The 2011 Budget

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Section Economic Policy and Statistics Section

This note provides a brief summary of the main measures announced in the Budget on 23 March 2011 and the reaction to them. It also contains the Office for Budget Responsibility's updated forecasts for the economy and public finances.

Further information is available in the two other Library publications:

Background to the 2011 Budget, 18 March 2011 (SN/EP/5895)

Economic Indicators, Budget update, 22 March 2011 (RP/11/27)

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Contents

1 Summary of main points 3

2 Revised Office for Budget Responsibility forecasts 3

2.1 GDP growth 3

2.2 The budget deficit 4

2.3 Public sector debt 4

3 Budget measures 4

3.1 Income tax personal allowance 4

3.2 Fuel duty 5

3.3 Air passenger duty 6

3.4 Cut in corporation tax 6

3.5 Change in indexation of direct taxes from RPI to CPI 6

3.6 Cost of selected Budget measures 7

4 The Plan for Growth 8

4.1 Competitive tax system 8

4.2 Business growth 8

4.3 Investment and exports 9

4.4 Workforce 9

4.5 Enterprise Zones 9

5 Reaction 10

5.1 Political 10

5.2 Media and commentators 11

1 Summary of main points

Overall the Budget is approximately revenue-neutral compared with existing plans. In contrast to the June 2010 Budget, there are few large scale changes to taxation and public spending levels.

- Fuel duty has been cut by 1p per litre. That contrasts with a scheduled rise of RPI inflation plus 1p. While oil prices remain high, lower fuel duty will be funded by increased taxes on oil companies. This was called the “Fair Fuel Stabiliser” by the Chancellor.

- The personal income tax allowance will rise to £8,105 in April 2012. Corporation tax was cut.

The Office for Budgetary Responsibility (OBR) published its revised economic forecasts.

- The OBR revised its forecast for economic growth in 2011 and 2012 downwards.

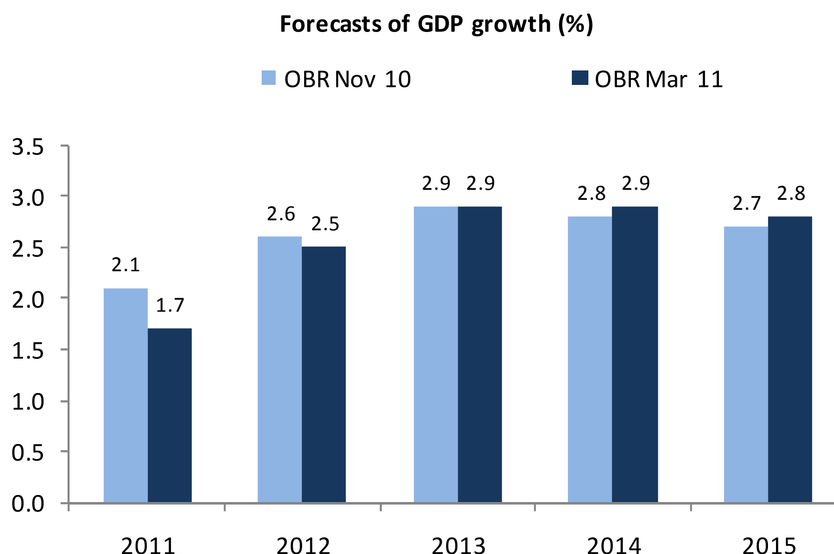
- The OBR revised its forecasts of the deficit (public sector net borrowing) upwards for each year from 2011/12 to 2015/16.

The Government also published a *Plan for Growth*, aimed at improving the UK’s international competitiveness and re-balancing the economy both geographically and between industries.

