Background to the 2013 Budget

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Section Economic Policy and Statistics Section

This note sets out the background to the 2013 Budget which will take place on 20 March. The Office for Budget Responsibility (OBR) will publish revised forecasts for the economy and public finances on the same day.

The Library will publish a special edition of Economic Indicators on 19 March – the day before the Budget.

A separate Library note will be published shortly after the Budget summarising the main points.

This note includes data published up to 13 March. The Office for National Statistics will be publishing new data before the Budget on the following dates:

- 19 March: Inflation
- 20 March: Employment and unemployment
- 21 March: Public finances

These will be available on the ONS website.

Contributors

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1 Introduction

The Chancellor is under pressure to find ways of kick-starting the economy, following growth of just 0.2% in 2012 and the possibility that the economy may enter a triple dip recession. Output remains 3% below its pre-recession peak. Forecasters predict another year of sluggish growth for the UK economy. The weak outlook for growth has already led to the loss of the UK's AAA credit rating. The labour market is, however, performing better with employment up by nearly 600,000 over the last year while unemployment is nearly 160,000 lower than a year ago (updated labour market figures are published on Budget day).

Various suggestions have been made for policies to boost growth including increasing infrastructure spending and further tax cuts. Such policies would require offsetting tax increases or cuts to other budgets unless borrowing was allowed to rise. Ahead of June's Spending Review, some are questioning the Government's decision to ring-fence certain areas of spending. There has also been some speculation that the Budget may announce a change to the Bank of England's remit to allow monetary policy to do more to support the economy.

The Coalition's previous Budgets have announced large increases in the income tax personal allowance, taking 2.2 million out of income tax. It is likely that there will be a further increase to meet the Coalition Agreement pledge to raise the allowance in real terms each year towards the target of £10,000. Large increases are expensive, however, and the Budget would have to set out how this would be funded.

Government borrowing fell by a quarter between 2009/10 and 2011/12. Borrowing in 2012/13 is complicated by a number of special factors obscuring the underlying trend. In the Autumn Statement, the Chancellor said that borrowing would fall this year "any way you present these figures." This is now looking much less certain. The 4G auction raised £1 billion less than expected and borrowing over the year to date is £7.5 billion higher than last year, once the exceptional factors are stripped out. The Institute for Fiscal Studies (IFS), while stressing the uncertainty around the figures, has said that borrowing is more likely to increase slightly this year than decrease slightly.

2 The economy

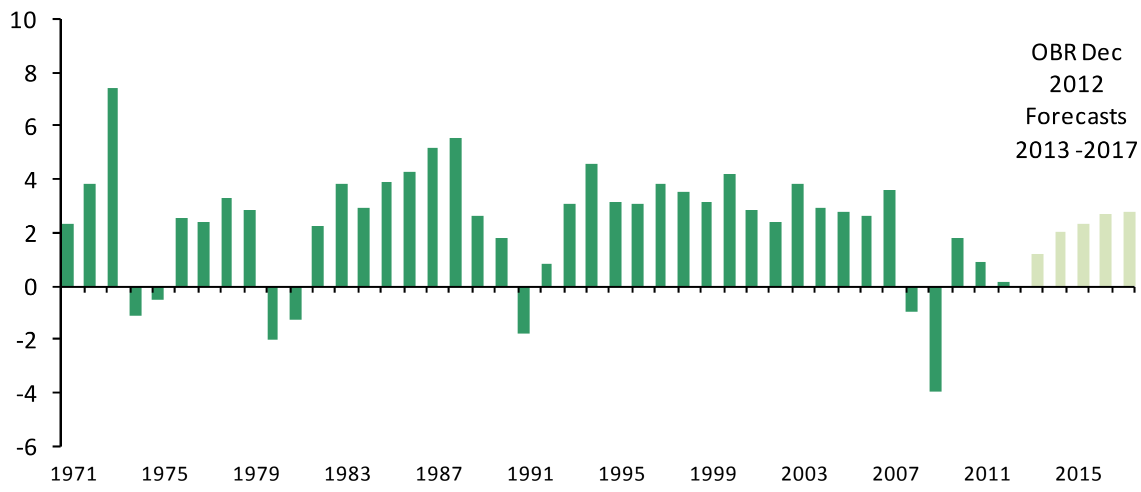
2.1 GDP

The economy grew by 0.2% in 2012. This is a slower rate of growth than either 2011 (0.9%) or 2010 (1.8%). The slow rate of growth in 2012 was much lower than the OBR had forecast in March 2012. In December, the OBR said:

> The economy has performed less strongly this year than we expected at the time of our last forecast in March, primarily reflecting the weakness of net exports. Looking forward, the recovery still lacks momentum.
>
> We are more pessimistic about the economy's medium term growth prospects than we were in March. We expect weak productivity to constrain nominal [i.e unadjusted for inflation] earnings growth for longer, with a slower fall in inflation delaying the pick-up in real incomes. The outlook for the world economy and UK exports has deteriorated and we expect the difficulties of the euro area to depress confidence and put upward pressure on bank funding costs for longer. [1]

GDP growth

Annual % change, real terms



Sources: ONS, OBR

The economy entered recession[2] for a second time following the financial crisis when output fell by 0.1% in Q1 2012. The economy emerged from recession in Q3 2012, when growth was estimated to be 1.0%, after contracting for three quarters in a row. However, data for Q4 2012 show that the economy contracted by 0.3%. The UK economy could now technically return to recession if output falls in Q1 2013. In December, the OBR forecast that the economy would be flat in Q1.

