11 has been revised. There has been a reduction in the NFR of £20.2 billion – from £182.7 billion, in the revision to financing announced on 22 April 2010, to £162.5 billion. The reduction in the NFR is the net effect of:

- a decrease in the CGNCR of £20.3 billion from the March Budget 2010 forecast which includes a fall in PSNB of £14 billion; and
- £0.1 billion of buybacks.

B.15 NS&I is not forecast to make a contribution to net financing; this forecast is unchanged from the projection in the revision announced on 22 April 2010.

B.16 In order to meet the reduction in the NFR, the DMO's remit has been revised. The revisions to financing are shown in Table B3.

Table B3: Financing requirement forecast

	£ billion			
	2009-10	2010-11		
	Outturn	March Budget	April Revision[1]	June Budget
Central government net cash requirement	**198.9**	**166.4**	**166.4**	**146.1**
Gilt redemptions	16.6	39.0	38.6	38.6
Financing for the official reserves	4.0	4.0	4.0	4.0
Financing for the Asset Purchase Facility	-0.9	0.0	0.0	0.0
Buy-backs[2]	0.4	0.0	0.0	0.1
Planned short-term financing adjustment[3]	-0.6	-24.0	-26.3	-26.3
Gross financing requirement	**218.4**	**185.4**	**182.7**	**162.5**
Less Assumed net contribution from National Savings and Investments	1.6	0.0	0.0	0.0
Net financing requirement	**216.8**	**185.4**	**182.7**	**162.5**
Financed by:				
Debt issuance by the Debt Management Office				
Treasury bills	19.4	-1.9	-2.5	-2.5
Gilts	227.6	187.3	185.2	165.0
Of which:				
Conventional				
Short	75.4	59.0	59.0	52.6
Medium	71.3	45.0	42.9	38.2
Long	51.6	45.3	45.3	40.4
Index-linked	29.3	38.0	38.0	33.8
Other planned changes in short-term cash position[4]				
Changes in Ways & Means[5]	-3.8	0.0	0.0	0.0
Unanicipated changes in short-term cash posi	**26.3**	**0.0**	**0.0**	**0.0**
Total financing	**243.1**	**185.4**	**182.7**	**162.5**
Short-term debt levels at end of financial year				
Treasury bill stock in market hands[7]	63.3	60.8	60.8	60.8
Ways & Means	0.4	0.4	0.4	0.4
DMO net cash position	26.8	0.5	0.5	0.5

Note: Totals may not sum due to rounding.

[1] The financing arithmetic for 2010-11 was revised on 22 April 2010. This revision followed the publication of the outturn CGNCR for 2009-10. The outturn CGNCR was £2.1 billion lower than projected in the March 2010 Budget. The reduction in the CGNCR, among other factors, resulted in an increase in the DMO's net cash position at the Bank of England as at 31 March 2010 of £2.4 billion above that projected in the March 2010 Budget. This increase results in a larger than planned short-term financing adjustment in 2010-11 (by £2.3 billion) in 2010-11 from the projection in the March 2010 Budget.

[2] Purchases of "rump" gilts which are older, small gilts, declared as such by the DMO and in which Gilt-edged Market Makers (GEMMs) are not required to make two-way markets. The Government will not sell further amounts of such gilts to the market but the DMO is prepared, when asked by a GEMM, to make a price to purchase such gilts.

[3] To accommodate changes to the current year's financing requirement resulting from: (i) publication of the previous year's outturn CGNCR; (ii) an increase in the DMO's cash position at the Bank of England; and / or (iii) carry over of unanticipated changes to the cash

[4] Total planned changes to short-term debt are the sum of: (i) the planned short-term financing adjustment; (ii) net Treasury bill sales; and (iii) changes to the level of the Ways and Means Advance.

[5] Reflects the Government's decision to repay £3.8 billion of the remaining balance of the Ways and Means Advance in 2009-10.

[6] A negative (positive) number indicates an addition to (reduction in) the financing requirement for the following financial year.

[7] The DMO has operational flexibility to vary the end-financial year stock subject to its operational requirements in 2010-11.

B.17 The NFR will be financed by:

- £165 billion in gross gilt issuance (a decline of £20.2 billion from the projection in the April 2010 revision); and
- a reduction of £2.5 billion in the planned Treasury bill stock as at 31 March 2011 (unchanged from the projection in the April 2010 revision).

B.18 Reflecting these changes, gross gilt issuance of £165 billion is expected to be split as follows:

- £52.6 billion of short maturity gilt issuance (31.9 per cent of total issuance);

- £38.2 billion of medium maturity gilt issuance (23.2 per cent of total issuance);
- £40.4 billion of long maturity gilt issuance (24.5 per cent of total issuance); and
- £33.8 billion of index-linked gilt issuance (20.5 per cent of total issuance).

B.19 The proportionate split of gross gilt issuance between gilts of different maturities and types takes into account the factors in paragraph B.5 and is unchanged from that in the April 2010 revision. As at 31 March 2010, the average maturity of the outstanding debt stock was 13.2 years. The maturity of the outstanding debt stock in the UK is the longest in the G7.

B.20 Auctions will remain the Government's primary method by which to issue gilts. The Government will continue to use supplementary methods – syndication, mini-tenders and the post auction 'top up' facility – to issue gilts in the remainder of 2010-11. It is anticipated that, for the year as a whole:

- £132 billion (80 per cent of total issuance) will be issued through pre-announced auctions;
- £26 billion (16 per cent of total issuance) will be issued by syndication; and
- £7 billion (4 per cent of total issuance) will be issued through mini-tenders.

B.21 The proportionate split of gilt issuance by method of issuance is broadly unchanged from the revision to financing announced 22 April 2010. These revisions will be implemented in the third and fourth quarters of 2010-11. Further details can be found in the DMO's Press Notice issued on 22 June 2010 which is available on the DMO's website: www.dmo.gov.uk.

Office for
Budget
Responsibility

Budget forecast

June 2010

C OBR Budget forecast

C.1 The interim Office for Budget Responsibility's (OBR) Terms of Reference (TOR) require it to produce a forecast at the Budget, incorporating the impact of policy measures announced at or before the Budget, and to make a judgement on whether the Government's policy is consistent with a better than 50 per cent chance of achieving the fiscal mandate set by the Government.

C.2 We have produced a Budget forecast which incorporates the effects of all measures, plus a number of updated assumptions and judgements. Our Budget economic forecast is for GDP to grow by 1.2 per cent in 2010 and 2.3 per cent in 2011, rising to 2.7 to 2.9 per cent in the later years of the forecast.

C.3 Table C1 sets out an overview of our Budget fiscal forecast. The fiscal forecast is for:

- public sector net borrowing (PSNB) to fall from 11.0 per cent of GDP in 2009-10 to 1.1 per cent in 2015-16;
- public sector net debt (PSND) to increase from 53.5 per cent of GDP in 2009-10 to a peak of 70.3 per cent in 2013-14, falling to 69.4 per cent in 2014-15 and 67.4 per cent in 2015-16; and
- the cyclically-adjusted current budget deficit of 5.3 per cent of GDP in 2009-10 to be eliminated by 2014-15 and reach a surplus of 0.8 per cent of GDP in 2015-16.

Table C1: Fiscal forecast overview

	Per cent of GDP							
	Outturn	Estimate	Forecasts					
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Surplus on current budget	-3.5	-7.5	-7.5	-5.7	-4.0	-2.3	-0.9	0.0
Public sector net borrowing	6.7	11.0	10.1	7.5	5.5	3.5	2.1	1.1
Public sector net debt[1]	44.0	53.5	61.9	67.2	69.8	70.3	69.4	67.4
Cyclically-adjusted surplus on current budget	-3.1	-5.3	-4.8	-3.2	-1.9	-0.7	0.3	0.8
Cyclically-adjusted net borrowing	6.3	8.7	7.4	5.0	3.4	1.8	0.8	0.3

[1] *Debt at end March; GDP centred on end March.*

C.4 We have continued to illustrate the uncertainty around this central projection using fan charts which are based on past forecast errors. They therefore make no allowance for the possibility that the Budget itself may have reduced the probability of tail events associated with a loss of confidence in the sustainability of the pre-Budget path for fiscal deficits.

C.5 The key policy measures affecting the economic and fiscal forecasts are:

- a policy decision to reduce total spending by an additional £32 billion a year by 2014-15, including debt interest savings;
- an increase in the standard rate of VAT from 17.5 per cent to 20 per cent with effect from 4 January 2011;
- an increase in the employer NICs threshold by £21 per week in addition to indexation from April 2011. The personal tax allowance for under 65s will increase by £1,000 to £7,475 in 2010-11;
- a bank levy based on banks' balance sheets will be introduced from 1 January 2011. It is proposed that the levy will be set at a rate of 0.07 per cent, with a lower initial rate of 0.04 per cent in 2011; and
- a reduction in the main rate of corporation tax from 28 per cent to 24 per cent over four years, with a one per cent reduction from 1 April 2011, and a reduction in capital allowances from 2012, including a reduction in the capital allowance on the general pool of plant and machinery from 20 per cent to 18 per cent in April 2012.

C.6 To incorporate the effects of policy measures on the economic and fiscal forecasts, we have certified the Government's policy costings, which reflect the direct impact of policy changes, and have made judgements as to the indirect effects of policy changes on the economy and public finances.

C.7 The Budget announces the Government's forward-looking fiscal mandate to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period. At this Budget, the end of the forecast period is 2015-16.

C.8 The 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.

C.9 We judge that the Government's policy is consistent with a greater than 50 per cent chance of achieving the fiscal mandate set for 2015-16. Our forecast also shows that there is a greater than 50 per cent chance of achieving the fiscal mandate in 2014-15, a year ahead of the date set in the Government's mandate.

C.10 We have also assessed the probability of meeting the Government's target for debt. Taken independently, and on the basis of our central forecast, there is a greater than 50 per cent chance of this target being met in 2015-16. There is also a greater than 50 per cent chance of it being met a year early, in 2014-15.

C.11 As noted at the time, the pre-Budget forecast's use of market expectations to derive the path of interest rates probably resulted in an upward bias to that forecast. The market may have been expecting lower interest rates as a result of additional fiscal tightening in the Budget. If that tightening had not occurred then interest rates would probably have been higher and economic activity lower in the pre-Budget forecast. As a result, the pre-Budget forecast does not provide a firm basis for comparison to produce an estimate of the effects of the Budget measures on the economy.

Terms of reference

C.12 This annex sets out the OBR's economic and fiscal forecasts up to 2015-16. They take into account the effects of policy measures announced at or before the Budget on the economy and public finances. We have made or agreed all judgements in the forecasts. There has been no ministerial involvement in the forecast at any stage.

C.13 The Terms of Reference for the interim OBR were agreed with the Chancellor on 8 June 2010. They set out the interim OBR's role for the Budget, which is to publish:

- an updated forecast for the public finances and the economy, incorporating the impact of policy measures announced at the Budget; and
- a judgement on whether the Government's policy is consistent with a better than 50 per cent chance of achieving the Government's fiscal policy mandate.

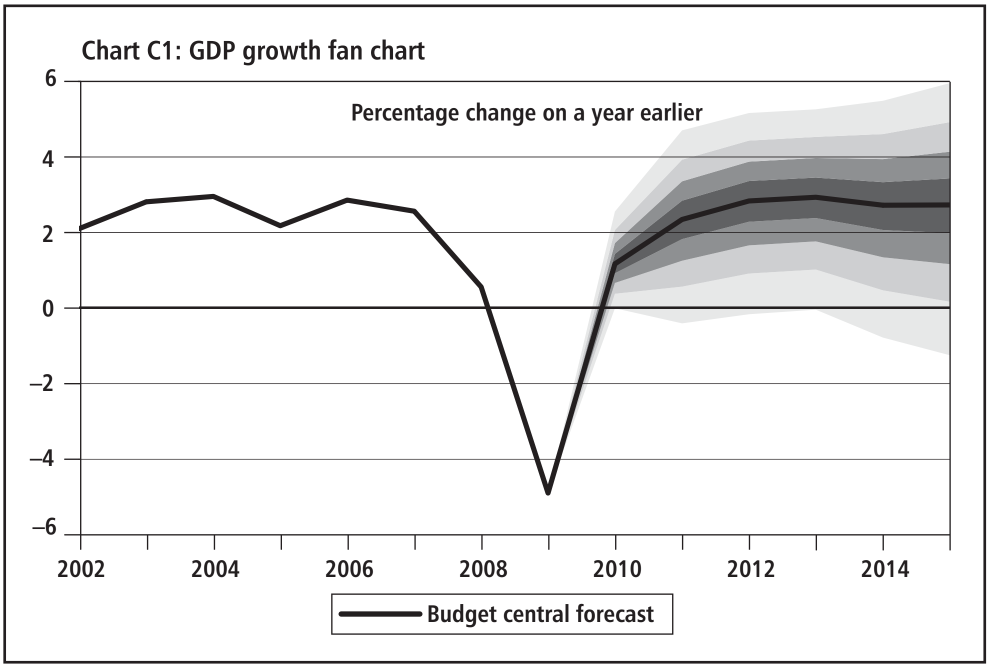
C.14 The TOR also require the interim OBR to provide advice to the Chancellor on the appropriate arrangements for the permanent OBR. We will report on this in the coming weeks, in the light of our reflections on how the interim OBR has operated for this Budget.