2 Revised Office for Budget Responsibility forecasts

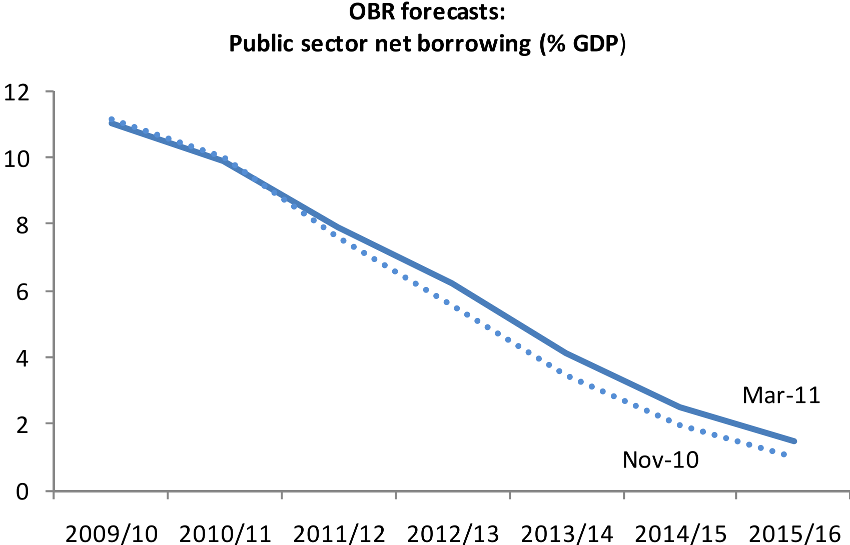
2.1 GDP growth

The OBR revised downwards its forecasts for GDP growth in both 2011 and 2012 (see chart below). Growth this year is now forecast to be 1.7%, down from the OBR’s November forecast of 2.1%. Growth in 2012 has also been revised downwards to 2.5% from 2.6%. The forecast for 2013 is unchanged and the forecasts for 2014 and 2015 have been revised upwards slightly.



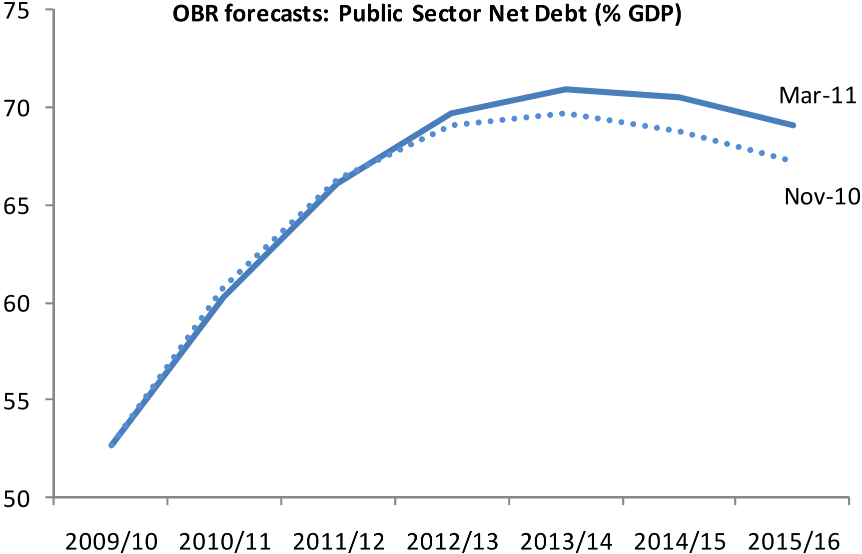
2.2 The budget deficit

The OBR's forecast for the budget deficit in 2010/11 has been revised downwards by £2.6 billion from £148.5 billion to £145.9 billion. The forecast for the budget deficit has increased in every year from 2011/12 to 2015/16. It is around £11 billion (0.5% of GDP) higher by 2015/16.



2.3 Public sector debt

The forecasts for public sector net debt have been revised up slightly in the OBR's forecast compared with its November forecast.