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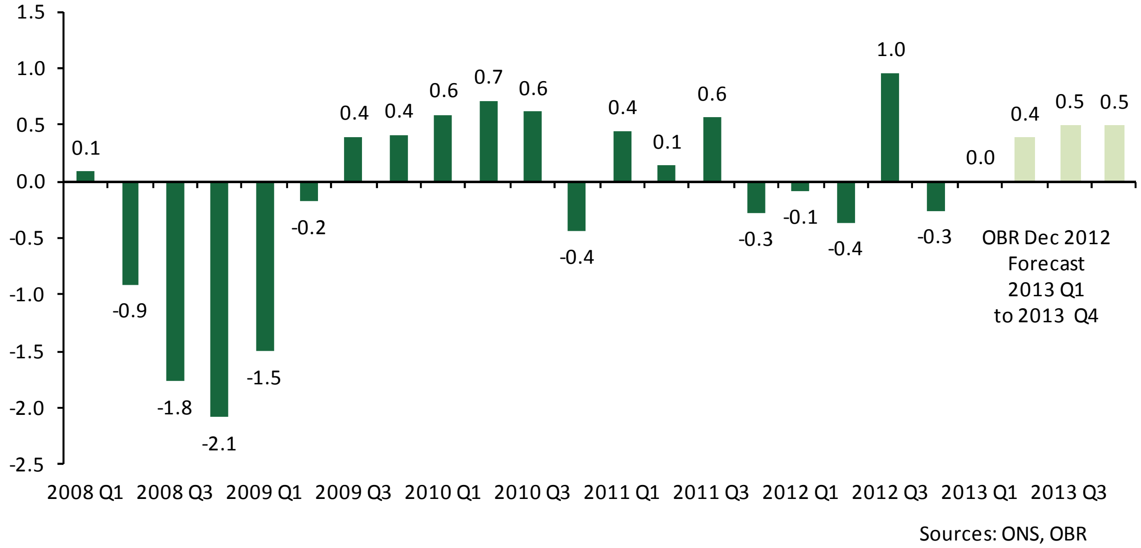
1 OBR, *Economic and Fiscal Outlook*, December 2012, p5

2 A recession is technically defined as two consecutive quarters of negative growth.

GDP growth
Quarter on quarter % change, real terms



The table below shows contributions to GDP in each of the last four quarters by expenditure component.

Contributions to growth (quarter-on-quarter), of the expenditure components of GDP

	2012 Q1	2012 Q2	2012 Q3	2012 Q4
Final Consumption Expenditure				
Households	0.3	0.3	0.2	0.1
Non Profit Institutions Serving Households	-0.1	0.1	-0.1	-0.1
General Government	0.8	-0.4	0.1	0.2
Gross Capital Formation	-0.4	0.5	0.4	-0.4
of which Gross Fixed Capital Formation	0.1	0.3	-0.1	-0.1
Exports	-0.5	-0.4	0.5	-0.5
Imports	0.0	0.4	0.1	-0.4
Net trade	-0.5	-0.8	0.4	-0.1
Real GDP growth	-0.1	-0.4	1.0	-0.3

Source: ONS, Statistical bulletin: Second estimate of GDP - 4th quarter 2012

The latest estimates of GDP for Q4 2012 suggest that general Government and household consumption made the largest contribution to GDP growth although this was offset by negative growth in the other expenditure components. The outlook for trade and the recent trends in sterling are discussed in section 2.7 on the international economy.

Construction sector output rose by 0.9% in Q4 2012 following three consecutive quarterly contractions. Manufacturing output fell by 1.3%. Output in the services sector, by far the largest sector in the economy, fell by 0.1%, with the distribution, hotels & catering services sub-sector falling by 0.5% and government & other services sub-sectors falling by 0.8%.

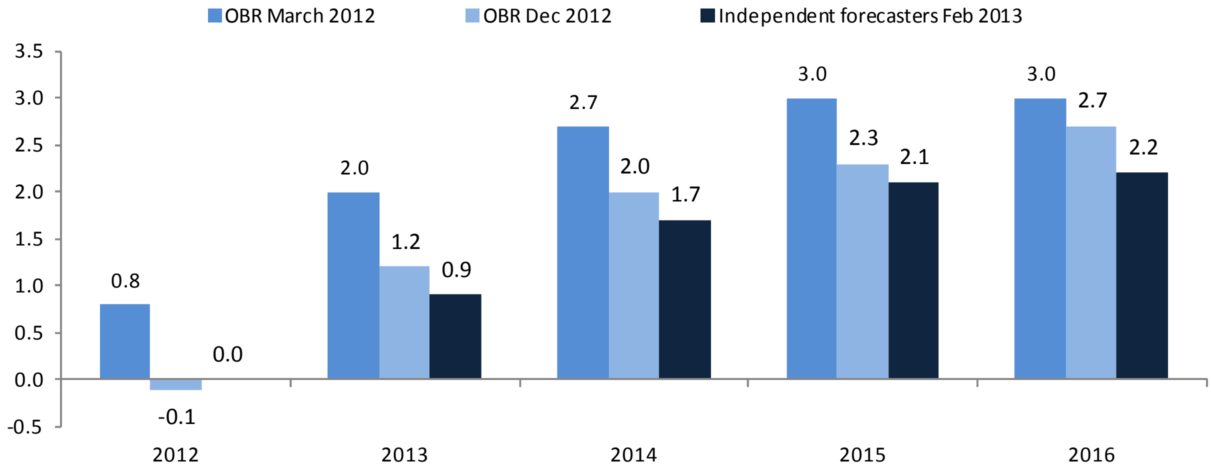
Overall, the construction sector contribution to the last quarter growth figure of -0.3% was 0.1 of a percentage point, the production sector -0.3 of a percentage point and the services sector -0.1 of a percentage point.

