The 2012 Budget

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Section Economic Policy and Statistics Section

This note sets out the main measures announced in the 2012 Budget, presented by the Chancellor on 21 March 2012. It also includes the Office for Budget Responsibility's updated forecasts for the economy and public finances.

The background to the Budget is set out in a separate Library note. The Library has also published a special Budget edition of the Economic Indicators Research Paper.

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1 Introduction

George Osborne's first Budget, the "Emergency Budget" of June 2010, was characterised by major fiscal decisions with substantial impacts on the public finances: a rise in VAT and cuts to public spending in the tens of billions. His second Budget, in 2011, was broadly fiscally neutral and its tax and spending measures were relatively minor in the context of the overall public finances. George Osborne's third Budget was more like his second than his first.

There were few surprises in policy terms. Many of the main policy measures had been reported by the press in the days leading up to the Statement. Indeed, *the Independent* went as far as to call it "the most comprehensively leaked of any in recent times".

Among the widely expected changes was the increase in the income tax personal allowance to £9,205 in 2013/14. This was the single most substantial policy in terms of fiscal impact: it will cost the Exchequer around £3.5 billion per year. Another widely expected measure was the reduction in the additional rate of income tax from 50% to 45% from 2013/14. One of the justifications for this is that the rate raises so little – and its reduction barely registers in the Budget costings.

Perhaps the biggest surprise was the freezing of age-related personal allowances for people aged over 65 from April 2013 and their restriction to those eligible at that point. This is expected to raise more than £1 billion a year by 2015/16.

The Chancellor also announced cuts to the main rate of Corporation Tax (on top of those in the last Budget), an increase in the income threshold for the removal of child benefit (together with a taper to ease the "cliff edge" effect) and a range of revenue-raising measures targeting tax avoidance.

The major difference between this Budget Statement and other major recent set-piece economic occasions was that it did not take place in the context of worsening wider conditions. The Office for Budget Responsibility's forecasts were almost entirely unchanged from those in November 2011. While any improvements to forecasts were minor, the Chancellor will be relieved that the projections have stopped getting progressively worse.

2 Key points

- An increase in the **income tax personal allowance** of £1,100 in April 2013 to £9,205. The basic rate limit is cut by £2,215 to £32,245.

- The **age-related personal allowances** for those aged 65 and over will be frozen from April 2013 at their 2012/13 levels until they align with the allowance for those aged under 65. From April 2013, the age-related allowance will be restricted to those eligible at that point.

- The **50% top rate of income tax** is to be cut to 45% from April 2013.

- **Corporation tax** will be cut by an extra 1% from April 2012 to 24%. The further cuts of 1% in the next two years will still take place meaning corporation tax will be 22% in April 2014.

- **Child benefit** will be withdrawn from households where someone has an income over £50,000 rather than households with a higher rate taxpayer as previously announced. The withdrawal of child benefit will apply gradually for households where someone has an income of between £50,000 and £60,000.

- **Stamp duty:** a new rate of 7% on residential property over £2 million.

- **Bank levy:** an increase in the rate from 0.088% to 0.105%.

- The **OBR's forecasts** for the economy and public finances are largely unchanged compared with November.

- **GDP growth**: the economy is forecast to grow by 0.8% this year and by 2.0% in 2013. The economy is forecast to avoid a double-dip recession.

- CPI **inflation** is forecast to fall to 2.8% this year and 1.9% in 2013.

- the **unemployment rate** is forecast to peak at 8.7% this year and then fall to 6.3% in 2016.

- **Public sector borrowing** is forecast to fall from £120 billion in 2012/13 to £21 billion in 2016/17.[1]