3 Budget measures

3.1 Income tax personal allowance

The Government's aim is to increase the personal allowance to £10,000 making progress towards this target in real terms every year. The June 2010 Budget announced a £1,000 increase in the personal allowance in April 2011 to £7,475. This Budget announced a further

real terms increase to £8,105 in April 2012. If the personal allowance had been indexed by the RPI only, it would have increased to £7,865.[1] These two increases in the personal allowance in April 2011 and April 2012 will take 1.1 million people out of income tax and make 25 million people better off.

The increase in the personal allowance in April 2011 was accompanied by a reduction in the threshold at which income tax starts to be paid at 40%. This was to ensure that only basic rate taxpayers would gain from the increase in the personal allowance. The Government has not done this for 2012/13.[2] Raising the personal allowance from April 2012 costs just over £1 billion in 2012/13 rising to £1.2 billion in 2015/16.

3.2 Fuel duty

Under the previous Government's plans fuel duty was due to increase by 1 penny above inflation on 1 April 2011. This would have increased duty from around 59p a litre to around 63p. The Government announced an immediate cut in fuel duty by 1 penny per litre. The inflation increase which had been due to come into effect on 1 April 2011 will be delayed until 1 January 2012. This will increase fuel duty by 3.02p a litre.

The 2012/13 increase in duty will come into effect on 1 August 2012 (rather than 1 April). These measures will cost £1.9 billion in 2011/12 and between £1.6 billion and £2.1 billion in each year between 2012/13 and 2015/16.

Under the previous Government's plans, fuel duty was to increase by 1 penny above inflation every April until 2014. The Government has replaced this with a fair fuel stabiliser:

> As part of the fair fuel stabiliser, fuel duty will increase by RPI when oil prices are high. However, in years when the oil price falls below a set trigger price on a sustained basis, the Government will increase fuel duty by RPI plus 1 penny per litre. The Government believes that a trigger price of $75 per barrel would be appropriate, and will set a final level and mechanism after seeking the views of oil companies and motoring groups.[3]

The cut in fuel duty is funded by an increase in taxation of the oil and gas industry. UK oil and gas production is more profitable when the oil price is high, as it is at the moment. The Supplementary Charge on oil and gas production will increase to 32% at midnight on 23 March. In future, if the oil price falls below a certain price, the Supplementary Charge will be reduced:

> In future years, if the oil price falls below a set trigger price on a sustained basis, the Government will reduce the Supplementary Charge back towards 20 per cent on a staged and affordable basis while prices remain low. Fuel duty will increase by RPI plus 1 penny per litre in each such year. The Government believes that a trigger price of $75 per barrel would be appropriate, and will set a final level and mechanism after seeking the views of oil and gas companies, and motoring groups.[4]

The cut in fuel duty was welcomed by motoring groups such as the RAC and AA but the taxation of the oil and gas industry was criticised by its trade association, Oil and Gas UK. It

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1 Based on the OBR's forecast of RPI inflation in September 2011 of 5.2%.

2 The basic rate limit has been reduced by £630 so that the level of income at which higher rate taxes are paid in unchanged. A freeze in this threshold had been announced by the previous Government in the 2009 Pre-Budget Report.

3 HM Treasury, Budget 2011, para 2.131

4 HM Treasury, Budget 2011, para 1.148

said the move would harm investor confidence and noted that investment in the industry supported nearly 500,000 jobs. It said:

> Today's move in the Budget runs counter to the Government's stated desire to promote growth, jobs and exports – all of which this industry was delivering and will now find much more difficult to sustain. Importantly it will also most likely increase this country's dependence on imported oil and gas and thus diminish its energy security.[5]

3.3 Air passenger duty

In last year's Budget, the Government said it would look at changes to aviation tax, including moving from a per passenger to a per plane tax. The Budget said that the Government will not bring in a per plane duty at the present time, given concerns over its legality.