2.2 Growth forecasts

The OBR expect the economy to grow by 1.2% in 2013. Growth of 0.0% and 0.4% is forecast for Q1 and Q2 2013. Higher growth (2.0%) is forecast for 2014. In the medium term, the OBR expects growth of 2.3% in 2015 and 2.7% in 2016.

The chart below compares the OBR's December 2012 forecast with the latest average independent forecast and the OBR's March 2012 forecast. The OBR's forecasts for growth are higher than the latest average of independent forecasters.

GDP growth forecasts
Annual % change, real terms



Sources: OBR, HM Treasury

The table below shows the extent to which independent forecasters have downgraded the growth outlook for the UK economy in 2013. This time last year, independent forecasters were expecting growth of 1.8% in 2013. They are now forecasting 0.9%.

Forecasts of GDP growth in 2013 (%)

OBR	
Pre - Budget 2010	2.8
Post-Budget 2010	2.9
Nov-10	2.9
Mar-11	2.9
Nov-11	2.1
Mar-12	2.0
Dec-12	1.2
Average of independent forecasts	
Feb-12	1.8
Mar-12	1.7
Apr-12	1.7
May-12	1.7
Jun-12	1.7
Jul-12	1.5
Aug-12	1.3
Sep-12	1.2
Oct-12	1.1
Nov-12	1.1
Dec-12	1.1
Jan-13	1.0
Feb-13	0.9

Source: HMT, *Forecasts for the UK Economy: a comparison of independent forecasts* ; OBR

The OECD's latest forecasts for the UK, published in November 2012, forecast growth of 0.9% this year and 1.6% in 2014. The OECD places the UK third out of the G7 countries for growth in 2013 and fourth in 2014. The IMF forecasts growth of 1.0% in 2013 and 1.9% in 2014.

OECD/IMF forecasts for real GDP growth, %

	OECD		IMF	
	2013	**2014**	**2013**	**2014**
UK	**0.9**	**1.6**	**1.0**	**1.9**
Canada	1.8	2.4	1.8	2.3
France	0.3	1.3	0.3	0.9
Germany	0.6	1.9	0.6	1.4
Italy	-1.0	0.6	-1.0	0.5
Japan	0.7	0.8	1.2	0.7
US	2.0	2.8	2.0	3.0
Eurozone	-0.1	1.3	-0.2	1.0
OECD	1.4	2.3	...	...

Sources: OECD, *Economic Outlook* , No 92, November 2012
IMF, *World Economic Outlook update* , January 2013

The OECD's latest UK economic survey commented that:

> Lingering effects from the global financial crisis, the restrictive impact from necessary fiscal consolidation and headwinds from the euro area sovereign debt crisis risk prolonging and worsening the economic downturn and hurting the long-term growth potential.
>
> Monetary policy is the primary tool to stimulate the economy, but the fiscal framework and earned policy credibility allow a flexible response to economic weakness. The recovery from the recession is projected to continue to be slow and uneven. Although the scope for macroeconomic policy is becoming more circumscribed, sustained monetary stimulus through expanded quantitative easing, liquidity provision by the Bank of England and government-backed funding schemes need to continue to support the economy. The government deficit remains high and public finances will come under pressure from population ageing in the long term. The fiscal stance remains appropriate. However, if growth significantly underperforms expectations over the coming months, the flexibility of the fiscal framework should be utilised. [3]

[3] OECD, *Economic Surveys: United Kingdom*, February 2013, p8

The UK's credit rating

On 22 February, the credit rating agency Moody's lowered the UK's sovereign credit rating by one notch, from *Aaa* (its highest assessment) to *Aa1*. This was the first time the UK had been downgraded by a major ratings agency since it was first assigned a sovereign debt rating in 1978. It leaves Germany and Canada as the only remaining G7 countries that have a top rating from all three major agencies.

Credit ratings and outlook

Major ratings agencies, G7 countries, 13th March 2013

	S&P		Moody's		Fitch	
	rating	*outlook*	*rating*	*outlook*	*rating*	*outlook*
Canada	AAA	+/-	Aaa	+/-	AAA	+/-
France	AA+	-ve	Aa1	+/-	AAA	-ve
Germany	AAA	+/-	Aaa	-ve	AAA	+/-
Italy	BBB+	-ve	Baa2	-ve	A-	-ve
Japan	AA-	-ve	Aa3	+/-	A+	-ve
UK	AAA	-ve	Aa1	+/-	AAA	-ve
US	AA+	-ve	Aaa	-ve	AAA	-ve

Moody's decision was motivated by the persistent weakness of GDP growth and the resultant difficulties the Government has faced in achieving its desired pace of fiscal consolidation. In particular, the slippage on its debt rule* announced in the 2012 Autumn Statement, and worse than expected borrowing figures in subsequent months, were interpreted as signals that the sluggish growth environment was posing a mounting challenge to the Government's efforts.