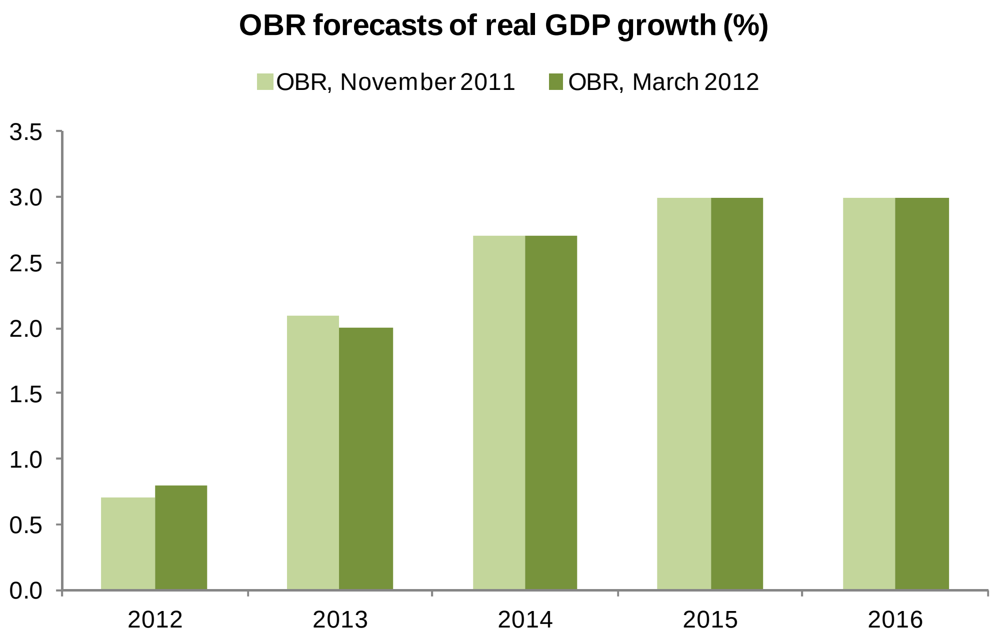
- **Fiscal targets:** the OBR reports that the Government has a better than 50% chance of meeting its targets for borrowing and debt.

[1] excluding the effects of the transfer of the Royal Mail pension fund to the public sector

3 OBR forecasts for the economy and public finances

3.1 GDP growth and inflation

The Office for Budget Responsibility's forecasts for the economy have changed very little compared with those published in November. The forecast for GDP growth in 2012 has been revised up marginally from 0.7% to 0.8%. the forecast for 2013 has been revised down marginally from 2.1% to 2.0%. Forecasts for 2014, 2015 and 2016 are unchanged.

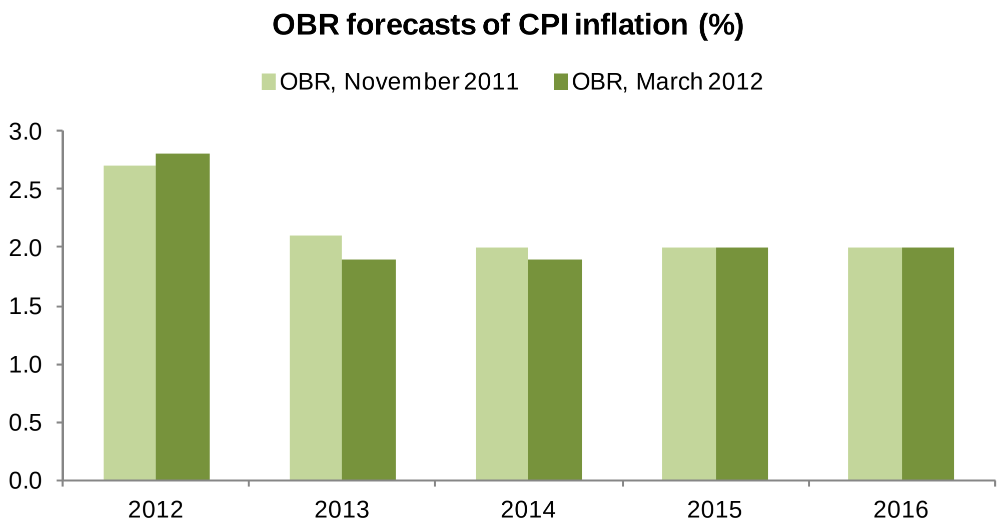


OBR forecasts of GDP growth

	2012	2013	2014	2015	2016
OBR, November 2011	0.7	2.1	2.7	3.0	3.0
OBR, March 2012	0.8	2.0	2.7	3.0	3.0

The OBR forecast that the economy will avoid a technical recession. Following the decline in output in Q4, 2011 the economy is forecast to grow by 0.3% in Q1, 2012. Growth is forecast to be flat in Q2, 2012 growing by 0.6% in Q3 and 0.3% in Q4.