The Budget announced a consultation on air passenger duty (APD). This includes plans to make flights on business jets subject to the tax. APD rates will be frozen in 2011/12. The RPI increase will be deferred and brought in alongside the April 2012 increase.[6] This costs £145 million in 2011/12.

3.4 Cut in corporation tax

The 2010 Budget announced a cut in corporation tax from 28% to 24% over four years from April 2011. This year's Budget announced an additional cut of one percentage point in April 2011, reducing the rate from 28% to 26%. Three further cuts of one percentage point will reduce the rate to 23% by April 2014. The Government says that this "will help the UK maintain the lowest rate in the G7".[7] The extra cut announced in this year's Budget cost the Treasury £425 million in 2011/12 rising to nearly £1.1 billion in 2015/16. To offset the benefits banks would receive from this change, the bank levy rate will increase to 0.078% from 1 January 2012.

3.5 Change in indexation of direct taxes from RPI to CPI

Until now, the "default" indexation for direct taxes used the Retail Prices Index (RPI) from the September before the start of the tax year. The 2010 Budget announced that the Government was reviewing the use of the Consumer Price Index (CPI) for indexing taxes and duties. The 2010 Budget also announced a switch to the CPI for indexation of benefits.

This year's Budget announced that the default indexation assumption for direct taxes (as opposed to indirect taxes on consumption, such as excise duties) will be the CPI from April 2012. To protect employers and older people, the employer national insurance threshold and age related allowances will increase by the RPI for the remainder of the Parliament. A Budget note published by HMRC indicates that the RPI will still be used for indexation of some income tax allowances, at least in 2012/13.[8] The Government's aim to increase the personal allowance to £10,000 means that this is likely to be increased by more than either CPI or RPI.

This policy change raises £105 million in 2012/13 rising to nearly £1.1 billion by 2015/16. The CPI is generally lower than the RPI (see chart below). Between 2011/12 and 2015/16, the OBR forecasts that the CPI will increase by 8.6% compared with 15.1% for the RPI. As a

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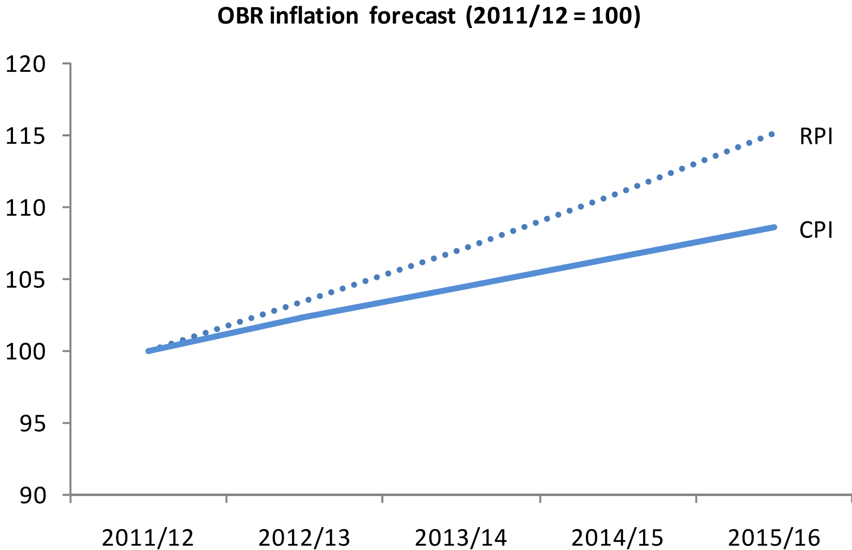
[5] Oil and Gas UK Press Release, Oil and Gas UK responds to 2011 Budget announcement, 23 March 2011
[6] HM Treasury, Budget 2011, para 2.140
[7] HM Treasury, Budget 2011, para 1.74
[8] HMRC Tax Information and Impact Note, *Income Tax Personal Allowance for Those Aged Under 65 for 2012/13*, 23 March 2011

result, indexing allowances by CPI means they will generally be lower than they would have been if RPI had been used. If allowances are lower, this generally means that the Government raises more revenue. This change only relates to the default indexation. The Government can choose to increase allowances by more than CPI as they have done in both this Budget and the last.