The political implications of the decision are probably more serious than the economic consequences, at least in the short term. UK Government borrowing costs, measured by bond yields, were entirely unaffected by the move.** This is partly because UK Government bonds are so widely-traded that the analysis and judgement of ratings agencies rarely imparts any new information to the market. It is also a consequence of the UK being able to issue its own currency; unlike the eurozone countries, it is therefore is not at risk of default in the conventional sense.

However, the downgrade may have been one factor, alongside comparatively favourable economic developments in the US and the seemingly greater tolerance by the Bank of England for above-target inflation, contributing to the sharp decline in sterling seen in recent weeks.

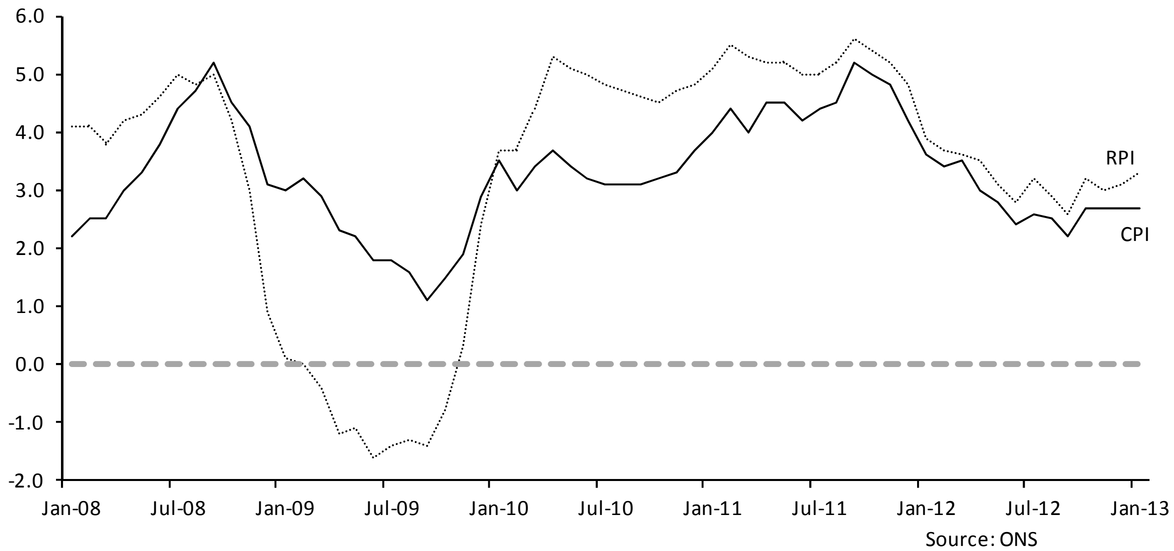
* The Government set a 'supplementary fiscal target' for public sector net debt to be falling as a percentage of GDP by 2015/16. In its December 2012 *Economic and Fiscal Outlook*, the OBR forecast that the debt to GDP ratio would still be rising at this point, and would not begin falling until a year later, in 2016/17.

** For instance, the benchmark yield on ten year government bonds was 2.12% on 21 February, 2.12% on 22 February (the date of the Moody's downgrade) and 2.09% on Monday 25 February.

2.3 Inflation

Inflation has been above the Bank of England's 2% CPI target for the last thirty eight months. It is currently 2.7% on the CPI measure and 3.3% as measured by the RPI. Inflation has fallen since it peaked at over 5% in September 2011.

Inflation
% change over 12 months



The OBR forecast that CPI inflation will fall over the next few years. It forecasts 2.5% inflation in 2013 (compared with 2.8% in 2012), 2.2% in 2014 and 2.0% in 2015.

The OECD forecasts CPI inflation in the UK of 1.9% this year (amongst the highest in the G7 countries) and 1.8% next year.

OECD forecasts for inflation, %

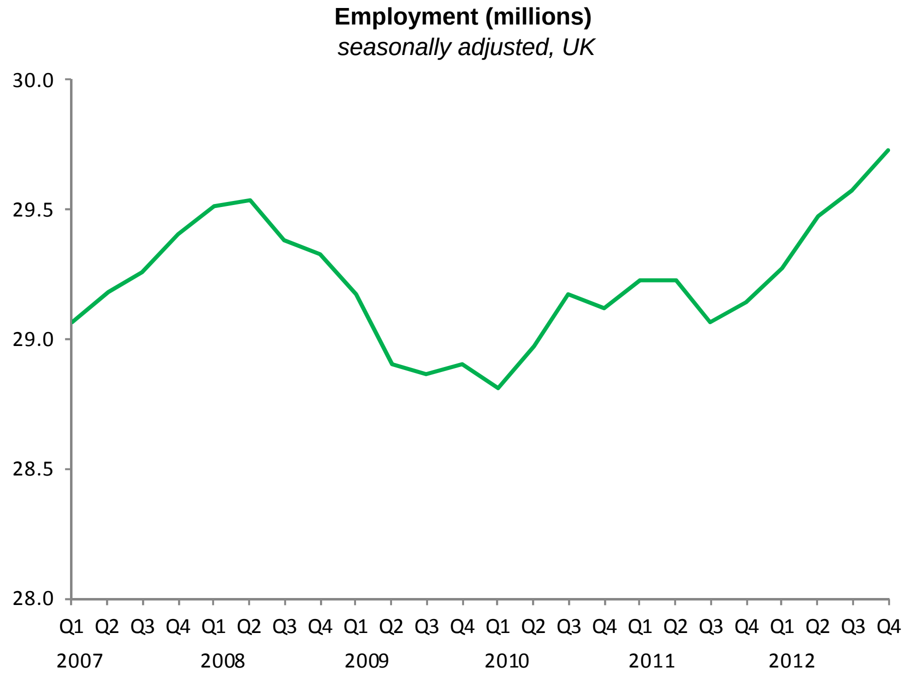
	2013	2014
UK (CPI)	1.9	1.8
Canada	1.4	1.8
France	1.3	1.2
Germany	1.9	2.0
Italy	1.9	0.9
Japan	-0.5	1.3
US	1.8	2.0
Euro area	1.6	1.2