The Budget forecast

Economic forecast

C.15 Our central GDP growth forecast to 2015 is shown in black in Chart C1. Pairs of probability bands show the range of risks surrounding the central forecast. Each band represents 10 per cent of the probability distribution.[1] The distribution suggests that the probability of growth in 2010 being within 1 percentage point of our central forecast (i.e. between 0.2 per cent and 2.2 per cent) is 70 per cent. The probability of growth being within 1 percentage point of our central forecast in 2011 (i.e. between 1.3 per cent and 3.3 per cent) falls to below 40 per cent and to around 30 per cent in 2014.

[1] The top and bottom 10 per cent bands are not shown in the chart.



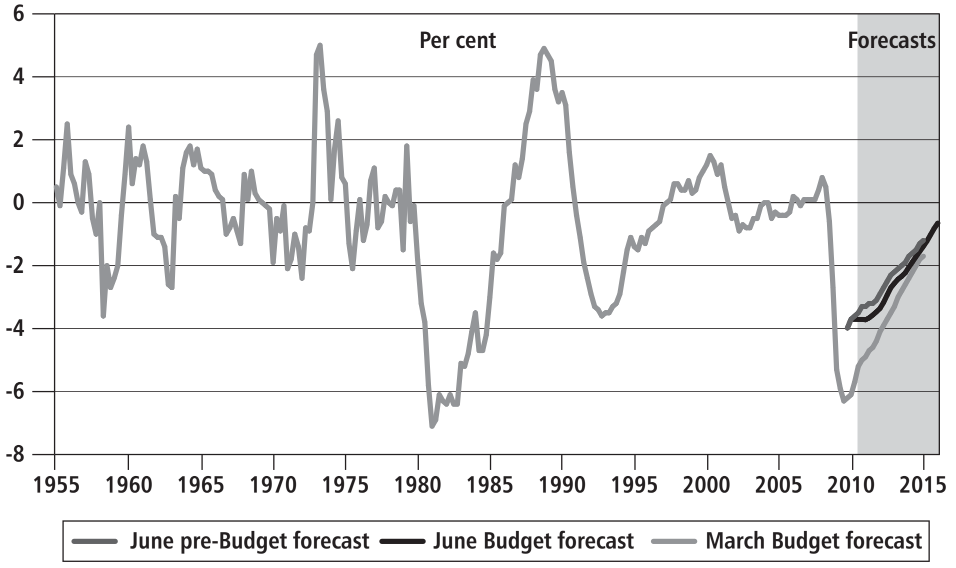
C.16 As discussed in Annex A of the OBR *Pre-Budget forecast* document, the fan chart is based on past errors in Treasury forecasts. We have therefore used the same distribution of errors as in the pre-Budget forecast. No allowance has been made for the possibility that the Budget itself may have reduced the probability of tail events associated with a loss of confidence in the sustainability of the pre-Budget path for fiscal deficits.

GDP growth

C.17 GDP growth rises from 2010, reaching 2.9 per cent in 2013. Growth then eases in 2014 and 2015 as demographic changes reduce the growth of the potential labour supply, though actual growth remains above trend.

C.18 In the near term, economic activity is weaker than in the pre-Budget forecast. On the demand side this reflects Budget measures which restrain government spending and real household disposable income, holding back consumer demand. In 2010 as a whole GDP is forecast to rise by 1.2 per cent followed by 2.3 per cent in 2011 (against 1.3 per cent and 2.6 per cent in the pre-Budget forecast). From 2012 onwards GDP growth recovers as prices and wages adjust and monetary policy continues to support demand. Compared with the pre-Budget forecast, growth is stronger from 2013 onwards as the economy adjusts back towards potential output. By the end of the forecast the adjustment is still not quite complete, so that the output gap is slightly larger in 2014 than it was in the pre-Budget forecast, as shown in Chart C2.

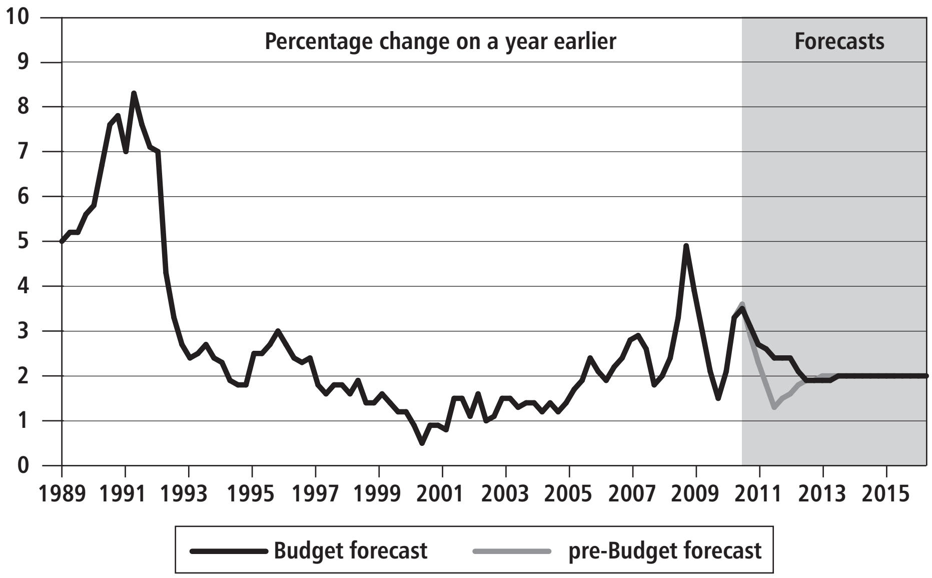
Chart C2: The output gap[1]



[1]Output gap estimates on a quarterly basis, based on the latest National Accounts data and expressed as actual output less trend output as a percentage of trend output (non-oil basis).

Inflation **C.19** CPI inflation stays around 3 per cent in the near term. It then declines more gradually than in the pre-Budget forecast because of the rise in the standard rate of VAT to 20 per cent in January 2011 and the higher oil price assumed in the Budget forecast. Once the short-term effects of the VAT increase have passed through, the larger output gap and cuts in public spending place downward pressure on inflation in line with the pre-Budget forecast. CPI inflation falls back to a little under 2 per cent in early 2012 and then settles at the 2 per cent target over the medium term, as shown in Chart C3.

Chart C3: CPI[1]



[1]Outturns until 2010Q1; forecast for every second quarter from 2010Q2 to 2015Q4.

Labour market **C.20** The decline in employment appears to be coming to an end and we expect a modest recovery in employment in the second half of 2010. Even so, for 2010 as a whole employment is around ½ per cent lower than in 2009. From 2011, as GDP growth gathers momentum and demographic factors boost the population of working age, employment rises more rapidly, reaching 30 million by 2015. In the near term the increase in employment is not enough to offset the rise in the population of working age with the result that the ILO unemployment rate continues to rise, reaching a peak of 8.1 per cent by the end of the year. Thereafter, the more rapid increase in employment is sufficient to lower unemployment, so that the ILO unemployment rate falls to 6 per cent in 2015. Claimant count unemployment continues to fall throughout the forecast period.

C.21 A simple comparison of the two forecasts would show that unemployment is higher, and employment lower, than in the pre-Budget forecast. The differences in the ILO unemployment rate are small initially, reaching a peak of 0.2 percentage points in 2013 before narrowing slightly.

Households **C.22** Wages and salaries growth rises gradually throughout the forecast, reaching 5½ percent in 2014. Consumption growth rises in the forecast to rates of over 2 per cent from 2013, but it remains below the rate of growth of GDP.

C.23 Nominal household disposable incomes are lower than in the pre-Budget forecast. There are positive effects from the personal allowance and NICs threshold changes. But there are offsetting effects, primarily from lower labour income as a result of tightening measures, and reduced transfers. The direct effect on incomes is partially offset by a decline in saving: while the saving ratio remained in a narrow 7¼-7½ per cent range in the pre-Budget forecast, it falls to 5½ per cent by 2015 in the Budget forecast. The level of real consumption is weaker than in the pre-Budget forecast, particularly in 2011 and 2012, as lower household incomes and the rise in VAT reduce household demand.

Companies **C.24** Business investment is forecast to pick up during 2010, though in the year as a whole it rises by only 1½ per cent. The recovery is maintained in 2011, although it takes until 2013 before investment returns to its pre-recession peak. From 2011 onwards business investment rises at rates between 8 and 11 per cent.

C.25 The measures to reform corporation tax, which are estimated to reduce the cost of capital faced by firms by about 3 per cent, should have a positive effect on investment. The introduction of the bank levy may partially offset the fall in the cost of capital should banks pass on some or all of the levy in the form of a higher cost of corporate finance. Even this partial offset is likely to be moderated to the extent that the levy is reflected in lower bank profits and remuneration.

C.26 Business investment growth is higher than in the pre-Budget forecast as the boost from the lower cost of capital feeds through. Business investment also strengthens as resources released from the government sector flow into the private sector. The level of business investment is around 1 per cent higher in 2014 than in the pre-Budget forecast.

C.27 Firms are expected to absorb some of the rise in VAT through lower profit margins and not to pass through the full increase to consumers. As a result, company profits as a share of GDP are lower, by 0.4 percentage points in 2014, than in the pre-Budget forecast.

External sector

C.28 Net trade is forecast to subtract from growth in 2010, as relatively robust import growth outweighs still-sluggish exports. As the recovery in UK export markets strengthens and sterling's past depreciation boosts UK export volumes, net trade is forecast to contribute positively to growth.

C.29 The lower overall level of domestic demand in the Budget forecast feeds through to imports, which are about ½ per cent lower by 2014 than in the pre-Budget forecast. The reduction in imports is slightly less than in domestic demand as a result of the composition of the Budget – business investment (which has a relatively high import content) is higher while public spending (which has a low import content) is reduced.

C.30 The depreciation of sterling has boosted exporters' profits as firms have not passed all of the fall in sterling through to prices. This should encourage existing firms to strive to increase exports and new firms to enter the UK export market and export volumes to rise as a result. The corporate tax measures and release of resources from the government sector should support this supply-side response. By 2014 the volume of exports is about ¾ per cent higher than in the pre-Budget forecast.

C.31 The combination of stronger export and weaker import volumes has a positive effect on the non-oil trade balance. There is a partial offset from the oil account since the Budget forecast is based on a higher oil price than the pre-Budget forecast. Overall, the trade deficit narrows by around £35 billion over the forecast period. The reduction in the current account deficit is rather smaller but it still falls from over £25 billion in 2010 to near-balance in 2015 (that is, from 1¾ per cent of GDP to near zero). The current account deficit is about ¼ per cent of GDP lower than in the pre-Budget forecast in 2014.