On inflation, the OBR's forecasts are largely unchanged compared with November. The forecast for CPI inflation this year has been revised up to 2.8% from 2.7%. The forecasts for 2013 and 2014 have been revised downwards slightly.

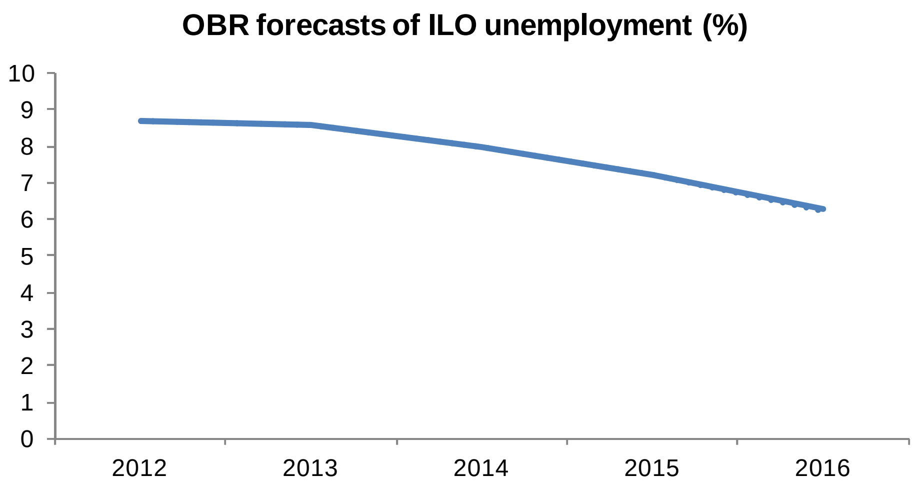


OBR forecasts of CPI inflation (%)

	2012	2013	2014	2015	2016
OBR, November 2011	2.7	2.1	2.0	2.0	2.0
OBR, March 2012	2.8	1.9	1.9	2.0	2.0

3.2 Employment and unemployment

The OBR's forecasts for unemployment are unchanged compared with those made in November.



The OBR's forecast for the claimant count has been revised down since November. Claimant count unemployment is forecast to be 1.65 million in 2012 before falling to 1.19 million in 2016. The forecast for employment is unchanged compared with November. Employment is forecast to increase from 29.1 million in 2012 to 30.0 million in 2016.

OBR forecasts: employment and unemployment

	2012	2013	2014	2015	2016
Employment, millions					
November 2011	29.1	29.2	29.4	29.7	30.0
March 2012	29.1	29.2	29.4	29.7	30.0
ILO unemployment, %					
November 2011	8.7	8.6	8.0	7.2	6.2
March 2012	8.7	8.6	8.0	7.2	6.3
Claimant count, millions					
November 2011	1.75	1.77	1.67	1.45	1.23
March 2012	1.65	1.64	1.52	1.35	1.19

3.3 The public finances

The OBR's forecasts for borrowing and debt are in the table below. They are broadly similar to the forecasts published in November. Public sector borrowing is forecast to fall from £120 billion (7.6% of GDP) in 2012/13 to £21 billion (1.1%) in 2016/17.[2] Public sector debt is now forecast to be slightly lower than previously expected, peaking at 76.3% of GDP in 2014/15 and falling in the next two years.