Source: OECD, *Economic Outlook,* November 2012

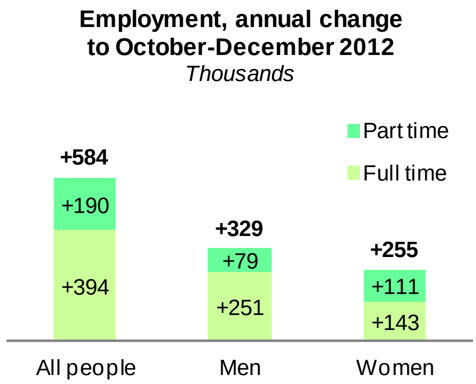
2.4 Employment

The number of people in employment rose during 2012. Latest data show that it increased by 154,000 over the last quarter and was up by 584,000 over the last year, to 29.73 million in the three months to December 2012 – an all-time high (partly as a result of population change).

The employment rate (the proportion of the population in work) for those aged 16-64 was 71.5% in the three months to December 2012, up 0.3 percentage points from the last quarter and up 1.1 percentage points from the year before. This compares to a pre-recession rate of 73.0% in March-May 2008.



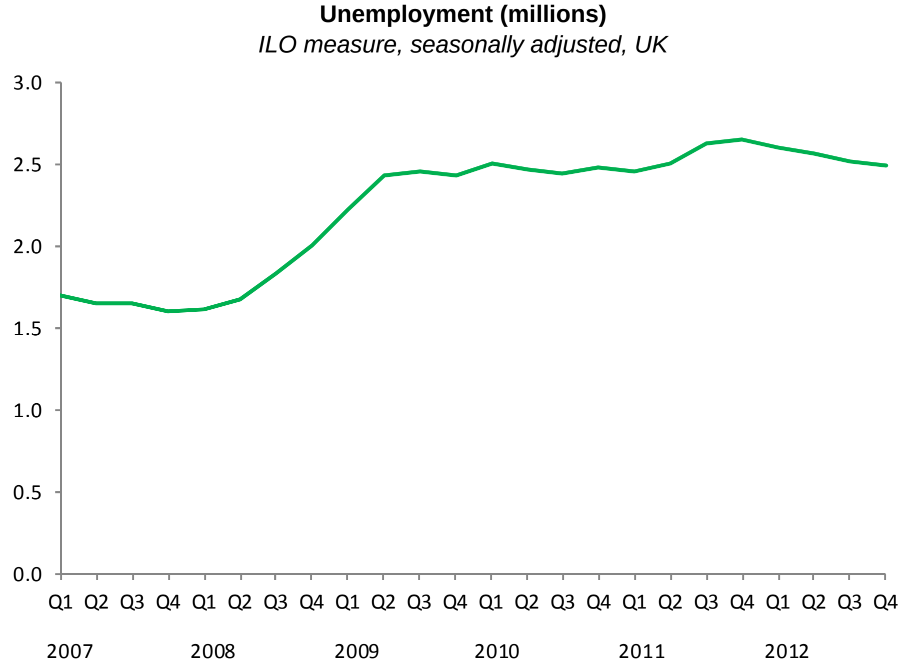
Full-time employment was 21.65 million in the three months to December 2012, an increase of 394,000 on a year before. The number employed part-time was 8.08 million, up by 190,000 on the year before. The number working in part-time jobs because they could not find a full-time job was 1.38 million, 17.5% of all part-time workers. Private sector employment has increased by 840,000 since Q2 2010 (1.13 million since Q1 2010).[4]



2.5 Unemployment

The number of people unemployed was 2.50 million in the three months to December 2012, a decrease of 14,000 compared with the previous quarter and 156,000 lower than a year earlier. This represents 7.8% of the economically active population, down 0.1 percentage points from the previous quarter and 0.6 percentage points lower than a year before.

[4] These figures include staff in further education colleges, who were reclassified to the private sector in 2012, in the private sector for the whole period.



The unemployment rate in the UK is slightly below the OECD average and in the middle of the pack among G7 countries. It is lower than in Italy, France and the US (just) but higher than in Canada, Germany and Japan.

International comparisons of unemployment
OECD Harmonised unemployment rates
%, December 2012 (except where stated)

UK	**7.8 (a)**
Canada	7.0 (b)
France	10.6
Germany	5.3
Italy	11.2
Japan	4.2
US	7.9 (b)
Eurozone	11.7
OECD	8.0

Notes: (a) Oct 2012; (b) Jan 2013
Source: OECD

In December, the OBR forecast that the unemployment rate would average 8.0% in 2012 and 8.2% in 2013 and 2014, before falling to 8.0% in 2015, 7.6% in 2016 and 7.1% in 2017.