Table C2: Detailed summary of central economic forecast[1]

	Percentage change on a year earlier, unless otherwise stated						
		Forecasts					
	2009	2010	2011	2012	2013	2014	2015
World economy							
World GDP at purchasing power parity	-0.8	4.0	4.2	4.5	4.5	4.6	4.6
Euro Area GDP	-4.0	0.7	1.4	1.7	1.9	2.3	2.4
World trade in goods and services	-11.0	6.1	6.2	7.2	7.3	7.3	7.4
UK export markets[2]	-11.5	4.1	4.7	6.4	6.6	6.5	6.4
UK economy							
Gross domestic product (GDP)	-4.9	1.2	2.3	2.8	2.9	2.7	2.7
Expenditure components of GDP							
Domestic demand	-5.3	1.6	1.4	1.9	2.2	2.2	2.3
Household consumption[3]	-3.2	0.2	1.3	1.7	2.1	2.2	2.2
General government consumption	2.2	1.7	-1.1	-2.0	-2.3	-3.0	-2.1
Fixed investment	-14.9	-0.5	3.9	7.9	8.8	8.0	6.9
Business	-19.3	1.4	8.1	10.0	10.9	9.5	8.2
General government	15.7	-4.9	-19.0	-8.5	-6.6	0.6	2.0
Private dwellings	-19.7	-6.5	5.6	8.2	8.5	7.1	6.6
Change in inventories[4]	-1.2	1.2	0.4	0.0	0.0	0.0	0.0
Exports of goods and services[5]	-10.6	4.3	5.5	6.3	6.1	5.9	5.7
Imports of goods and services[5]	-11.9	5.6	2.1	2.7	3.6	4.0	4.2
Balance of payments current account							
£ billion	-18	-25	-28	-22	-15	-9	-2
Per cent of GDP	-1.3	-1.7	-1.8	-1.4	-0.9	-0.5	-0.1
Inflation							
CPI (Q4)	2.1	2.7	2.4	1.9	2.0	2.0	2.0
RPI (Q4)	0.6	3.7	3.2	3.2	3.3	3.4	3.5
Terms of trade[6]	-0.8	-0.9	-2.4	-1.0	-0.1	0.0	0.0
GDP deflator at market prices	1.3	3.2	2.1	2.1	2.6	2.7	2.7
Labour market							
Employment (millions)	29.0	28.8	28.9	29.2	29.5	29.8	30.1
Wages and salaries	-1.0	1.2	2.3	3.1	4.9	5.4	5.4
Average earnings[7]	1.0	2.1	1.9	2.3	3.8	4.4	4.4
ILO unemployment (% rate)	7.6	8.1	8.0	7.6	7.0	6.5	6.1
Claimant count (Q4, millions)	1.6	1.5	1.5	1.4	1.3	1.2	1.1
Household sector							
Real household disposable income	3.2	0.2	1.2	1.3	1.5	1.7	1.8
Saving ratio (level, per cent)	7.0	6.9	6.8	6.4	6.0	5.6	5.4
House prices	-7.8	5.9	1.6	3.9	4.5	4.5	4.5
Nominal indicators							
Nominal GDP	-3.6	4.4	4.4	5.0	5.6	5.4	5.5
Non-oil PNFC profits[8]	-5.1	1.5	9.0	10.1	9.3	7.6	8.7

[1] *All growth rates in this table are rounded to the nearest 1 decimal place. This is not intended to convey a degree of unwarranted accuracy.*

[2] *Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.*

[3] *Includes households and non-profit institutions serving households.*

[4] *Contribution to GDP growth, percentage points.*

[5] *Trade levels are distorted by MTIC fraud.*

[6] *Ratio of export to import prices.*

[7] *Wages and salaries divided by employees.*

[8] *Private non-oil non-financial corporations' gross trading profits.*

Table C3: Contributions to GDP growth[1]

	Percentage points, unless otherwise stated						
		Forecasts					
	2009	2010	2011	2012	2013	2014	2015
GDP growth, per cent	-4.9	1.2	2.3	2.8	2.9	2.7	2.7
Main contributions							
Private consumption	-2.1	0.2	0.8	1.1	1.3	1.4	1.4
Business investment	-2.1	0.1	0.8	1.0	1.1	1.1	1.0
Dwellings investment[2]	-0.6	-0.2	0.2	0.2	0.3	0.2	0.2
Government[3]	0.8	0.3	-0.7	-0.6	-0.6	-0.6	-0.4
Change in inventories	-1.2	1.2	0.4	0.0	0.0	0.0	0.0
Net trade	0.7	-0.5	0.9	0.9	0.7	0.5	0.5

[1] Components may not sum to total due to rounding, omission of transfer costs of land and existing buildings, and the statistical discrepancy.
[2] The sum of public corporations and private sector investment in new dwellings and improvements to dwellings.
[3] The sum of government consumption and general government investment.

Table C4: Quarterly GDP growth profile

	Percentage change on previous quarter											
						Forecasts						
	2009				2010				2011			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-2.6	-0.7	-0.3	0.4	0.3	0.6	0.6	0.6	0.5	0.6	0.6	0.7

Fiscal forecast

C.32 In our report published on 14 June 2010 we set out fiscal forecasts based on the policies announced or introduced by the previous Government, our own view of economic prospects, and market expectations of interest rates. Our new forecasts embody the effects of all firm and final policy announcements made by the Government, including the public expenditure cuts announced on 24 May 2010 and the measures announced in this Budget. They do not take account of any proposals whose effects are not quantifiable or where final decisions have yet to be taken.

Scorecard costings

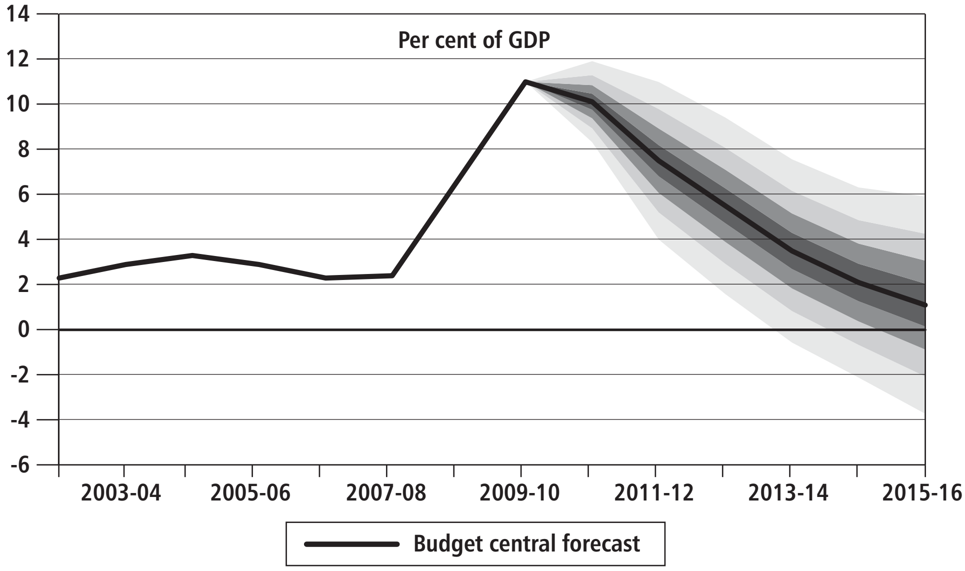
C.33 To produce the Budget forecast, the OBR has scrutinised the Government's assessment of the direct cost or yield of Budget policy decisions that affect the economy and public finance forecasts, and has certified that the Government's assessment represents a reasonable and central view given information currently available.[2] The costings have been produced on the basis of our Budget economic forecast. As with all forecasts, these costings are inevitably subject to a degree of uncertainty, particularly where full information from administrative data or supporting research evidence is not available. The behavioural response to the bank levy is particularly uncertain, as is the fiscal impact of the introduction of new benefit rules in housing and disability benefits. We would expect that some Budget policy costings will develop further as new evidence on the impact of policy measures becomes available.

[2] In the case of pensions tax relief, the OBR has included in its forecasts the projected yield from the measure in Finance Act 2010 – a restriction of relief on pension contributions for individuals on high incomes. The OBR has noted that the Chancellor intends to change this legislation and will consider the revised approach in future forecasts.

C.34 The forecast for the public finances set out in this annex is a central view of future prospects. But significant uncertainties apply to all forecasts at all times, and particularly to fiscal forecasts at the present time. The degree of uncertainty increases during the forecast period. We attempt to quantify the range of uncertainty through the use of fan charts. The methodology for this is set out in detail in the *Pre-Budget forecast* document.

C.35 Chart C4 shows our central forecast for PSNB as a share of GDP – the solid black line – and the probability of outcomes deviating from that forecast. The distribution shows that the probability of PSNB in 2010-11 being within one percentage point of the central forecast is around 50 per cent. The probability of PSNB being within one percentage point of the central forecast in 2011-12 falls to around 30 per cent and to around 20 per cent in 2014-15. There is a 50 per cent probability of PSNB being 1.1 per cent of GDP or lower in 2015-16.

Chart C4: Public sector net borrowing fan chart



Forecast approach and assumptions

C.36 Our fiscal forecast approach is as set out in detail in the *Pre-Budget forecast* document. In particular we have produced a central forecast. This differs from the approach used by the previous Government, under which some assumptions were designed to add caution to the fiscal forecast. Table C5 shows the key determinants of the Budget forecast. The changes to the economy forecast set out above result in revised paths for GDP and its components, prices and claimant count unemployment. We have also updated equity prices, oil prices and interest rates for the Budget forecast. In all other cases, this forecast is based on the same assumptions as in our pre-Budget forecast. The *Pre-Budget forecast* document explains these assumptions and our judgements in detail.

C.37 Our forecasts for expenditure are based on the totals announced by the Government in this Budget. The final allocation between Annually Managed Expenditure (AME) and Departmental Expenditure Limits (DEL) will be decided in the Spending Review. In our forecast, implied levels of DEL are derived by subtracting our forecasts of AME from the announced spending totals. The AME forecasts include the effect of the measures announced in this Budget, but not the effect of any further measures the Government may announce in the Spending Review.

Table C5: Determinants of the fiscal forecast

	Percentage change on a year earlier, unless otherwise specified							
	Outturn	Estimate	Forecasts					
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
GDP and its components								
Real GDP	-1.4	-3.7	1.8	2.4	2.9	2.8	2.7	2.7
Nominal GDP (£ billion)[1]	1434	1408	1474	1539	1620	1710	1803	1902
Nominal GDP[1]	1.1	-1.8	4.7	4.4	5.3	5.5	5.4	5.5
Wages and salaries[2]	1.9	-0.6	1.7	2.4	3.5	5.3	5.4	5.4
Non-oil PNFC profits[2, 3]	0.6	-5.1	1.5	9.0	10.1	9.3	7.6	8.7
Consumer spending[2, 3]	4.0	-1.9	4.3	4.3	4.3	4.8	4.9	5.0
Prices and earnings								
GDP deflator	2.5	1.9	2.9	1.9	2.3	2.6	2.7	2.7
RPI (September)[4]	5.0	-1.4	4.2	3.4	3.0	3.2	3.4	3.5
Rossi (September)[5]	6.3	1.8	4.4	3.0	2.4	2.5	2.5	2.5
Whole economy earnings growth	1.8	1.5	2.0	1.9	2.6	4.1	4.4	4.4
Other key fiscal determinants								
Claimant count unemployment (Q4, millions)[6]	1.10	1.62	1.50	1.45	1.37	1.26	1.17	1.08
VAT gap (per cent)	15.3	13.3	12.7	12.6	12.7	12.7	12.7	12.8
Financial and property sectors								
Equity prices (index)[7]	2383	2619	2677	2795	2943	3106	3274	3455
HMRC financial sector profits[1, 3, 8]	-17.0	2.7	8.9	5.5	5.5	6.0	6.0	6.0
Residential property prices[9]	-5.6	-3.0	4.1	2.3	4.2	4.5	4.5	4.5
Residential property transactions[10]	-47.4	14.0	5.2	22.6	17.0	12.1	4.3	1.0
Commercial property prices[11]	-27.3	5.9	6.7	7.8	9.8	6.5	4.7	3.6
Commercial property transactions[10]	-21.0	-17.5	9.0	6.5	4.5	5.4	5.2	4.8
Oil and gas								
Oil prices ($ per barrel)[3]	98	62	78	82	85	87	88	90
Oil production (million tonnes)[3, 12]	71.7	67.8	64.6	61.5	58.2	55.6	52.7	50.1
Gas production (billion therms)[3, 12]	25.5	21.6	20.3	19.3	18.4	17.5	16.8	15.9
Interest rates								
Market short-term interest rates (per cent)[13]	4.6	0.8	1.1	1.8	2.4	3.2	3.8	4.2
Market gilt rates (per cent)[14]	3.8	3.1	3.4	4.0	4.5	4.8	5.0	5.1

[1] *Not seasonally adjusted.*
[2] *Nominal.*
[3] *Calendar year.*
[4] *Used for revalorising excise duties in current year and uprating income tax allowances and bands in the following year.*
[5] *RPI excluding housing costs.*
[6] *UK seasonally-adjusted claimant count.*
[7] *FTSE All-share index.*
[8] *HMRC Gross Case 1 trading profits.*
[9] *Communities and Local Government (CLG) property prices index.*
[10] *ONS property transactions series.*
[11] *Outturn data from HMRC information on stamp duty land tax.*
[12] *DECC forecasts available at www.og.decc.gov.uk.*
[13] *3-month sterling interbank rate (LIBOR).*
[14] *Weighted average interest rate on conventional gilts.*

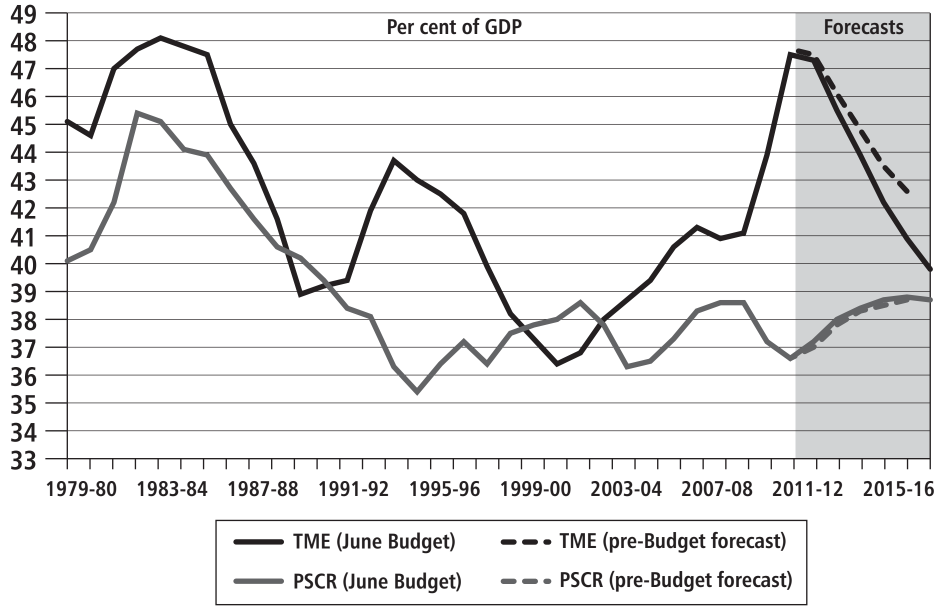
Budget forecast

C.38 The key fiscal aggregates are set out in Table C6 and Table C7. Public sector net borrowing falls from 11.0 per cent of GDP in 2009-10 to 1.1 per cent in 2015-16. The current budget deficit falls from 7.5 per cent of GDP to 0.0 per cent over the same period. Public sector net debt is forecast to rise to a peak of 70.3 per cent of GDP in 2013-14, before falling to 67.4 per cent in 2015-16. The cyclically-adjusted current budget moves from a deficit of 5.3 per cent of GDP in 2009-10 to a surplus of 0.8 per cent in 2015-16.