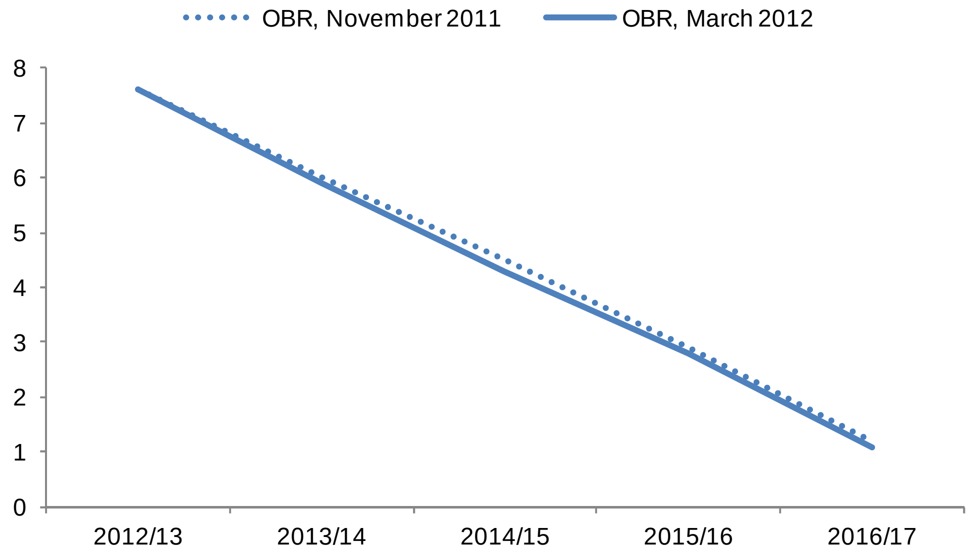
OBR forecasts: public finances

	2012/13	2013/14	2014/15	2015/16	2016/17
Net borrowing, £ billion					
November 2011	120	100	79	53	24
March 2012	120	98	75	52	21
Net borrowing, % GDP					
November 2011	7.6	6.0	4.5	2.9	1.2
March 2012	7.6	5.9	4.3	2.8	1.1
Net debt, £ billion					
November 2011	1182	1300	1397	1470	1515
March 2012	1159	1272	1365	1437	1479
Net debt, % GDP					
November 2011	73.3	76.6	78.0	77.7	75.8
March 2012	71.9	75.0	76.3	76.0	74.3

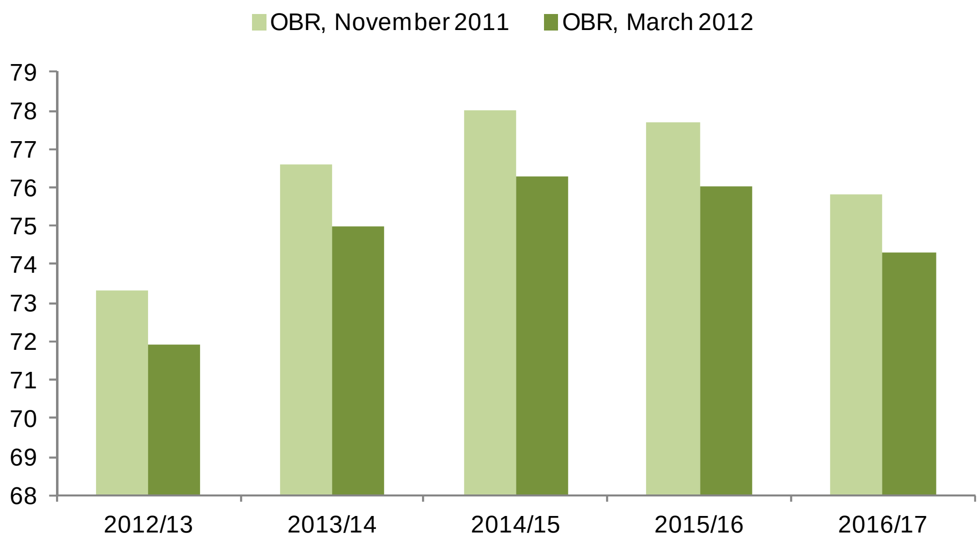
Note: borrowing figure for 2012/13 excludes the effect of the transfer of Royal Mail pension fund to the public sector

[2] These figures exclude the effect of the transfer of the Royal Mail pension fund to the public sector. This has the effect of reducing borrowing by £28 billion in 2012/13 due the way the office for National Statistics treats this transfer. In effect, the assets are included in the public finances for 2012/13 but the liabilities, which are treated as contingent liabilities, are not. As this could give a misleading picture of the underlying state of the public finances, the figures in this note exclude the boost from the Royal Mail pension fund.