The OECD's latest unemployment forecasts are shown in the table below. In the UK, unemployment is forecast to increase from 8.0% in 2012 to 8.3% in 2013, before falling back to 8.0% in 2014. This would make UK unemployment the third highest in the G7 in 2014, below France (10.9%) and Italy (11.8%). UK unemployment would remain well below that of the Eurozone average and around the OECD average throughout this forecast period.

OECD unemployment forecasts, %

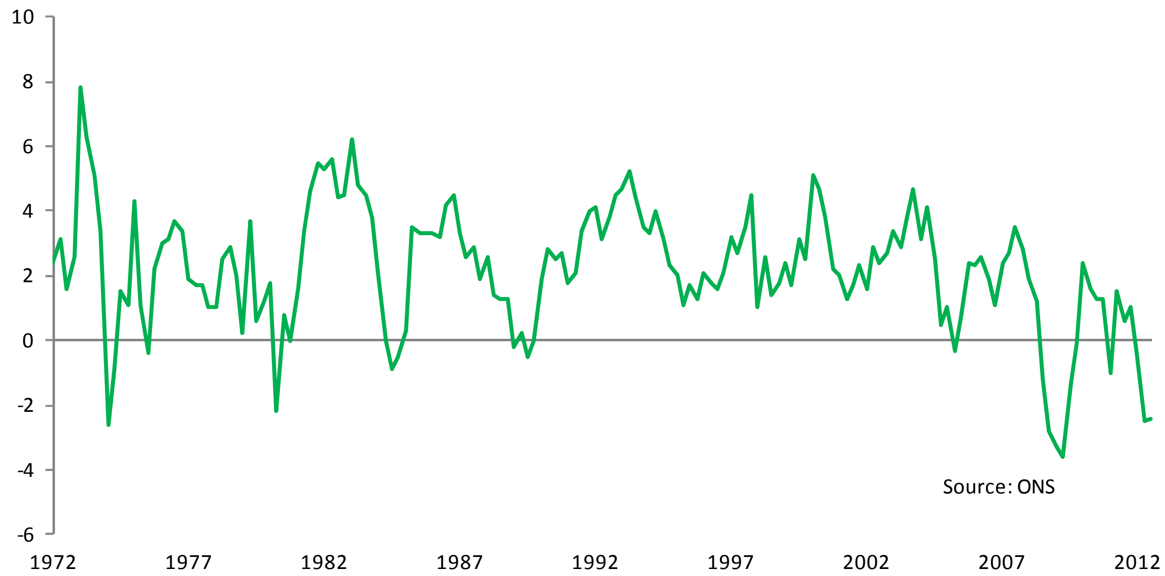
	2012	2013	2014
UK	**8.0**	**8.3**	**8.0**
Canada	7.3	7.2	6.9
France	9.9	10.7	10.9
Germany	5.3	5.5	5.6
Italy	10.6	11.4	11.8
Japan	4.4	4.4	4.3
US	8.1	7.8	7.5
Eurozone	11.1	11.9	12.0
OECD	8.0	8.2	8.0

Source: OECD, Economic Outlook No. 92, Nov 2012

2.6 Productivity

Productivity refers to how efficiently inputs (labour and capital) are used to produce outputs (goods and services). The chart below shows the annual percentage change in productivity in the UK economy since 1972.

UK output per hour worked
Annual % change



The fall in productivity at the onset of the downturn was the largest annual fall since 1974 when there was a three day working week in the UK. The chart also shows that there were negative changes for periods beginning in 1974, 1975, 1980, 1989, 2008 and 2012, in most cases periods in which UK output also fell or grew slowly. In 2011, productivity was 0.5% higher than it was in 2010.

Output per hour worked in the UK

Annual % change, seasonally adjusted

2007	2.9
2008	-0.2
2009	-2.1
2010	1.6
2011	0.5

Source: ONS (series LZVD)