The Government also said that it will review the use of the CPI for indirect taxes once its fiscal consolidation plans have been implemented and the duty increases inherited from the previous Government have come to an end.[9] If the Government were to use the CPI rather than RPI for indexing indirect taxes, it would raise less revenue.



3.6 Cost of selected Budget measures

The table below summarises the additional revenue or cost to the Exchequer expected from some of the major policy decisions made as part of the Budget. It also gives overall net figures: the Budget is approximately revenue neutral over the entire period to 2015/16, compared with previous plans.

Selected Budget policy decisions
£ million, impact on public finances compared with baseline plans (positive number implies higher revenue)

	2011/12	2012/13	2013/14	2014/15	2015/16
Personal allowance increase	0	-1,050	-1,210	-1,200	-1,230
Fuel duty - reduction and removal/delay of increases	-1,900	-1,600	-1,700	-2,100	-2,100
North Sea oil changes	+1,780	+2,240	+2,120	+2,090	+1,870
Air Passenger Duty - defer RPI increase	-145	0	0	0	0
Corporation tax - main rate decreases	-425	-810	-910	-1,000	-1,075
Corporation tax - other changes	-50	-260	-650	-910	-1,000
CPI indexation of direct taxes (from RPI)	0	+105	+235	+630	+1,080
Tax avoidance, evasion and administration measures	+985	+1,055	+1,255	+1,300	+1,335
All Budget policy decisions	**-10**	**-265**	**+25**	**-115**	**+335**

Source: *Budget 2011 Red Book* (HC 836), table 2.1

[9] HM Treasury, Budget 2011, para 1.128

Many of the major measures announced in the Budget have a net cost to the Exchequer. These costs are partly offset by a variety of revenue-raising tax avoidance, evasion and administration measures, which are expected to raise a total of £5.9 billion over five years, as well as other revenue-raising measures such as increased tax on oil companies and CPI indexation of direct taxes as the default.

4 The Plan for Growth

The Government published *The Plan for Growth* alongside the Budget.[10] It partly consists of the initial results of the rolling Growth Review, announced in *The path to strong, sustainable and balanced growth* in November 2010.[11] The Growth Review will continue for the remainder of the Parliament.

The Government intends to make the UK more competitive relative to other countries. It also hopes to achieve more even growth between regions and balance between industries.

The *Plan for Growth* lists four "overarching ambitions":

1. To create the most competitive tax system in the G20;
2. To make the UK one of the best places in Europe to start, finance and grow a business;
3. To encourage investment and exports as a route to a more balanced economy; and
4. To create a more educated workforce that is the most flexible in Europe.

The Government has announced policy changes under each of these objectives.

4.1 Competitive tax system

Measures include:

- A further one percentage point reduction in the main rate of corporation tax from April 2011, in addition to the annual one percentage point reductions already announced;
- Measures to simplify the tax system, including consultation on options for integrating the operation of income tax and National Insurance Contributions.

4.2 Business growth

Announcements include:

- Exemption for micro (fewer than 10 employees) and start-up businesses from new domestic regulations for three years;
- An extension of the small business rate relief holiday for a further year (from October 2011);
- Scrapping plans for some new regulations, including some proposed in the Equalities Act 2010, and a public review of existing regulations;

[10] *The Plan for Growth*, HM Treasury and BIS, March 2011
[11] *The path to strong, sustainable and balanced growth*, HM Treasury and BIS, November 2010

- Changes to the planning system, including "a powerful presumption in favour of sustainable development";
- Various proposals to increase the availability of finance to businesses.