Public sector net borrowing, % GDP



OBR forecasts of government debt, % GDP



3.4 The fiscal mandate

The Government announced its “fiscal mandate” in the June 2010 Budget. The mandate requires the cyclically-adjusted current budget to be balanced by the end of a rolling five year period, currently 2016/17. A cyclically-adjusted (or “structural”) measure is used as this removes the effect of the economic cycle and thus gives a better indication of the underlying state of the public finances. The mandate also gives some protection to capital spending as the current balance excludes net investment spending.

The Government also has a supplementary target for public sector debt. This requires public sector net debt to fall as share of GDP at the fixed date of 2015/16. According to the Treasury, this target ensures that the public finances are restored to a sustainable path.

The OBR assesses the Government's chances of meeting the fiscal mandate and the supplementary target. At the Budget, the OBR reported that the Government has a greater than 50% chance of hitting both targets.

OBR forecasts: Cyclically adjusted current balance, % GDP

	2012/13	2013/14	2014/15	2015/16	2016/17
November 2011	-3.9	-2.7	-1.6	-0.6	0.5
March 2012	-4.2	-2.7	-1.5	-0.7	0.5

Note: negative figures indicate a deficit, positive figures a surplus

4 Budget measures

4.1 Income tax personal allowance for those aged under 65

The Budget confirmed the £630 increase in the personal allowance for 2012/13 at £8,105 and the cut in the basic rate limit of £630 to £34,370.[3] The Budget announced an increase of £1,100 in the personal allowance to £9,205 for 2013/14 This is an increase of £850 in real terms. The basic rate limit will be cut by £2,125 in cash terms in 2013/14 to £32,245.[4] The National Insurance Upper Earnings will continue to be aligned with the higher rate threshold.

According to the Treasury, these measures will take 840,000 people from income tax altogether and provide a real terms benefit of £170 to most basic rate taxpayers. 23.6 million people will gain. 1.8 million people will lose out from these measures with an average loss of £185. These measures cost the Treasury £3.3 billion in 2013/14 rising to 3.6 billion in 2016/17.

4.2 Income tax personal allowance for those aged 65 and over

Those aged 65 and over currently receive a higher personal allowance than those aged under 65. In 2012/13, those aged 65-74 will receive an allowance of £10,500 and those aged 75 and over will have an allowance of £10,660. These compare with an allowance of £8,105 for those aged under 65.

The Budget announced two changes to the age-related personal allowance taking effect from April 2013:

- The allowances will be restricted to those eligible at that point
- The allowances will be frozen at their 2012/13 levels until they align with the personal allowance. Age-related allowance will then be removed.

According to the Government, there will be no cash losers from this measure (as the allowance is not being cut in cash terms). However, as the allowance is not being uprated

[3] The basic rate limit is the range of income at which income tax is paid at the basic rate of 20%.

[4] As a consequence, the higher rate threshold will fall from £42,475 to £41,450. The higher rate threshold is the sum of the personal allowance and the basic rate limit – i.e. the point at which tax starts being paid at 40%. As a result, 300,000 people will be brought into higher rate tax.

with inflation, there will be real terms losses. In 2013/14, 4.41 million will be worse off in real terms with an average loss of £83. Of these, 360,000 people aged 65 lose an average of £285.

There are no official published estimates of the numbers affected by local area. The regional estimates in the table below assume that the number of people affected in each region is in proportion to that region's estimated share of income taxpayers aged 65 and over in 2011-12. HMRC estimates that there are 4.77 million such taxpayers.[5]

Changes to age-related personal allowance

Regional estimates of numbers affected

	thousands
North East	170
North West	480
Yorkshire and Humber	340
East Midlands	320
West Midlands	370
East of England	450
London	410
South East	710
South West	460
Wales	240
Scotland	370
Northern Ireland	90
Total	4,410

Sources: Library estimates based on HMRC data

Note: estimated based on numbers of income taxpayers aged 65 and over
figures rounded to nearest 10,000

These changes to the age-related allowance raise £360 million for the Treasury in 2013/14 rising to £1.25 billion in 2016/17.

Further information is in a Library note: Age-related personal allowance.