C.39 The pre-Budget forecast included projections up to 2014-15. To be consistent with the Government's fiscal mandate the Budget forecast includes projections for 2015-16. Total public sector current receipts in 2015-16 fall slightly from 2014-15 as a share of GDP. Rising income tax receipts as a percentage of GDP in 2015-16 are offset by declines in VAT, offshore corporation tax and some excise duties. Offshore corporation tax falls as a share of GDP due to our assumption of declining UK oil and gas production. Fuel duties and vehicle excise duty decline as a percentage of GDP due to assumptions of increased fuel efficiency. VAT declines because of our assumption of rebalanced economic growth with consumption growing more slowly than the economy as a whole.

C.40 Overall Resource AME rises by 2 per cent in real terms in 2015-16. Social security increases by around 1½ per cent in real terms driven primarily by the linking of the Basic State Pension and pension credits to average earnings, and demographic changes. The net cost of public service pensions continues to rise, to £10 billion in 2015-16.

Chart C5: Receipts and expenditure[1]



[1] *Public sector current receipts (PSCR) and Total Managed Expenditure (TME).*

Table C6: Fiscal aggregates

	Per cent of GDP							
	Outturn	Estimate	Forecasts					
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Receipts and expenditure								
Public sector current receipts	37.2	36.6	37.2	38.0	38.4	38.7	38.8	38.7
Total managed expenditure	43.9	47.5	47.3	45.5	43.9	42.2	40.9	39.8
Deficit								
Surplus on current budget	-3.5	-7.5	-7.5	-5.7	-4.0	-2.3	-0.9	0.0
Public sector net borrowing	6.7	11.0	10.1	7.5	5.5	3.5	2.1	1.1
Cyclically-adjusted surplus on current budget	-3.1	-5.3	-4.8	-3.2	-1.9	-0.7	0.3	0.8
Cyclically-adjusted net borrowing	6.3	8.7	7.4	5.0	3.4	1.8	0.8	0.3
Financing								
Central government net cash requirement	11.3	14.1	9.9	7.8	5.5	3.8	2.0	1.1
Public sector net cash requirement	4.2	9.6	9.3	7.7	5.6	4.3	2.5	1.5
Sustainability								
Public sector net debt[1]	44.0	53.5	61.9	67.2	69.8	70.3	69.4	67.4
Net worth[2]	22.4	13.8	6.9	2.4	-0.8	-2.5	-2.2	-0.2
Primary balance	-5.0	-9.0	-7.4	-4.8	-2.7	-0.6	0.9	1.9
Stability and Growth Pact								
Treaty deficit[3]	6.8	11.3	10.1	7.6	5.6	3.6	2.2	1.2
Cyclically-adjusted Treaty deficit[3]	6.4	9.0	7.5	5.1	3.5	1.9	0.9	0.4
Treaty debt ratio[4]	55.8	71.2	78.9	83.6	85.5	84.9	83.1	80.4
	£ billion							
Surplus on current budget	-49.7	-105.6	-110	-88	-65	-40	-17	0
Net investment	46.4	49.0	39	27	24	20	21	21
Public sector net borrowing	96.1	154.7	149	116	89	60	37	20
Central government net cash requirement	162.4	198.9	146	121	90	65	35	21
Public sector net debt	616.9	771.5	932	1,059	1,162	1,235	1,284	1,316
Memo: Output gap (% of GDP)	*-1.0*	*-4.1*	*-3.7*	*-3.5*	*-2.8*	*-2.3*	*-1.6*	*-0.9*

Note: All measures are shown on the basis which excludes the temporary effect of the financial interventions except the aggregates shown in the Financing and Stability and Growth Pact sections.

[1] *Debt at end March; GDP centred on end March.*

[2] *Estimate at end December; GDP centred on end December.*

[3] *General government net borrowing on a Maastricht basis.*

[4] *General government gross debt on a Maastricht basis.*

Table C7: Components of net borrowing

	£ billion							
	Outturn	Estimate	Forecasts					
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Current budget								
Current receipts	533.8	514.6	548	584	622	662	700	737
Current expenditure	564.7	600.6	637	651	665	679	693	711
Depreciation	18.7	19.7	21	22	22	23	24	25
Surplus on current budget	**-49.7**	**-105.6**	**-110**	**-88**	**-65**	**-40**	**-17**	**0**
Capital budget								
Gross investment[1]	65.1	68.7	59	49	47	43	45	46
Less depreciation	-18.7	-19.7	-21	-22	-22	-23	-24	-25
Net investment	46.4	49.0	39	27	24	20	21	21
Net borrowing	**96.1**	**154.7**	**149**	**116**	**89**	**60**	**37**	**20**

[1] *Net of asset sales; for a breakdown see June Budget 2010: the economy and public finances - supplementary material.*

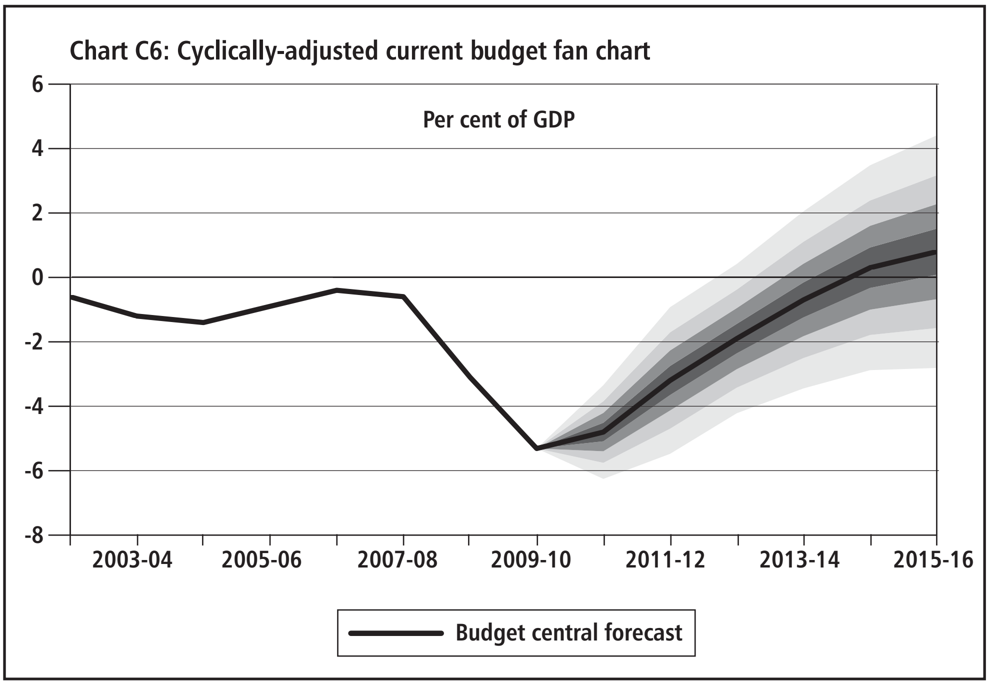
Fiscal mandate

C.41 The Budget announces the Government's forward-looking fiscal mandate to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period. At this Budget, the end of the forecast period is 2015-16.

C.42 The 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.

C.43 Chart C6 shows the central (median) forecast for the cyclically-adjusted surplus on current budget – the solid black line – and an illustration of the scale of uncertainty around our forecast, based on past forecasting errors made by the Treasury. The successive pairs of lighter shaded areas represent 10 per cent probability bands, implying that there is an 80 per cent chance that the actual outturn will lie within the range captured by the lightest bands shown on the chart.[3] The chart indicates that in 2014-15 and 2015-16 there is a greater than 50 per cent chance of the cyclically-adjusted current budget being balanced or in surplus.[4,5]

[3] The top and bottom 10 per cent bands are not shown on the chart.
[4] The method used to construct this chart is consistent with that set out in Annex A of the pre-Budget forecast for PSNB. The sample uses errors since 1998. The data, which are unavoidably based on a small sample size, show a smaller standard deviation for the four- and five-year ahead forecast errors than the three-year ahead forecast errors. Given our expectation that uncertainty increases over the forecast period we have assumed that the standard deviation increases in line with the average increase over the first three years. We have also made this assumption for 2015-16, as there are no data on forecasting errors six years ahead.
[5] The outturn for the cyclically-adjusted surplus on current budget, and cyclically-adjusted net borrowing, is based on HM Treasury estimates of the output gap, and does not necessarily represent the OBR's view of the cyclical position of the economy before 2009-10.



C.44 On this basis, we judge that the Government's policy is consistent with a greater than 50 per cent chance of achieving the fiscal mandate set for 2015-16. Our forecast also shows that there is a greater than 50 per cent chance of achieving the fiscal mandate in 2014-15, a year ahead of the date set by the Government.

C.45 We have also assessed the probability of meeting the Government's target for debt. Given our central forecast for economic growth and the path of net debt, PSND will fall as a percentage of GDP in 2014-15 or 2015-16 if PSNB is less than 3 per cent of GDP in those years. Our central forecast implies that in 2014-15 there is a 50 per cent probability that PSNB will be below 2.1 per cent and in 2015-16 there is a 50 per cent probability that PSNB will be below 1.1 per cent. On this basis, our assessment is that there is a more than 50 per cent chance of debt as a percentage of GDP falling in 2015-16[6]. There is a smaller, but still more than 50 per cent, chance of debt falling in 2014-15, a year earlier than the target.

Comparisons with the Pre-Budget forecast

C.46 In this section we describe and explain the differences between the pre-Budget and Budget forecasts. The Budget forecast includes the effect of all firm policy announcements made by the Government and a number of other changes.

C.47 The other changes include updating the assumptions on market interest rates, oil prices and equity prices. Oil prices are assumed to move in line with the prices implied by futures markets as of 3 June 2010, whereas the pre-Budget forecast used prices from 25 May 2010. Oil prices are $5-8 a barrel higher than previously assumed. Starting points for equity prices and market expectations of interest rates are based on an average for the ten working days ending 3 June 2010. The pre-Budget forecast used the average for the ten working days to 26 May 2010.

[6]Our assessment applies to the probability of achieving the fiscal mandate and the target for debt separately, rather than jointly.

Direct effect of Budget policy measures

C.48 The traditional way of reporting the effect of Budget measures, whether announced in the Budget or in the Pre-Budget Report, has been in the form of a table like Table 2.1 in Chapter 2. This table sets out the direct effects of the policy measures on the fiscal forecast. The explanation for the changes is provided in the Budget supplementary document *Policy costings: methodology paper*.

C.49 The main measures set out are:

- a policy decision to reduce total spending by an additional £32 billion a year by 2014-15, including debt interest savings;
- an increase in the standard rate of VAT from 17.5 per cent to 20 per cent with effect from 4 January 2011;
- an increase in the employer NICs threshold by £21 per week in addition to indexation from April 2011. The personal tax allowance for under 65s will increase by £1,000 to £7,475 in 2010-11;
- a bank levy based on banks' balance sheets will be introduced from 1 January 2011. It is proposed that the levy will be set at a rate of 0.07 per cent, with a lower initial rate of 0.04 per cent in 2011; and
- a reduction in the main rate of corporation tax from 28 per cent to 24 per cent over four years, with a one per cent reduction from 1 April 2011, and a reduction in capital allowances from 2012, including a reduction in the capital allowance on the general pool of plant and machinery from 20 per cent to 18 per cent in April 2012.