4.3 Investment and exports

Measures include:

- An extension of the capital allowances short life asset regime for plant and machinery from four years to eight years;
- The creation of 21 Enterprise Zones (see below);
- Reform of support for inward investment and to exporters;
- Sector-specific support measures for the key industries considered in the first phase of the Growth Review, including advanced manufacturing and construction.

4.4 Workforce

Announcements include:

- Funding for up to 100,000 work experience placements (20,000 already announced) over the next two years and 50,000 additional apprenticeship places over four years;
- At least 24 new University Technical Colleges;
- Various measures to increase the supply of housing and therefore promote labour mobility, including a shared equity programme aimed at helping first time buyers buy newly constructed homes.

4.5 Enterprise Zones

21 new Enterprise Zones (EZs) will be established. The first ten of these will be in Local Enterprise Partnerships (LEPs) "that include the UK's major urban centres and areas that have significant untapped potential".[12] The location of specific zones will be a matter for each LEP. The first ten LEPs to gain new EZs will be:

- Birmingham and Solihull;
- Leeds City Region;
- Sheffield City Region;
- Liverpool City Region;
- Greater Manchester;
- West of England;
- Tees Valley;
- North Eastern;

[12] *The Plan for Growth*, HM Treasury and BIS, March 2011, p33

- the Black Country;
- and Derby & Derbyshire with Nottingham & Nottinghamshire.

London will also have an EZ, and will be able to choose its site.

On 24 March, the locations of four Enterprise Zones were announced.

> ... the first four areas are able to confirm the exact location of their new zones as Boots campus in Nottingham, Liverpool Waters, Manchester Airport and the Mayor has said London's Zone would be in the Royal Docks.[13]

A further ten EZs will be determined by competition. A letter of invitation will be sent to the chairs of each LEP, including a prospectus for new EZs. The Government has stated that it will "seek to make decisions on the final ten zones in the summer".[14]

Businesses occupying the new EZs will receive a 100% business rate discount over a five year period for businesses that move into an EZ during the course of this Parliament. All business rates growth within the zone for a period of 25 years will be retained and shared by the local authorities in the LEP area. The Government and relevant local authority will be able to develop "radically simplified planning approaches" in the EZs.[15] Superfast broadband will be rolled out throughout the EZs, "through guaranteeing the most supportive planning environment, and, if necessary, public funding".[16]

5 Reaction

5.1 Political

In his response to the Budget, Ed Miliband criticised the Government's record on economic growth and the speed and scale of its deficit reduction programme. He said:

> What is the Chancellor's singular achievement? To deliver a budget for growth that downgrades the growth forecasts. Growth is down this year to 1.8%, and it is downgraded next year too. That did not happen by chance; it happened by choice - the Chancellor's choice - and it was the wrong choice: to go too far and too fast. In the Chancellor's own words in the June Budget, he chose to go £40 billion further and faster in tax rises and spending cuts than our plan to halve the deficit over four years. That pace of cuts has seen consumer confidence fall in almost every month since the general election.
>
> [...]
>
> The Chancellor also promised in his June Budget that he would deliver "low inflation", and what has happened? Inflation has risen, month after month after month. That did not simply happen by accident. It is happening because the Chancellor made the wrong decision on VAT. Same old taxes, same old Tories.
>
> The Chancellor promised us falling unemployment too, and what has happened since he delivered his first Budget? Over 60,000 more people are now looking for work. To this Tory Government, just like those of the past, unemployment is a price worth

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[13] DCLG Press Notice, *First four new generation enterprise zone locations identified*, 24 March 2011

[14] *The Plan for Growth*, HM Treasury and BIS, March 2011, p33

[15] HM Treasury, *Budget 2011,* p32

[16] *Ibid,* p32

> paying. People who heard the Chancellor's Budget speech today will wonder what world he was describing.[17]

Mr Miliband said he would look at measures to promote growth but said “there is little reason to believe they will make the difference to growth that we need”.[18]