4.3 50p rate of income tax

The 50p rate of tax, paid on income over £150,000, will be cut to 45p with effect from April 2013. This measure will affect 330,000 individuals. The Treasury estimates that this will cost £50 million in 2013/14 rising to £110 million in 2016/17. These estimates, are, however, dwarfed by the impact of forestalling measures (i.e. consequential behavioural changes), which the Treasury estimate may cost £2.4 billion in 2012/13 but yield £1.75 billion in 2014/15.

HMRC published evidence alongside the Budget on the impact of the 50p rate. This used a range of evidence including 2010/11 self assessment returns. The HMRC report said:

5 HMRC tables 2.1 and 2.2

> Although there is uncertainty around these estimates, sensitivity testing demonstrates that is difficult to construct a plausible outcome consistent with a yield estimate as high as those original forecasts. The conclusion that can be drawn from the Self Assessment data is therefore that the underlying yield from the additional rate is much lower than originally forecast (yielding around £1 billion or less), and that it is quite possible that it could be negative.[6]

There are no official published estimates of numbers of beneficiaries by local area. The regional estimates in the table below assume that the number of people affected in each region is in proportion to that region's estimated share of additional rate taxpayers in 2011-12.[7]

Cut to additional rate of income tax

Estimated number of beneficiaries by region

	Thousands
North East	5
North West	19
Yorkshire and Humber	14
East Midlands	13
West Midlands	16
East of England	36
London	101
South East	72
South West	18
Wales	4
Scotland	17
Northern Ireland	4
Abroad/unknown	10
UK total	330

Source: HMRC data and Library calculations

Note: based on number of additional rate payers in 2011-12, factored up to UK estimate for 2013-14 and rounded to nearest thousand

These estimates are approximate and should be sued with caution.

4.4 Child benefit

Background

At the 2010 Conservative Party Conference, the Chancellor said that from 2013 Child Benefit would be withdrawn from families with a higher rate taxpayer. Child Benefit would continue to be paid to all families, but would be clawed back where the recipient, or their partner, paid higher rate tax. The October 2010 Spending Review put the estimated savings from this policy at £2.5 billion a year.

The Treasury estimated that the withdrawal of Child Benefit from January 2013 from families containing at least one higher rate taxpayer would affect around 1.5 million families.[8]

6 HMRC, *The Exchequer effect of the 50% additional rate of income tax*, 21 March 2012, page 2
7 HMRC tables 2.1 and 2.2
8 HC Deb 20.10.2011 c1127W

The policy was criticised for the "cliff edge" withdrawal of Child Benefit that would result. Those with pre-tax incomes just above the threshold would no longer get any benefit. Those just below the threshold would get the full benefit but could lose it all after a modest rise in pre-tax income. The Institute for Fiscal Studies estimated that around 170,000 families could increase their net income if an individual in that family managed to lower their pre-tax income to just below the higher rate tax threshold, and about 200,000 families slightly below the higher rate threshold could find themselves with a lower net income if their pre-tax income were to rise slightly.[9]

The change was also viewed as potentially unfair between single and dual earner couples. A couple could individually have incomes below the threshold but combined incomes up to twice the new threshold and still keep the benefit.

In January 2012 the Prime Minister suggested that government was looking again at the "cliff edge" some families might face with the removal of child benefit for all top-rate taxpayers.[10]

2012 Budget

In the Budget, the Chancellor said that the threshold for withdrawal of Child Benefit would be where individual incomes are above £50,000 per year (and not the higher rate threshold of around £43,000). This change results in an Exchequer cost of £690 million in 2013-14, which reduces the annual saving from the original proposal to around £1.7 billion.

For those with incomes above £50,000, Child Benefit is to be withdrawn at 1% for each £100 of income from January 2013. This means that there will be no Child Benefit entitlement for families where any earner has an income over £60,000. This change means that 750,000 families who would previously have had all their benefit withdrawn will now keep some or all of it.

HMRC estimates that 1.2 million families will however still be affected by the tax charge which will be introduced as the mechanism to withdraw benefit: 70% of these will lose all their Child Benefit and 30% will lose a portion. The average loss will be around £1,300 per year. The taper will be implemented through self assessment and PAYE, with a potential 500,000 increase in the number of people subject to self assessment and additional annual operational costs to HMRC of £20 million to £25 million. Marginal tax rates on the taper will be higher for larger families.