C.50 Table 2.1 shows the *direct* effect of individual measures. The effect of each Budget measure is generally calculated as the difference between applying the pre-Budget and Budget regime to the levels of total incomes and spending at factor cost expected after the Budget. Such calculations do not show the *total* effect on receipts or spending after possible changes in the level or pattern of spending or other macroeconomic variables induced by that change. For example, a change in duties, in addition to indexation, might change consumption of the good bearing the duty and thereby reduce the dutiable base. It might also have an effect on GDP, through its effects on aggregate demand. The table would show the yield of the measure incorporating the effect of the change in duties applied to the reduced base. It would not necessarily show the total effect on duty receipts, since it would not show the possible effects which come through the reduction in aggregate demand.

C.51 The economic and fiscal forecasts which accompanied previous Budgets and Pre-Budget Reports did embody the total effects of policy measures, including both direct and indirect effects. The judgement on the indirect effect of policy measures has typically been made in the round, taking account of all the measures and based on the prevailing macroeconomic circumstances at the time. However, since many things change between fiscal events, it was not possible to distinguish indirect effects of policy changes from the many other factors affecting the forecasts.

C.52 On this occasion, matters are rather different since the OBR has recently published a pre-Budget forecast. Although as described above, there have been other changes since the pre-Budget forecast was completed, the main source of changes is the Budget measures. It is therefore desirable to explain how the measures have changed the economic forecast and hence the fiscal forecast.

Monetary policy response

C.53 The pre-Budget forecast does not provide a firm basis for an estimate of the effects of the Budget measures on the economy because the pre-Budget and Budget forecasts are both based on market expectations of interest rates. These are likely to have incorporated some expectation of further fiscal tightening but it is impossible to judge how much, as described in Box C1. This may have introduced an upward bias into the pre-Budget forecast and make comparison misleading.

Box C1: Short and long-term interest rates in the pre-Budget and Budget forecasts

In the pre-Budget forecast, we emphasised that the use of market expectations to derive the path of interest rates was potentially inconsistent. It may have biased the economic forecast upwards, with consequential effects on the fiscal forecasts. That inconsistency might have been present in both short and long-term interest rates.

It is very difficult to calculate the possible degree of bias, but a thought experiment might provide a guide to its upper limit. It would be normal to expect some monetary policy response to additional fiscal tightening, to help offset the impact on aggregate demand if that were necessary to meet the inflation target. Suppose that:

- markets had correctly predicted the degree of tightening in the Budget and the MPC's reaction to it; and
- the MPC was able to offset precisely the demand effects of the Budget measures, and aimed to do so.

If this were the case, the short-term interest rates used in the pre-Budget forecast, which assumed no further fiscal tightening, would be too low. To be consistent, they would instead be higher to the degree required to compensate for the smaller fiscal tightening. Applying those higher interest rates would mean that, under these strong assumptions, the output path in the pre-Budget forecast would be the same as in the Budget projections.

There is a similar argument for long-term interest rates. Long-term interest rates are determined in international financial markets, and can be affected by many factors including expectations of future monetary policy, the fiscal position and risk premia. Empirically, lower debt and deficits are associated with lower long-term bond yields, though the relationship is complicated and probably non-linear. The likely effect of the Budget on long-term interest rates can nevertheless be estimated by using regression estimates of the relationship between bond yields and government deficits, debt, the output gap and inflation. This calculation suggests that bond yields could have been around 30 basis points higher over the next three years without the measures in this Budget.

Taking these points together, if the market expected further fiscal tightening in the Budget, then following the path of fiscal policy in the pre-Budget forecast would imply higher interest rates than those used. If higher interest rates had been assumed in the pre-Budget forecast, the implied path of output would have been lower. In other words, the differences in the path of output between the two forecasts would be at least partly offset by the effect of the different interest rate paths.

These calculations are illustrative, highly uncertain and depend on a range of assumptions. For example, although there was a widespread expectation of further fiscal tightening in the Budget, it is not possible to establish what exactly the market was expecting. The MPC is also unlikely to be able to offset precisely the demand effects of the Budget. Consequently, were it possible to produce one, it is unlikely that an adjusted pre-Budget profile for output would be identical to the Budget profile. Nonetheless, this illustration helps explain why it is potentially misleading to interpret the difference between the pre-Budget and Budget forecasts as the economic impact of the Budget measures.

Fiscal multipliers

C.54 The OBR has applied a range of fiscal multipliers to key Budget measures to help inform its judgement on the overall impact of the Budget forecasts. These multipliers are shown in Table C8. A figure of 0.6, for example, means that a measure which has a direct effect of raising revenue by 1 per cent of GDP is estimated to reduce GDP by 0.6 per cent in the short run. The multipliers are based on a range of empirical studies[7] which, together with judgement, can be applied to specific policy changes. The table shows the impact multipliers, which show the immediate effect of the change. We assume that the immediate effect is reduced over time through a number of processes as the economy adjusts. These include a monetary policy response as well as real wage adjustments which allow those who have become unemployed to find jobs elsewhere and higher private sector investment as the private sector expands its capacity in order to make use of the resources no longer employed in the public sector.

Table C8: Estimates of fiscal multipliers

	Impact multipliers
Change in VAT rate	0.35
Changes in the personal tax allowance and National Insurance Contributions (NICs)	0.3
AME welfare measures	0.6
Implied Resource Departmental Expenditure Limits (RDEL)	0.6
Implied Capital Departmental Expenditure Limits (CDEL)	1.0

C.55 While the multipliers help inform the judgement over the impact of the Budget package on aggregate demand they provide only a partial and summary estimate of the economic effects that we have considered in preparing the forecast.

C.56 The Budget measures to increase the personal allowance for income tax and the employer NICs threshold will change post-tax labour income. The overall effect on aggregate labour supply will reflect both the income effect, where employees need to work fewer hours for the same income, and the substitution effect that encourages the supply of labour since the opportunity cost of leisure has risen. The net effect on aggregate labour supply is ambiguous since some people may be encouraged into work while others already employed may work fewer hours. Our central judgement is that in the long run and in aggregate the effects are offsetting so that the elasticity of labour supply is zero. This implies that in the long run the incidence of these two measures falls on real wages so that labour income is permanently higher.

C.57 The Budget measures relating to the changes in the corporation tax regime are not explicitly incorporated via multipliers. The cost of capital, which is the fundamental determinant of business investment in the long run, will be altered by the reforms to corporation tax. The cuts in the corporation tax rate more than offset the cuts in investment allowances so that the estimated cost

[7] A review of estimates for fiscal multipliers for different policy instruments and countries is available in *Fiscal Multipliers*, Antonio Spilimbergo, Steve Symansky, Martin Schindler (IMF Staff Position Note), May 2009. Further evidence was taken from papers including: *Fiscal Policy Action in the Banking Crisis*, National Institute Economic Review, January 2009; *Fiscal Stabilisation and EMU*, HM Treasury, 2003; *Public Investment and the Golden Rule: Another (Different) Look*, Roberto Perotti (IGIER Working Paper No 277), 2006; and *Estimating Tax and Benefit Multipliers in Europe*, Ali J Al-Eyd and Ray Barrell, Economic Modelling (Vol 22), 2005.

of capital for new investment is lower for all non-financial companies, and the rate of return from the existing capital stock is higher. Our judgement is that this measure will promote a higher level of business investment throughout the forecast than would otherwise have been the case.

C.58 An appropriate multiplier has informed the judgement on the effect of the increase in the rate of VAT on demand. The initial incidence of an increase in the rate of VAT will depend on how selling prices change in response. If firms leave their price net of tax unchanged the increase in VAT will be fully reflected in prices; alternatively if they reduce this price some of the incidence will be borne by firms in lower profits. Drawing on evidence of domestic and international changes in VAT rates, we judge that around two thirds of the VAT increase will be passed on relatively quickly to prices, with further adjustment in the following year. The increase in prices lowers real incomes and hence, all else equal, consumption. The remaining incidence of the VAT increase is borne by the firm.

C.59 It could be argued that the impact multipliers for policies which have been pre-announced for later years should be smaller since people and firms will have had longer to anticipate them and act accordingly, but we have not made any adjustment for that possible effect. Against that, the multipliers may be larger if cuts to benefits, for example, affect households without ready access to credit. The multipliers we have used go some way to correcting the potential error in using what might be inconsistent assumptions on interest rates in the pre-Budget forecast since they are partly estimated over periods in which there has been a monetary policy response to fiscal tightening.

Long-run effect

C.60 It is possible for policy changes to have permanent effects to the extent that they improve or worsen the supply-side performance of the economy. Our judgement on the effect of the Budget policy package is based on the assumption that trend output will not be changed.

Comparison of the pre-Budget and Budget fiscal forecasts

C.61 Table C9 reconciles our pre-Budget and Budget forecasts by summarising the changes in PSNB and the cyclically-adjusted current budget for the period to 2014-15.

C.62 As Table C9 shows, PSNB is £33 billion lower in 2014-15, compared with the pre-Budget forecast, because:

- the direct effects of total policy decisions, excluding debt interest savings, reduce PSNB by £37 billion in 2014-15;
- debt interest payments, excluding the effect of moving to updated interest rates, reduce borrowing by £3 billion in 2014-15;
- the updated market assumptions reduce borrowing by £2 billion in 2014-15. This includes the effect of updated interest rates, which reduce debt interest costs by around £1 billion; and
- other changes raise borrowing by £9 billion in 2014-15.

C.63 Table C9 also shows the change in the cyclically-adjusted current balance in 2014-15 between the pre-Budget and Budget forecast. Our forecast is for a slightly larger output gap than in the pre-Budget forecast. This means that a larger proportion of total borrowing is estimated to be cyclical rather than structural in the Budget forecast.

Table C9: Changes to the fiscal aggregates since the pre-Budget forecast

	£ billion					
	Estimate	Forecasts				
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Public sector net borrowing						
Pre-Budget forecast	**156.1**	**155**	**127**	**106**	**85**	**71**
Direct effect of total policy decisions[1]	0.0	-8	-16	-23	-31	-37
Changes from updated market assumptions	0.0	0	-1	-2	-2	-2
Debt interest, excluding effect of updated interest rates	0.0	1	1	-1	-2	-3
Other changes	-1.5	2	5	9	9	9
Budget	**154.7**	**149**	**116**	**89**	**60**	**37**
	Per cent of GDP					
Cyclically-adjusted surplus on current budget						
Pre-Budget forecast	**-5.3**	**-5.2**	**-4.2**	**-3.1**	**-2.3**	**-1.6**
Direct effect of total policy decisions[1]	0.0	0.5	1.0	1.4	1.8	2.1
Other	0.1	-0.2	-0.1	-0.2	-0.2	-0.1
Budget	**-5.3**	**-4.8**	**-3.2**	**-1.9**	**-0.7**	**0.3**

[1] *Equivalent to the 'total policy decisions excluding debt interest savings' line in Table 2.1.*

Changes in receipts compared to the pre-Budget forecast

C.64 Table C10 shows the changes in the key fiscal aggregates compared to the pre-Budget forecast. Tables C11 to C14 show the detailed Budget forecasts for receipts and expenditure, and the changes compared to the pre-Budget forecast. The key changes to the receipts forecast are:

- **income tax and NICs** are around £10 billion lower than in the pre-Budget forecast by 2014-15. This is primarily the direct effect of the increases in the employer NICs threshold and the personal allowance. It is also partly due to the effect on receipts of our Budget forecast for earnings and employment;
- **VAT** receipts are higher than the pre-Budget forecast by £11 billion by 2014-15. This is due to the direct yield of the increase in the VAT rate, with a partial offset from the change to the forecast of real consumption;
- **onshore corporation tax** is around £2½ billion lower than the pre-Budget forecast in 2014-15. The direct effects of the Budget enterprise package reduce corporation tax by around £1¼ billion by 2014-15. In addition, corporation tax receipts are affected by the lower Budget forecast for company profits;
- **offshore corporation tax** is around £1 billion higher in 2014-15 than in the pre-Budget forecast. This is due to updating oil price futures to 3 June 2010; and
- **further changes to receipts** primarily reflect the direct effect of Budget policy measures, such as the yield from the new bank levy. There is also an increase in VAT refunds as a result of the VAT rate change, which is fiscally neutral as it is offset in AME.