He was also critical of the measures to tax banks and the cut in petrol duty:

> While we are on the subject of broken promises, let us remember what the Prime Minister said before the election: he said he would be the banker basher in chief. The Chancellor made great play of that in his Budget speech, but the reality is this: last year Labour's bonus tax raised £3.5 billion-it is in the Red Book - and this year the bank levy raises just £1.9 billion; it is a Tory Government cutting taxes for the banks while they raise taxes for everybody else. He should have used the money from the bank levy to invest in the future jobs fund - which they abolished - to make a real difference to housing in this country and to boost enterprise.
>
> [...]
>
> What about their decision on petrol? The Chancellor has done the same thing again. He has cut duty by 1p, but he has whacked up VAT on fuel by 3p. Families won't be fooled; it's Del Boy economics. For a two-earner family, both on average wages, it will be 5p up in the basic rate of income tax and just 1p down next year.[19]

5.2 Media and commentators

Opening remarks, by Paul Johnson, Director, Institute for Fiscal Studies, IFS Post Budget 2011 briefing, 24 March 2011:

> The fiscal picture
>
> The Chancellor has announced cuts in public spending and increases in taxes which, between them, will if delivered form the most dramatic fiscal tightening to deal with the biggest fiscal deficit this country has seen in 60 years. But he announced all that last year. As far as the public finances are concerned the totality of measures announced in yesterday’s Budget was a fiscal non event. The new measures announced will, between them, have almost no impact on public spending, on borrowing or on total tax revenues.
>
> Even so, in the context of a dramatic expected improvement, the public finance forecasts have got marginally worse. This is because inflation will be higher, and growth lower, than previously expected. The independent Office for Budget Responsibility (OBR) has seen its forecast for last year’s growth missed by some margin in part due to last winter’s snow, and has downgraded its growth forecasts for this year and next. Even though it has increased its growth forecasts for 2014 and 2015, the overall effect is that the OBR now expects total receipts to fall short of non-investment spending in 2015-16, leaving a deficit of 0.2% of national income, rather than a surplus of 0.3%.
>
> But it is not just lower growth that has resulted in these less optimistic public finance forecasts. High inflation is an even bigger culprit as it feeds through directly into higher social security payments, payments of public sector pensions and debt interest repayments.

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[17] HC Deb 23 March 2011, cc967-8
[18] HC Deb 23 March 2011, c969
[19] HC Deb 23 March 2011 c970

The Chancellor can take some comfort, though, from the fact that the OBR has not changed its estimate of potential output and potential growth. As a result, its forecast of the cyclically adjusted deficit – that is, the amount of borrowing that is thought to be impervious to economic recovery – has hardly changed. The OBR is still forecasting a cyclically adjusted current surplus of 0.4% of national income by 2014-15. And it is this cyclically adjusted measure which the Chancellor is targeting in his "fiscal mandate".

As the OBR itself acknowledges, the biggest threat to the public finances is "the possibility that we have over-estimated the amount of spare capacity in the economy, now or in the future". In other words, the forecasts are now even more dependent on a bounce back in the rate of economic growth from 2013. Given these forecasts it is clear why the Chancellor, sticking to his deficit reduction plans, did not feel able to engage in a net giveaway. Going forward he is going to be uncomfortably dependent on the judgments that the (independent) OBR makes over the (unobservable) potential output of the economy. We all need to hope that the OBR proves a better forecaster of the public finances than it has been of the weather.

Spending and taxing

We will see big changes to our incomes and our public services over the coming years, though not as a result of yesterday's measures.

Higher inflation however not only affects the public finances but also means that cuts to public services are bigger than they would have been, and could be harder to deliver. Simply because inflation is turning out higher than expected, real cuts to public service spending are now on course to be, on average, one percentage point greater over the next four years than was announced in the spending review.