4.5 Stamp duty

The Budget announced a new 7% rate of stamp duty for properties over £2 million to apply from 22 March 2012. Prior to this announcement, the top rate was 5%. According to HMRC, there are currently around 3,000 residential property transactions over £2 million a year. This measure is forecast to raise £150 million in 2012/13 rising to £300 million in 2016/17. Other measures to tackle stamp duty avoidance on high value property were also announced.

4.6 Corporation tax

The Budget announced a further cut in corporation tax over and above the reductions which had already been announced in the last two Budgets. The 2012 Budget announced that corporation tax would be cut to 24% from April 2012 rather than 25% as previously planned.

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9 IFS Green Budget February 2012

10 Interview with the House Magazine 12 January 2012

The 1% cut planned for April 2013 and April 2014 will still take place. As a result, the rate will be 22% from April 2014 rather than 23% under the previous plans. This measure costs the Treasury £405 million in 2012/13 rising to £920 million in 2016/17.

4.7 Value of selected Budget measures

The Budget was broadly fiscally neutral. Furthermore, within that overall neutrality, the individual measures had relatively small costs or gains to the Exchequer in the context of the overall public finances.

The table below shows the value of some of the major policy decisions:

Fiscal impact of selected Budget policy decisions
£ million

	2012/13	2013/14	2014/15	2015/16	2016/17
Tax changes					
Personal allowance increase to £9,205	0	-3,320	-3,450	-3,510	-3,580
Age-related allowances freeze, closure to new recipients	0	360	670	1,010	1,250
Reduction in additional rate of income tax to 45p	0	-50	-100	-100	-110
Cap on unlimited income tax reliefs	0	neg	490	240	300
Corporation tax - further 1% reductions	-405	-730	-820	-880	-920
Stamp duty measures	150	245	290	325	375
Corporation tax - further 1% reductions	-405	-730	-820	-880	-920
Bank levy increase	10	420	455	455	455
Tobacco duty increase RPI +5%	70	50	50	45	45
Spending changes (costed to end of Spending Review period)					
Afghanistan: reduced Special Reserve spending	100	800	1,500		
Child benefit removal: £50,000 threshold, taper to £60,000	-185	-690	-630		
Total policy decisions	**470**	**-1,710**	**235**	**460**	**1,140**
Forestalling impacts of 50p rate reduction/cap on reliefs	-2,400	760	1,750	-370	0
Total fiscal impact of policy decisions	**-1,930**	**-950**	**1,985**	**90**	**1,140**
Comparisons: Office for Budget Responsibility forecasts					
Public sector net borrowing (deficit)	*92,000*	*98,000*	*75,000*	*52,000*	*21,000*
Public sector net debt	*1,159,000*	*1,272,000*	*1,365,000*	*1,437,000*	*1,479,000*

Sources: HM Treasury Budget 2012 *Red Book* table 2.1
Office for Budget Responsibility, *Economic and Fiscal Outlook* , March 2012

- The biggest single change was the increase in the personal allowance to £9,205 (combined with the measures to leave higher rate taxpayers with a proportion of the benefit) in 2013-14. This costs the Exchequer approximately £3.5 billion a year.

- The most substantial revenue-raising measure is the freezing of age-related income tax allowances and restriction to existing recipients from April 2013. This will raise £1 billion compared with previous the previous policy (up-rating with the RPI) by 2015-16.