Changes in expenditure compared to the pre-Budget forecast

C.65 The key changes to the components of AME are:

- **social security** is around £6 billion lower than in the pre-Budget forecast by 2014-15. This is primarily due to the direct effects of the Budget social security policy measures. There is a partial offset from the change to the Budget forecast for inflation;
- **tax credits** are around £2 billion lower than in the pre-Budget forecast in 2014-15, predominantly due to the tax credit reforms announced in this Budget;
- **debt interest costs** are £4 billion lower in 2014-15 than in the pre-Budget forecast. Approximately £1 billion of this is due to the use of updated interest rates from 3 June. The remaining £3 billion is due to the lower borrowing profile as a result of the Budget policy measures; and
- **further changes to AME** include small changes to pensions, local authority self-financed expenditure and other capital expenditure reflecting the effects of Budget policy measures, and an increase in VAT refunds which is offset by higher receipts.

C.66 The Budget sets out the Government's overall spending plans in the period to 2015-16, with public sector current expenditure (PSCE) rising to £711 billion and public sector gross investment (PSGI) falling to £43 billion in 2013-14, before rising to £46 billion in 2015-16. In 2014-15, the plans for PSCE are £28 billion lower than in our pre-Budget forecast, which assumed that PSCE grew at the same nominal rates as in the March Budget. The plans for PSGI in 2014-15 are £2 billion lower than in our pre-Budget forecast which was based on the March Budget assumption for PSNI as a share of GDP.

C.67 Our Budget forecast shows implied Resource DEL (RDEL) derived as the difference between Resource AME and PSCE, and implied Capital DEL (CDEL) derived as the difference between PSGI and Capital AME. They do not represent the Government's plans for RDEL and CDEL.

C.68 Compared to the pre-Budget forecast implied RDEL is lower by £15.5 billion in 2014-15. This is derived from the lower PSCE plans offset by the reduced Resource AME forecast. Similarly, implied CDEL is £1.6 billion below the pre-Budget forecast, derived from lower PSGI plans offset by the reduced Capital AME forecast.

Table C10: Changes to the fiscal forecast

	Outturn	Estimate	Forecasts				
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Surplus on current budget (£ billion)							
March Budget	-48.9	-116.6	-124	-102	-84	-67	-51
Change	-0.4	10.2	10	4	3	3	3
OBR pre-Budget forecast	-49.3	-106.4	-114	-98	-80	-63	-48
Change	-0.4	0.7	4	10	15	23	31
June Budget	**-49.7**	**-105.6**	**-110**	**-88**	**-65**	**-40**	**-17**
Net investment (£ billion)							
March Budget	47.2	50.0	40	29	26	22	23
Change	0.0	-0.3	1	0	0	0	0
OBR pre-Budget forecast	47.2	49.7	41	29	26	22	23
Change	-0.8	-0.6	-2	-2	-2	-2	-2
June Budget	**46.4**	**49.0**	**39**	**27**	**24**	**20**	**21**
Net borrowing (£ billion)							
March Budget	96.1	166.5	163	131	110	89	74
Change	0.4	-10.4	-8	-4	-3	-4	-3
OBR pre-Budget forecast	96.5	156.1	155	127	106	85	71
Change	-0.4	-1.5	-6	-12	-17	-25	-33
June Budget	**96.1**	**154.7**	**149**	**116**	**89**	**60**	**37**
Net borrowing (per cent of GDP)							
March Budget	6.7	11.8	11.1	8.5	6.8	5.2	4.0
Change	0.0	-0.8	-0.7	-0.3	-0.2	-0.2	-0.1
OBR pre-Budget forecast	6.7	11.1	10.5	8.3	6.6	5.0	3.9
Change	0.0	-0.1	-0.4	-0.8	-1.1	-1.5	-1.8
June Budget	**6.7**	**11.0**	**10.1**	**7.5**	**5.5**	**3.5**	**2.1**
Cyclically-adjusted surplus on current budget (per cent of GDP)							
March Budget	-2.5	-4.8	-4.6	-3.4	-2.5	-1.8	-1.3
Change	-0.6	-0.5	-0.6	-0.8	-0.7	-0.5	-0.3
OBR pre-Budget forecast	-3.1	-5.3	-5.2	-4.2	-3.1	-2.3	-1.6
Change	0.0	0.1	0.4	0.9	1.2	1.6	1.9
June Budget	**-3.1**	**-5.3**	**-4.8**	**-3.2**	**-1.9**	**-0.7**	**0.3**
Cyclically-adjusted net borrowing (per cent of GDP)							
March Budget	5.8	8.4	7.3	5.3	4.1	3.1	2.5
Change	0.6	0.5	0.6	0.8	0.7	0.5	0.3
OBR pre-Budget forecast	6.4	8.8	8.0	6.1	4.7	3.5	2.8
Change	0.0	-0.1	-0.5	-1.0	-1.4	-1.7	-2.0
June Budget	**6.3**	**8.7**	**7.4**	**5.0**	**3.4**	**1.8**	**0.8**
Net debt (per cent of GDP) [1]							
March Budget	43.8	54.1	63.6	69.5	73.0	74.5	74.9
Change	0.2	-0.6	-1.5	-1.3	-1.1	-0.8	-0.5
OBR pre-Budget forecast	44.0	53.5	62.2	68.2	71.8	73.7	74.4
Change	0.0	0.0	-0.3	-1.1	-2.0	-3.4	-5.0
June Budget	**44.0**	**53.5**	**61.9**	**67.2**	**69.8**	**70.3**	**69.4**

Note: Totals may not sum due to rounding.

[1] *Debt at end March; GDP centred on end March.*

Table C11: Current receipts

	£ billion							
	Outturn	Estimate	Forecasts					
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
HM Revenue and Customs								
Income tax (gross of tax credits)[1]	153.5	145.6	150.2	156.3	167.6	181.4	195.2	208.5
of which: Pay as you earn	*128.5*	*122.9*	*130.1*	*133.3*	*137.7*	*147.6*	*158.4*	*169.2*
Self assessment	*22.5*	*21.7*	*21.5*	*24.2*	*29.2*	*32.5*	*35.1*	*37.1*
Income tax credits	-5.6	-5.6	-5.8	-6.1	-6.0	-5.8	-5.9	-5.9
National insurance contributions	96.9	95.6	98.9	102.6	106.4	113.9	120.9	127.7
Value added tax	78.4	70.1	80.7	96.3	99.1	102.6	106.7	111.0
Corporation tax[2]	43.7	36.5	43.3	46.7	50.8	54.1	56.9	59.7
of which: Onshore	*33.4*	*30.9*	*35.7*	*38.4*	*42.1*	*45.2*	*48.3*	*51.4*
Offshore	*10.4*	*5.6*	*7.6*	*8.3*	*8.7*	*8.9*	*8.6*	*8.3*
Corporation tax credits[3]	-0.6	-0.7	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Petroleum revenue tax	2.6	0.9	1.7	1.8	1.8	1.7	1.6	1.4
Fuel duties	24.6	26.2	27.3	28.9	30.3	31.8	33.4	34.7
Capital gains tax	7.8	2.5	2.6	3.3	2.7	3.3	3.9	4.3
Inheritance tax	2.8	2.4	2.2	2.3	2.4	2.6	2.9	3.1
Stamp duty land tax	4.8	4.9	5.8	7.1	9.3	11.1	12.5	13.5
Stamp taxes on shares	3.2	2.9	3.1	3.2	3.4	3.6	3.9	4.2
Tobacco duties	8.2	8.8	9.4	9.5	9.5	9.7	9.9	10.1
Spirits duties	2.4	2.6	2.6	2.6	2.7	2.8	2.9	3.0
Wine duties	2.7	2.9	3.2	3.3	3.5	3.7	4.0	4.3
Beer and cider duties	3.4	3.5	3.7	3.7	3.8	3.9	4.1	4.2
Air passenger duty	1.9	1.9	2.3	2.9	3.0	3.3	3.5	3.8
Insurance premium tax	2.3	2.3	2.3	2.8	2.7	2.8	2.8	2.8
Temporary bank payroll tax	0.0	0.0	2.5	0.0	0.0	0.0	0.0	0.0
Bank levy	0.0	0.0	0.0	1.2	2.3	2.5	2.4	2.3
Other HMRC receipts[4]	6.1	5.9	6.4	6.8	7.1	7.3	7.6	7.7
Total HMRC	439.1	409.1	441.7	474.4	501.8	535.5	568.2	599.6
Vehicle excise duties	5.6	5.6	5.9	6.0	6.1	6.2	6.3	6.4
Business rates	22.9	24.3	24.9	26.0	26.9	28.1	29.3	30.2
Council tax	24.4	25.0	25.3	25.6	26.6	27.7	28.9	29.8
VAT refunds	12.0	11.2	13.5	13.7	15.2	15.2	15.3	15.8
Other taxes and royalties[5]	4.0	4.5	4.3	5.4	6.1	8.3	8.6	9.1
Net taxes and NICs	508.0	479.7	515.5	551.2	582.7	621.0	656.5	690.8
Accruals adjustments on taxes	-4.7	6.7	2.7	1.2	4.2	3.2	3.2	3.3
Less own resources contribution to EU budget	-5.1	-3.8	-4.8	-4.8	-5.0	-5.1	-5.3	-5.5
Interest and dividends	7.7	3.5	4.5	5.5	7.5	9.0	10.5	11.6
Gross operating surplus	23.3	23.9	24.7	25.9	27.0	28.0	29.0	30.1
Other receipts[6]	4.6	4.5	5.1	5.3	5.5	5.9	6.2	6.6
Current receipts	533.8	514.6	547.7	584.2	621.9	661.9	700.1	737.0
Memo:								
Current receipts (% of GDP)	*37.2*	*36.6*	*37.2*	*38.0*	*38.4*	*38.7*	*38.8*	*38.7*
UK oil and gas revenues[7]	*12.9*	*6.5*	*9.4*	*10.2*	*10.6*	*10.5*	*10.1*	*9.7*

[1] *Income tax includes PAYE and Self Assessment receipts, and also includes tax on savings income and other minor income tax components.*

[2] *National Accounts measure, gross of enhanced and payable tax credits.*

[3] *Includes enhanced company tax credits.*

[4] *Consists of landfill tax, climate change levy, aggregates levy, betting and gaming duties and customs duties and levies.*

[5] *Includes EU ETS receipts and money paid into the National Lottery Distribution Fund.*

[6] *Includes TV licences and business rate payments by local authorities.*

[7] *Consists of offshore corporation tax and petroleum revenue tax.*

Table C12: Changes to current receipts since the pre-Budget forecast

	Changes since the pre-Budget forecast (£ billion)						
	Outturn	Estimate	Forecasts				
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
HM Revenue and Customs							
Income tax (gross of tax credits)[1]	0.0	0.0	-0.1	-3.4	-5.5	-4.1	-3.8
of which: Pay as you earn	*0.0*	*0.0*	*-0.1*	*-3.5*	*-5.0*	*-4.3*	*-4.0*
Self assessment	*0.0*	*0.0*	*0.0*	*0.2*	*-0.3*	*0.5*	*0.5*
Income tax credits	0.0	0.0	0.0	0.0	0.2	0.3	0.4
National insurance contributions	0.0	0.0	-0.1	-4.1	-5.6	-6.2	-6.2
Value added tax	0.0	0.0	0.1	9.9	9.9	10.2	10.7
Corporation tax[2]	0.0	0.0	0.1	-0.2	-0.6	-0.7	-1.4
of which: Onshore	*0.0*	*0.0*	*-0.4*	*-1.3*	*-1.6*	*-1.7*	*-2.4*
Offshore	*0.0*	*0.0*	*0.5*	*1.1*	*1.1*	*1.1*	*1.0*
Corporation tax credits[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Petroleum revenue tax	0.0	0.0	0.1	0.2	0.2	0.2	0.2
Fuel duties	0.0	0.0	-0.1	0.1	0.0	0.0	0.0
Capital gains tax	0.0	0.0	0.0	0.1	0.1	0.2	0.2
Inheritance tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stamp duty land tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stamp duty reserve tax	0.0	0.0	0.0	0.0	-0.1	-0.1	0.0
Tobacco duties	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Spirits duties	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Wine duties	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Beer and cider duties	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Air passenger duty	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Insurance premium tax	0.0	0.0	0.0	0.4	0.4	0.4	0.4
Temporary bank payroll tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank levy	0.0	0.0	0.0	1.2	2.3	2.5	2.4
Other HMRC receipts[4]	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Total HMRC	**0.0**	**0.0**	**-0.1**	**4.1**	**1.5**	**2.8**	**3.1**
Vehicle excise duties	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Business rates	0.0	0.0	0.0	-0.1	0.2	0.2	0.2
Council tax	0.0	0.0	0.0	-0.6	-0.6	-0.6	-0.6
VAT refunds	0.0	0.0	-0.3	-0.1	1.1	0.9	0.8
Other taxes and royalties[5]	0.0	-0.3	0.0	-0.2	-0.2	-0.2	-0.2
Net taxes and NICs	**0.1**	**-0.3**	**-0.4**	**3.2**	**2.1**	**3.1**	**3.3**
Accruals adjustments on taxes	-0.5	0.7	1.8	-0.6	-0.2	0.1	0.2
Less own resources contribution to EU budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest and dividends	0.0	-0.3	-0.1	0.0	0.0	-0.2	-0.3
Gross operating surplus	-0.2	-0.7	0.0	0.0	0.0	0.0	0.0
Other receipts[6]	0.4	-0.1	0.0	0.0	0.0	0.0	0.0
Current receipts	**-0.2**	**-0.7**	**1.2**	**2.7**	**1.9**	**3.0**	**3.2**
Memo:							
Current receipts (% of GDP)	*0.0*	*0.0*	*0.2*	*0.1*	*0.1*	*0.2*	*0.2*
UK oil and gas revenues[7]	*0.0*	*0.0*	*0.6*	*1.3*	*1.3*	*1.3*	*1.2*