In terms of the government's pledge to grow NHS spending in real terms year on year, this is now expected to be only barely met between 2010-11 and 2011-12. And then only because of a possible under-spend and the fact that they are comparing to actual spending in 2010-11, rather than a figure which takes account of temporary measures. At the time of the Spending Review the government used this figure including temporary measures as the comparator for all departments. If 2010-11 spending had been in line with the spending review baseline, then there would have been a small real cut in 2011-12. The government is meeting its pledge, but is sailing perilously close to the wind.

With regard to household incomes, these will fall by about two and a half per cent, or £750 a year, as a result of changes (including January's VAT rise) implemented this year. The richest households will be hardest hit. Over the whole parliament tax and benefit changes will hit household incomes to the tune of more like five per cent or £1,500 a year. Little changed as a result of yesterday's announcements.

Easily the most expensive thing that Mr Osborne did do yesterday was to cut duties on petrol and diesel, and abolish the 1% above inflation escalator on fuel duty. The political pressures that led him to this policy are clear. At some point, though, he is going to have to offer a long-term strategy for the taxation of the motorist. He is following a path well-travelled by his predecessors by not implementing previously planned duty increases. The effect, especially as cars become more efficient, is a continuing reduction in the tax per mile driven: this alone led the OBR to revise down forecast revenues from fuel duties in 2015–16 by £0.5bn compared to what they expected in November. In the long run we will have to find a sustainable way of taxing drivers, not least to reflect the costs they impose on others.

This less-than-green reduction in real fuel duties was accompanied by what is actually a rather radical green tax change – the introduction of a carbon price floor. By

underpinning the price charged through the European emission trading scheme this will provide long-term certainty to electricity generators which should help them make long-term investment decisions. It will also lead to higher fuel bills for households.

The other major focus for tax reform for households was once again on increasing the tax-free personal income tax allowance. Not only will this rise by £1,000 to £7,475 this April, but we now know that it will go up by a further £630 in April 2012, or £240 more than a rise in line with inflation would have warranted. This is another step towards the government's ambition for a £10,000 allowance. It remains a progressive way of cutting income tax bills.

One thing is perhaps slightly odd, though, in light of the Chancellor's welcome commitment to integrate the operation of income tax and National Insurance. He is not extending to NI the principle of increasing the point at which tax starts to be paid. Instead, along with other tax thresholds, the point at which NI starts to be paid will now rise more slowly in future, no longer rising in line with the RPI but rather being linked to the (generally lower) Consumer Price Index. The gap between the point at which people start to pay NI and the point at which they pay income tax will grow. The more general implication of this rather arcane change is that fiscal drag will now have an even greater impact on the tax take.

Of course this was also heralded by the Chancellor as a Budget for Growth. He is investing heavily in cuts to corporation tax adding a further 1p cut to the series of cuts announced last year such that by 2014-15 the main rate will have fallen from 28% to 23%. This is a substantial cut which should have some impact on corporate activity in the UK.

Conclusions

This budget could never match up to the scale of last year's two extraordinary fiscal events – the June Budget and the October Spending Review. In terms of the fiscal plans it is steady as she goes. But risks to the plans are already beginning crystallise in lower predicted growth and higher predicted inflation. And this higher inflation means that, in real terms, the cuts in public spending will be even more dramatic than planned.

Specific reforms are also relatively modest. There are some welcome changes to carbon taxation and some nods towards tax simplification. But there is perhaps less in the way of a long term strategy for tax reform than one might have hoped. The plan for growth again contains some potentially valuable elements, but alongside an awful lot of bits and pieces which promise to increase complexity in some areas just as the Chancellor looks to reduce it elsewhere.

Newspaper/BBC comment

The Chancellor bets on business coming to the rescue, Daily Telegraph editorial, 24 March 2011

The budget: Small change, Guardian editorial 24 March 2011

Stephanie Flanders, BBC Economics Editor, Micro trumps macro, Stephanomics blog, 23 March 2011