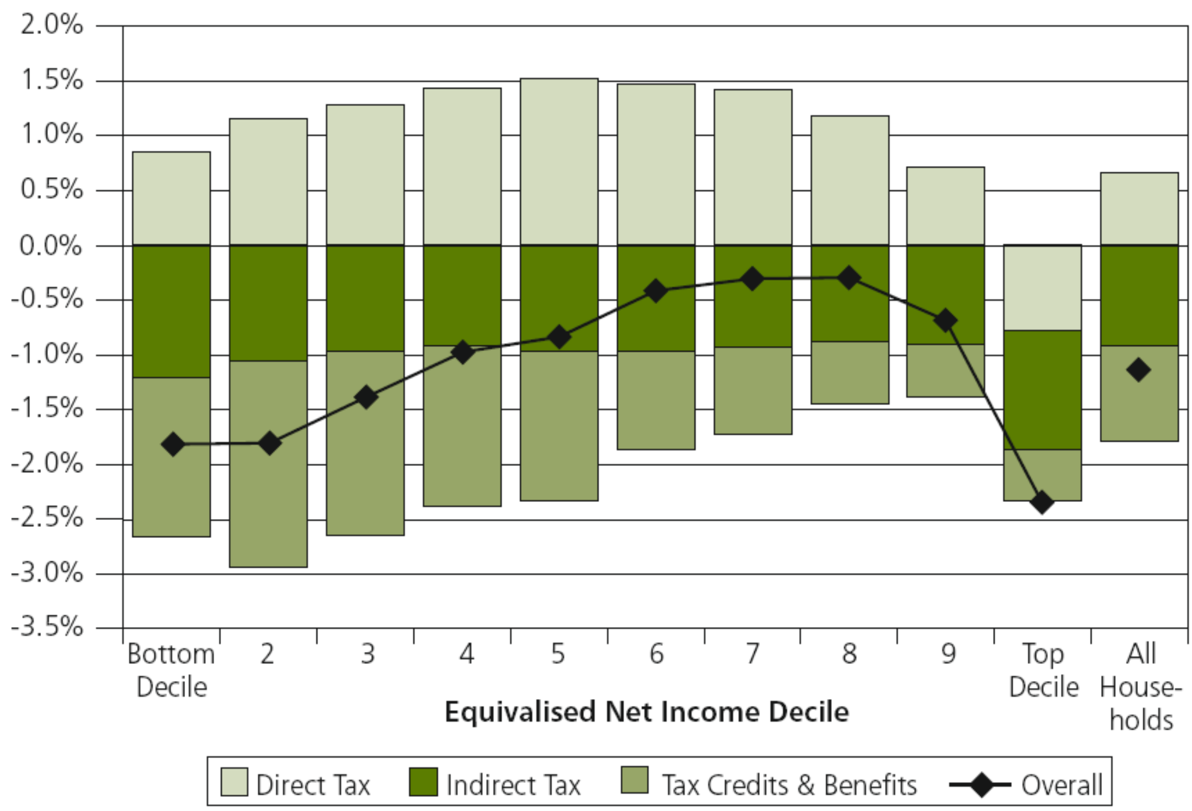
- The largest single line is not a policy measure. The reduction in the additional rate of income tax and the introduction of a cap on unlimited tax reliefs will not be put into place until 2013-14. This delay is expected to lead to substantial "forestalling impacts", or behavioural changes, which will affect the distribution of revenues between years.

5 Distributional effects

The Government have published an analysis of the average effects of all its planned changes to taxes, benefits and tax credits on households, broken down by income group.[11] This shows that households across the income distribution are expected to have a lower net income in 2013/14 than they would have done in the absence of the Government's reforms.

The 10% of households with the highest net incomes are expected to have the largest average percentage decrease in their incomes as a result of these changes, followed by the poorest 20% of households. The households that are expected to see the smallest average percentage decreases are those that are just above the middle of the income distribution.

Effects of Government's tax, tax credit and benefit changes as percentage of net income, 2013/14



Source: HM Treasury tax and benefit microsimulation model.

[11] The figures take account of measures from this Budget, Autumn Statement 2011, Budget 2011, Spending Review 2010, and the June Budget 2010, as well as changes that were announced before the June Budget 2010 which are being implemented by the Government. The only include changes that can be modelled robustly at a household level – these account for most tax, tax credit and benefit changes coming into effect in 2013/14. To produce the figures it has been assumed that there is not behaviour change as a result of these policies. Figures are averages for all households in each income group.

6 Budget reaction

The House of Lords Library have produced a Note which summarises responses to the Budget by the Opposition and a range of organisations and commentators.[12]

[12] House of Lords Library Note LLN 2012/011, *Budget 2012: Reaction*, by Ian Cruse and Edward Scott