[1] *Income tax includes PAYE and Self Assessment receipts, and also includes tax on savings income and other minor income tax components.*

[2] *National Accounts measure, gross of enhanced and payable tax credits.*

[3] *Includes enhanced company tax credits.*

[4] *Consists of landfill tax, climate change levy, aggregates levy, betting and gaming duties and customs duties and levies.*

[5] *Includes EU ETS receipts and money paid into the National Lottery Distribution Fund.*

[6] *Includes TV licences and business rate payments by local authorities.*

[7] *Consists of offshore corporation tax and petroleum revenue tax.*

Table C13: Total Managed Expenditure

	£ billion							
	Outturn	Estimate	Forecasts					
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
CURRENT EXPENDITURE								
Resource Departmental Expenditure Limits[1]	313.5	334.8	342.7	*343.1*	*341.4*	*341.2*	*337.7*	*340.0*
Resource Annually Managed Expenditure	251.3	265.8	294.6	308.0	323.1	337.4	355.0	371.4
of which:								
Social security benefits[2]	149.7	163.7	169.3	174.2	178.2	180.8	186.5	194.4
Tax credits[2]	19.9	22.9	23.9	24.8	25.3	25.9	27.1	28.5
Net public service pensions[3]	3.1	3.1	4.0	5.1	5.8	7.3	8.9	10.3
National Lottery	1.0	0.9	0.9	0.9	1.0	0.7	0.7	0.7
BBC domestic services	3.4	3.5	3.7	3.8	3.9	4.1	4.2	4.3
Other departmental expenditure	1.3	0.0	-0.5	2.0	2.0	2.0	2.0	2.1
Net expenditure transfers to EU institutions	3.1	6.4	8.3	8.3	8.3	9.3	10.3	8.7
Locally-financed expenditure	26.8	26.4	27.6	27.0	28.1	29.4	30.5	31.7
Central government gross debt interest	30.5	30.9	43.3	46.5	52.4	57.8	63.0	66.5
Accounting adjustments	12.6	7.9	14.1	15.3	18.1	20.1	21.8	24.0
Public sector current expenditure	564.7	600.6	637.3	651.1	664.5	678.6	692.7	711.4
CAPITAL EXPENDITURE								
Capital Departmental Expenditure Limits[1]	48.5	56.6	51.6	*41.4*	*39.6*	*37.0*	*38.7*	*40.8*
Capital Annually Managed Expenditure	16.6	12.1	7.8	7.3	6.9	6.3	6.2	5.2
of which:								
National Lottery	0.5	1.0	0.9	0.7	0.6	0.6	0.6	0.6
Locally-financed expenditure	7.5	6.3	5.4	4.8	4.6	4.4	4.4	3.6
Public corporations' own-financed capital expenditure	7.1	7.7	7.4	7.4	7.3	7.3	7.3	7.3
Central government grants to public sector banks	9.4	4.7	0.0	0.0	0.0	0.0	0.0	0.0
Other capital expenditure	0.2	1.3	2.1	1.6	1.6	1.6	1.6	1.6
Accounting adjustments	-8.2	-8.8	-7.9	-7.1	-7.2	-7.5	-7.7	-7.9
Public sector gross investment	65.1	68.7	59.5	48.7	46.5	43.3	44.9	46.1
Less public sector depreciation	-18.7	-19.7	-20.6	-21.6	-22.5	-23.4	-24.3	-25.2
Public sector net investment	46.4	49.0	38.9	27.2	24.0	19.9	20.6	20.9
TOTAL MANAGED EXPENDITURE [4]	629.8	669.3	696.8	699.8	711.0	722.0	737.5	757.5
of which:								
Departmental Expenditure Limits [1, 5]	*350.4*	*378.0*	*380.0*	*370.2*	*366.7*	*363.8*	*362.0*	*366.5*
Annually Managed Expenditure [6]	*279.5*	*291.2*	*316.8*	*329.6*	*344.4*	*358.1*	*375.6*	*391.0*
Memo:								
TME (% of GDP)	*43.9*	*47.5*	*47.3*	*45.5*	*43.9*	*42.2*	*40.9*	*39.8*
RDEL if grown in line with general economy inflation			*342.7*	*349.4*	*357.3*	*366.6*	*376.4*	*386.5*
CDEL if grown in line with general economy inflation			*51.6*	*52.7*	*53.8*	*55.3*	*56.7*	*58.3*

Note: All measures on a Clear Line of Sight basis.

[1] Implied DEL numbers from 2011-12 onwards. Calculated as the difference between Resource AME and PSCE in the case of Resource DEL, and between Capital AME and PSNI in the case of Capital DEL.

[2] For 2008-09 to 2010-11, child allowances in Income Support and Jobseekers' Allowance have been included in the tax credits line and excluded from the social security benefits line.

[3] Net public service pensions expenditure is reported on a National Accounts basis.

[4] TME is equal to the sum of PSCE, PSNI and public sector depreciation, on a basis which excludes temporary effects of financial interventions.

[5] Total DEL is given by resource DEL plus capital DEL less depreciation in DEL.

[6] Total AME is given by resource AME plus capital AME plus depreciation in DEL.

Table C14: Changes to Total Managed Expenditure since the pre-Budget forecast

	Changes since the pre-Budget forecast (£ billion)						
	Outturn	Estimate	Forecast				
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
CURRENT EXPENDITURE							
Resource Departmental Expenditure Limits	0.0	0.0	-3.4	*-5.4*	*-9.3*	*-11.5*	*-15.5*
Resource Annually Managed Expenditure	0.2	-1.5	0.9	-1.6	-4.0	-8.6	-12.4
of which:							
Social security benefits	0.0	0.0	0.0	-0.8	-1.0	-3.7	-5.6
Tax credits	0.0	0.0	0.0	-0.1	-0.9	-1.4	-1.9
Net public service pensions	0.0	0.0	0.0	-0.4	-0.4	-0.7	-0.5
National Lottery	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BBC domestic services	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other departmental expenditure	0.0	0.0	0.0	0.0	-0.1	-0.2	-0.3
Net expenditure transfers to EU institutions	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1
Locally-financed expenditure	0.0	0.0	0.0	-0.6	-0.6	-0.4	-0.4
Central government gross debt interest	0.0	0.0	1.1	0.4	-1.8	-2.8	-4.2
Accounting adjustments	0.2	-1.6	-0.3	-0.1	0.9	0.7	0.5
Public sector current expenditure	0.2	-1.5	-2.5	-7.1	-13.3	-20.1	-27.9
CAPITAL EXPENDITURE							
Capital Departmental Expenditure Limits[1]	0.0	0.0	-1.5	*-1.5*	*-1.5*	*-1.6*	*-1.6*
Capital Annually Managed Expenditure	-0.8	-0.6	-0.4	-0.5	-0.4	-0.4	-0.4
of which:							
National Lottery	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Locally-financed expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public corporations' own-financed capital expenditure	-0.7	0.9	0.0	0.0	0.0	0.0	0.0
Central government grants to public sector banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other capital expenditure	0.0	0.0	-0.3	-0.5	-0.6	-0.6	-0.6
Accounting adjustments	-0.1	-1.5	0.0	0.0	0.2	0.2	0.2
Public sector gross investment	-0.8	-0.6	-1.8	-2.0	-1.9	-1.9	-2.0
Less public sector depreciation	0.0	0.0	0.0	-0.1	0.0	0.0	0.0
Public sector net investment	-0.8	-0.6	-1.8	-2.1	-1.9	-1.9	-1.9
TOTAL MANAGED EXPENDITURE	-0.6	-2.1	-4.4	-9.1	-15.2	-22.0	-29.9
of which:							
Departmental Expenditure Limits	*0.0*	*0.0*	*-4.9*	*-6.9*	*-10.8*	*-13.1*	*-17.1*
Annually Managed Expenditure	*-0.6*	*-2.1*	*0.5*	*-2.2*	*-4.4*	*-8.9*	*-12.8*
Memo: TME (% of GDP)	*0.0*	*-0.1*	*-0.2*	*-0.6*	*-0.9*	*-1.3*	*-1.7*

Note: See footnotes to Table C13.

Table C15: Historical series of public sector balances, receipts and debt

	Per cent of GDP								
	Public sector current budget	Cyclically-adjusted surplus on current budget[1]	Public sector net borrowing	Cyclically-adjusted public sector net borrowing[1]	Public sector net cash requirement	Net taxes and national insurance contributions	Public sector current receipts	Public sector net debt[2]	Public sector net worth[3]
1970-71	6.8		-0.6		1.2	36.3	43.3		
1971-72	4.2		1.1		1.4	35.0	41.5		
1972-73	2.0		2.8		3.6	32.6	39.0		
1973-74	0.4	-0.7	4.9	6.0	5.8	31.9	39.5		
1974-75	-0.9	-2.5	6.5	8.1	8.9	34.5	42.1	52.1	
1975-76	-1.4	-1.6	7.0	7.2	9.2	35.3	42.7	53.8	
1976-77	-1.1	-0.6	5.5	5.0	6.3	35.1	43.0	52.3	
1977-78	-1.3	-1.2	4.3	4.1	3.6	34.1	41.3	49.0	
1978-79	-2.5	-2.3	5.0	4.8	5.2	33.1	40.1	47.1	
1979-80	-1.8	-1.7	4.1	4.0	4.6	33.5	40.5	43.9	
1980-81	-2.9	-1.5	4.8	3.4	5.1	35.5	42.2	46.0	
1981-82	-1.3	2.5	2.3	-1.5	3.3	38.0	45.4	46.2	
1982-83	-1.4	2.9	3.0	-1.4	3.1	38.2	45.1	44.8	
1983-84	-1.9	1.8	3.7	0.0	3.1	37.7	44.1	45.1	
1984-85	-2.1	0.9	3.6	0.6	3.0	38.2	43.9	45.3	
1985-86	-1.2	0.6	2.4	0.6	1.6	37.4	42.7	43.5	
1986-87	-1.4	-1.2	2.0	1.9	0.9	37.0	41.6	41.0	
1987-88	-0.4	-1.7	1.0	2.2	-0.7	36.8	40.6	36.8	74.0
1988-89	1.6	-1.0	-1.3	1.3	-3.0	36.1	40.2	30.5	79.0
1989-90	1.4	-1.4	-0.2	2.6	-1.3	35.4	39.4	27.7	70.9
1990-91	0.3	-1.2	1.0	2.6	-0.1	34.9	38.4	26.2	60.1
1991-92	-2.0	-1.5	3.7	3.3	2.3	33.8	38.1	27.4	52.8
1992-93	-5.6	-3.7	7.4	5.5	5.8	32.7	36.3	31.4	40.2
1993-94	-6.3	-4.0	7.7	5.4	6.9	31.8	35.4	36.5	29.7
1994-95	-4.8	-3.3	6.2	4.7	5.2	33.0	36.4	40.1	28.9
1995-96	-3.3	-2.4	4.7	3.8	4.2	33.6	37.2	41.9	21.6
1996-97	-2.7	-2.2	3.4	2.8	2.9	34.0	36.4	42.5	17.7
1997-98	-0.1	-0.1	0.7	0.6	0.1	35.1	37.5	40.6	15.3
1998-99	1.2	0.9	-0.5	-0.2	-0.7	35.5	37.8	38.4	14.4
1999-00	2.2	1.7	-1.6	-1.1	-0.9	35.5	38.0	35.6	17.4
2000-01	2.4	1.6	-1.9	-1.1	-3.7	36.3	38.6	30.7	23.0
2001-02	1.2	0.9	0.0	0.2	0.4	35.8	37.8	29.7	29.6
2002-03	-1.0	-0.6	2.3	1.9	2.2	34.3	36.3	30.8	28.2
2003-04	-1.5	-1.2	2.9	2.6	3.3	34.3	36.5	32.1	28.5
2004-05	-1.6	-1.4	3.3	3.1	3.2	35.2	37.3	34.0	28.6
2005-06	-1.1	-0.9	2.9	2.8	3.2	35.9	38.3	35.3	28.7
2006-07	-0.4	-0.4	2.3	2.3	2.6	36.1	38.6	36.0	28.9
2007-08	-0.3	-0.6	2.4	2.6	1.5	36.4	38.6	36.5	28.9
2008-09[4]	-3.5	-3.1	6.7	6.3	4.2	35.4	37.2	44.0	22.4