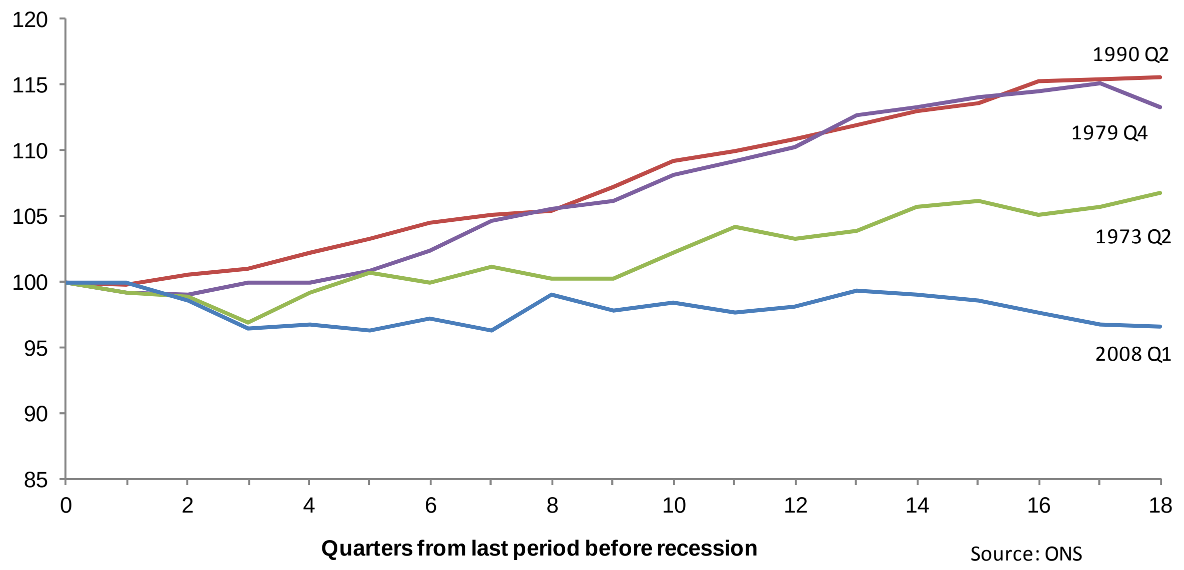
The Productivity Puzzle

In the initial stages of a recession, we expect productivity to fall as output contracts. However, this is not always accompanied by an immediate fall in employment levels. Over time, it is common for some people to lose their jobs or to reduce their hours of work. In a recession, the path of labour productivity is "determined by the relative sizes of the falls in output and total hours worked".[5]

The puzzle of recent years has been that economic output in the UK has been weak but that this has not been accompanied by a weak labour market. Current levels of productivity are lower than previous recessions.

UK labour productivity in recessions

Last period of quarterly growth = 100, quarterly data



Recent weak productivity growth is not confined to the UK. The UK's experience is similar to that of other European countries. However, in many countries productivity has not weakened to the same extent experienced in the UK, whilst productivity in the US has been relatively strong since 2009.[6]

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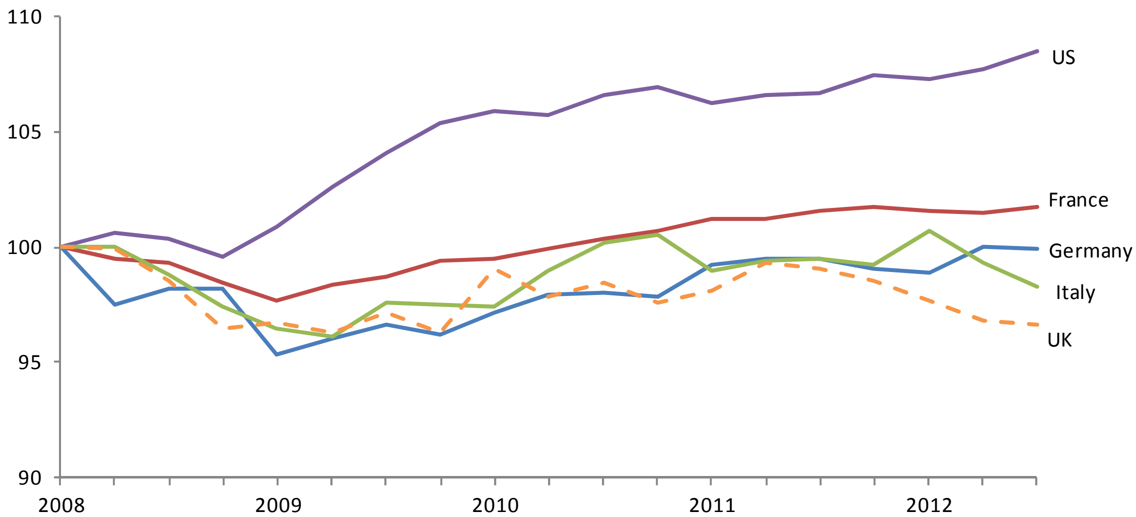
5 Institute for Fiscal Studies, *UK Productivity in the Recession*, 2010, p1

6 Real productivity per hour for the United States only covers the business sector as a total productivity measure is not publicly available

International comparisons of labour productivity
2008 Q1 = 100



Sources: ONS, Eurostat, Bureau of Labor Statistics

There are a variety of possible explanations for weak productivity growth in the UK. These are discussed below.

GDP

The 2008-09 recession was deeper than previous recessions with UK GDP falling by a total of 6.3% between Q1 2008 and Q3 2009. The loss of output in this period was almost two percentage points more than the 1979-1980 recession. Poor output figures may be expected to cause unusually poor productivity figures.

Labour market

Employment has recovered strongly since the post-recession trough in 2009. The most recent data for 2012 show the employment rate at 71.5%, only slightly below the pre-recession peak of 73.0% in Q2 2008.

This may be partly explained by the fact that since Q1 2008, the number of people in part-time employment has risen by 7.4% to 8.1 million. The increase in part-time working suggests that rather than downsizing the workforce, many firms have retained workers on shorter hours. This is part of a larger pattern known as 'labour hoarding' – some employers have retained a level of staffing following the recession which is not commensurate with their output, leading to many employees being underemployed and decreasing productivity overall.

Real wages

It has also been suggested that the relatively small rise in real wages in recent years has made it possible for businesses to hold onto labour and substitute it for capital. The latest data on gross hourly pay suggests that it was up by 1.1% on 2011, compared to an average growth of 4.0% a year in the years up to 2007. If growth in real wages had not been subdued since 2008 then it is possible workforces would have been cut and firms may have been more productive.

Financial services sector

Productivity in the finance and insurance sector has fallen by 9.6 percentage points from its 2009 Q4 peak. The finance and insurance sector affects the productivity of the rest of the economy due to its role in providing finance for business investment. For example, it has been suggested that the financial sector has extended forbearance to more firms in recent years, creating a strata of unproductive, 'zombie' companies. This may be partly because the financial services sector has become averse to funding riskier, but potentially more productive, new firms and ideas.