Source: Office for National Statistics and HM Treasury

[1] *The outturn for the cyclically-adjusted measures are based on HM Treasury estimates of the output gap, and do not necessarily represent the OBR's view of the cyclical position of the economy between 2006-07 and 2009-10.*

[2] *At end-March; GDP centred on end-March.*

[3] *At end-December; GDP centred on end-December.*

[4] *All measures are presented on the basis which excludes the temporary effect of financial interventions for 2008-09 except net worth which is presented on the basis that includes financial interventions.*

Table C16: Historical series of government expenditure

	£ billion (2008-09 prices)				Per cent of GDP			
	Public sector current expenditure	Public sector net investment	Public sector gross investment[1]	Total Managed Expenditure	Public sector current expenditure	Public sector net investment	Public sector gross investment[1]	Total Managed Expenditure
1970-71	195.3	37.3	59.7	254.9	32.7	6.2	10.0	42.7
1971-72	204.8	32.4	56.0	260.8	33.4	5.3	9.1	42.6
1972-73	213.1	31.2	55.7	268.8	33.2	4.9	8.7	41.9
1973-74	234.1	35.0	62.5	296.5	35.0	5.2	9.3	44.3
1974-75	258.1	37.5	66.4	324.5	38.7	5.6	10.0	48.6
1975-76	263.6	36.8	65.9	329.5	39.7	5.6	9.9	49.7
1976-77	270.8	30.2	60.3	331.1	39.7	4.4	8.8	48.5
1977-78	267.1	20.7	51.0	318.1	38.3	3.0	7.3	45.6
1978-79	275.1	18.0	49.1	324.2	38.2	2.5	6.8	45.1
1979-80	281.8	16.8	48.3	330.1	38.1	2.3	6.5	44.6
1980-81	290.0	13.5	45.5	335.5	40.6	1.9	6.4	47.0
1981-82	302.8	7.2	38.9	341.7	42.3	1.0	5.4	47.7
1982-83	309.7	11.4	42.2	352.0	42.3	1.6	5.8	48.1
1983-84	319.5	13.9	44.6	364.0	42.0	1.8	5.9	47.8
1984-85	327.8	12.2	41.4	369.2	42.2	1.6	5.3	47.5
1985-86	327.8	9.4	36.3	364.1	40.5	1.2	4.5	45.0
1986-87	333.1	5.7	32.7	365.8	39.7	0.7	3.9	43.6
1987-88	336.6	5.2	30.6	367.1	38.1	0.6	3.5	41.6
1988-89	329.1	3.2	28.6	357.8	35.8	0.3	3.1	38.9
1989-90	331.5	11.6	36.7	368.2	35.3	1.2	3.9	39.2
1990-91	333.7	12.6	35.6	369.3	35.6	1.3	3.8	39.4
1991-92	353.8	16.5	35.8	389.6	38.0	1.8	3.8	41.9
1992-93	371.5	17.2	36.1	407.6	39.8	1.8	3.9	43.7
1993-94	381.6	13.6	32.3	413.9	39.7	1.4	3.4	43.0
1994-95	393.4	14.0	32.7	426.1	39.3	1.4	3.3	42.5
1995-96	398.8	14.0	31.9	430.7	38.7	1.4	3.1	41.8
1996-97	397.8	7.3	24.1	421.9	37.6	0.7	2.3	39.9
1997-98	397.3	6.2	22.2	419.5	36.2	0.6	2.0	38.2
1998-99	399.8	7.6	23.4	423.2	35.2	0.7	2.0	37.3
1999-00	407.5	6.9	22.8	430.3	34.5	0.6	1.9	36.4
2000-01	426.8	6.3	22.5	449.3	35.0	0.5	1.8	36.8
2001-02	441.7	14.4	30.7	472.5	35.5	1.2	2.4	38.0
2002-03	461.0	16.1	33.0	494.1	36.1	1.3	2.5	38.7
2003-04	484.3	17.8	34.8	519.1	36.8	1.3	2.6	39.4
2004-05	505.6	22.8	40.0	545.6	37.6	1.7	2.9	40.6
2005-06	526.7	25.5	43.3	570.0	38.2	1.8	3.1	41.3
2006-07	535.6	27.3	45.5	581.0	37.7	1.9	3.2	40.9
2007-08	549.3	29.6	48.0	597.3	37.8	2.0	3.2	41.1
2008-09[2]	564.7	46.4	65.1	629.8	39.4	3.2	4.5	43.9

Source: Office for National Statistics and HM Treasury

[1] *Net of sales of fixed assets.*

[2] *All measures are presented on the basis which excludes the temporary effect of financial interventions for 2008-09.*

List of Abbreviations

AEF	Aggregate External Finance
AME	Annually Managed Expenditure
AMLD	Amusement Machine Licence Duty
APD	Air passenger duty
APR	Annual Percentage Rates
BCC	British Chamber of Commerce
BRC	Budget Responsibility Committee
BRE	Better Regulation Executive
CAP	Common Agricultural Policy
CBI	Confederation of British Industry
CCAs	Climate change agreements
CCL	Climate change levy
CDEL	Capital Departmental Expenditure Limits
CFC	Controlled Foreign Company
CGNB	Central Government Net Borrowing
CGT	Capital Gains Tax
CGNCR	Central Government Net Cash Requirement
CHP	Combined Heat and Power
CIPFA	Chartered Institute of Public Finance and Accountancy
CO_2	Carbon dioxide
CPI	Consumer Prices Index
CSR	Comprehensive Spending Review
CTC	Child Tax Credit
CTF	Child Trust Fund
DCMS	Department of Culture, Media and Sport
DCSF	Department for Children, Schools and Families
DEFRA	Department for Environment, Food and Rural Affairs
DEL	Departmental Expenditure Limit
DfES	Department for Education and Skills
DFID	Department for International Development
DfT	Department for Transport
DH	Department of Health
DIUS	Department of Innovation, Universities and Skills
DMO	Debt Management Office
DTI	Department of Trade and Industry
DVLA	Driver and Vehicle Licensing Agency
DWP	Department for Work and Pensions

EC	European Communities
ECA	Enhanced Capital Allowance
ECF	Enterprise Capital Fund
EEA	European Economic Area
EFG	Enterprise Finance Guarantee
EFRBS	Employer Financed Retirement Benefit Schemes
EFSR	Economic and Fiscal Strategy Report
EIS	Enterprise Investment Scheme
EMI	Enterprise Management Incentive
EPC	Economic Policy Committee
ERA	Employment Retention and Advancement
ERG	Efficiency and Reform Group
ERP	Energy Research Partnership
ESA	Employment and Support Allowance
ESA95	European System of Accounts 1995
EU	European Union
EU ETS	EU Emissions Trading Scheme
FDI	Foreign direct investment
FE	Further Education
FINROF	Funds Reporting in Non-Reporting Funds
FJR	Fortnightly Job Review
FRS	Financial Reporting Standard
FSA	Financial Services Authority
FSBR	Financial Statement and Budget Report
FSMA	Financial Services and Markets Act
FTI	Fast Track Initiative
G7	A group of seven major industrial nations (comprising: Canada, France, Germany, Italy, Japan, UK and US).
G8	The G8 is an informal group of eight countries: Canada, France, Germany, Italy, Japan, Russia, the UK and the US.
G20	A group of 20 Finance Ministers and Central Bank governors representing nineteen countries plus the European Union
GAAP	Generally Accepted Accounting Practices
GAAR	General Anti-Avoidance Rule
GAD	Government Actuary's Department
GCSE	General Certificate of Secondary Education
GDP	Gross Domestic Product
GGNB	General government net borrowing
GLA	Greater London Authority
GNI	Gross National Income
GO	Government Offices
GVA	Gross Value Added
HB	Housing Benefit
HGV	Heavy Goods Vehicles
HIPC	Heavily Indebted Poor Countries
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IAS	International Accounting Standards
IB	Incapacity Benefit

ICT	Information and Communications Technology
IDA	International Development Association
IEA	International Energy Agency
IFF	International Finance Facility
IFFIm	International Finance Facility for Immunisation
IFRS	International Financial Reporting Standards
IFS	Institute for Fiscal Studies
IHT	Inheritance Tax
ILO	International Labour Organisation
IMF	International Monetary Fund
IP	Intellectual Property
IPCC	Intergovernmental Panel on Climate Change
IPT	Insurance Premium Tax
ISA	Individual Savings Account
ISB	Invest to Save Budget
IUK	Infrastructure UK
IWC	In Work Credit
JSA	Jobseeker's Allowance
LABGI	Local Authority Business Growth Incentive
LASFE	Local authority self-financed expenditure
LATS	Landfill Allowance Trading Scheme
LBRO	Local Business Regulation Office
LDA	London Development Agency
LFS	Labour Force Survey
LHA	Local Housing Allowance
LIBOR	London Inter-Bank Offered Rate
LPG	Liquefied petroleum gas
LPL	Lower profits limit
LTCS	Landfill Tax Credit Scheme
LTPFR	Long Term Public Finance Report
LSC	Learning and Skills Council
MDGs	Millennium Development Goals
MDRs	Marginal deduction rates
MDRI	Multilateral Debt Relief Initiative
MIG	Minimum Income Guarantee
MoD	Ministry of Defence
MORI	Market and Opinion Research International
MPC	Monetary Policy Committee
MTIC	Missing Trader Intra-Community
NAO	National Audit Office
NCIS	National Criminal Intelligence Service
NDYP	New Deal for young people
NEA	National Enterprise Academy
NEET	Not in Education, Employment or Training
NEST	National Employment Savings Trust
NHS	National Health Service
NICs	National Insurance Contributions
NIESR	National Institute of Economic and Social Research
NMW	National Minimum Wage

NTNIC	Net taxes and national insurance contributions
NVQ	National Vocational Qualification
OBR	Office for Budget Responsibility
ODA	Overseas Development Assistance
OBR	Office for Budget Responsibility
ODPM	Office of the Deputy Prime Minister
OECD	Organisation for Economic Cooperation and Development
OFCOM	Office of Communications
OFGEM	Office of Gas and Electricity Markets
OFT	Office of Fair Trading
OGC	Office of Government Commerce
ONE	One North East
ONS	Office for National Statistics
OPEC	Organisation of Petroleum Exporting Countries
PAC	Public Accounts Committee
PAYE	Pay As You Earn
PBR	Pre - Budget Report
PCSO	Police Community Support Officers
PCT	Primary Care Trust
PEP	Personal Equity Plan
PFI	Private Finance Initiative
PPF	Pension Protection Fund
PSA	Public Service Agreement
PSCE	Public Sector Current Expenditure
PSCR	Public Sector Current Receipts
PSGI	Public Sector Gross Investment
PSNB	Public Sector Net Borrowing
PSND	Public Sector Net Debt
PSPC	Public Sector Pay Committee
PSNI	Public Sector Net Investment
R&D	Research and Development
RDA	Regional Development Agency
RDEL	Resource Departmental Expenditure Limits
REITs	Real Estate Investment Trusts
RES	Regional Economic Strategy
RPI	Retail Prices Index
RPIX	Retail Prices Index excluding mortgage interest payments
RTFO	Renewable Transport Fuels Obligation
SBRI	Small Business Research Initiative
SDLT	Stamp Duty Land Tax
SDRT	Stamp Duty Reserve Tax
SERPS	State Earnings Related Pension Scheme
SFLG	Small Firms Loan Guarantee
SGP	Stability and Growth Pact
SME	Small and medium-sized enterprise
SMI	Support for Mortgage Interest
STEM	Science Technology Engineering and Mathematics

TME	Total Managed Expenditure
TOR	Terms of Reference
TSB	Technology Strategy Board
UKTI	UK Trade and Investment
VAT	Value Added Tax
VCT	Venture Capital Trust
VED	Vehicle Excise Duty
WGA	Whole of Government Accounts
WTC	Working Tax Credit

LIST OF TABLES

LIST OF CHARTS

HM Treasury contacts

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If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558
Fax: 020 7270 4861

E-mail: public.enquiries@hmtreasury.gsi.gov.uk

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