Statistics

Another suggestion is that the official GDP figures are too low to reflect actual economic activity, or that the official employment data are too robust to reflect the actual labour market. The chief economist at the ONS has acknowledged that measurement error cannot be ruled out, but the ONS data comply with international standards and have been found to be broadly in line with information from tax revenue and private sector business surveys.

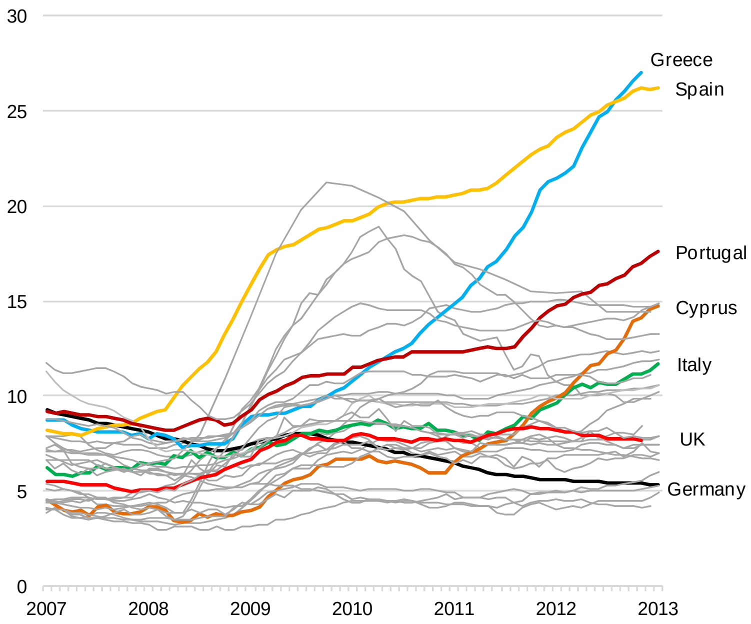
2.7 The international context

After a slowdown in 2012, the outlook for the global economy is showing some signs of improvement, although there remain significant political risks and uncertainties that will weigh down on confidence in 2013.

In the **eurozone**, the prospects for the currency union surviving its crisis have been improving thanks to a series of actions and commitments. In particular, the European Central Bank's pledge in September 2012 to buy government bonds in potentially unlimited quantities under certain conditions has bought time for the structural and political reforms necessary to ensure the survival of the euro. Of these reforms, the most important are the creation of a eurozone banking union and, related to this, allowing the permanent eurozone rescue fund, the European Stability Mechanism, to recapitalise the banks of beleaguered eurozone countries directly, rather than channel funds through their governments.

The divergence between the eurozone 'periphery and 'core' is reflected starkly in national labour market conditions

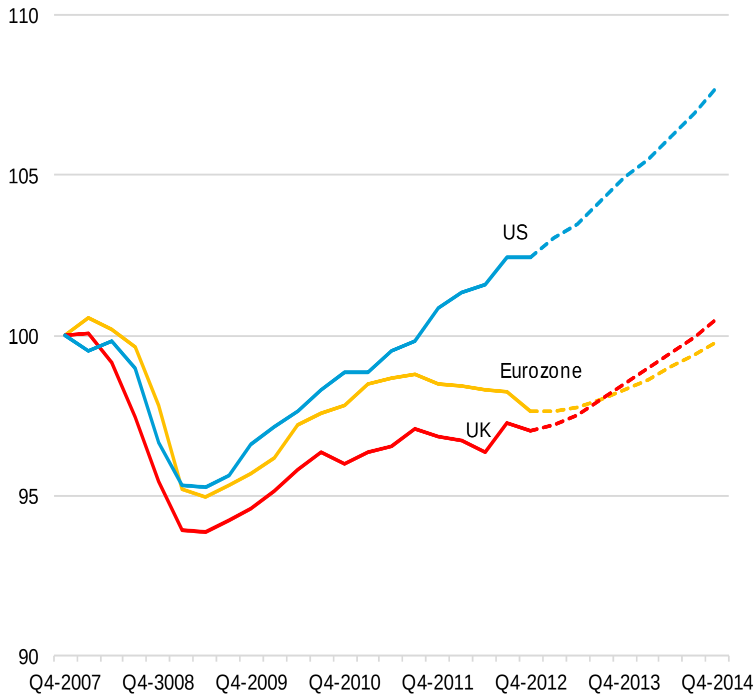
Monthly unemployment rate in selected highlighted EU Member States (coloured lines), and in all other EU Member States (grey lines)



However, as has become typical of the response to the crisis generally, the banking union continues to be delayed and diluted by political disagreement. This and other enduring problems mean that the eurozone crisis remains some way from being solved. Despite two restructurings, Greece's debt burden remains on an unsustainable trajectory and it seems likely that the eurozone will at some point have to face up to the idea of 'official sector intervention'; that is, restructuring the debt created through the lending by eurozone governments that took place under previous bailout packages. The cost of this may be still harder to sell to taxpayers in the eurozone 'core' now that these countries, too, are facing recession.

Austerity, imposed either directly as part of bailout agreements, or through political and market pressure, has generated considerable public resistance in Mediterranean countries, evidenced most recently in Italy by the success of Beppe Grillo's 'Five Star Movement' in its first ever national election. In Italy, the result will mean a period of political uncertainty likely to last several months; more broadly, it raises further doubts about whether policies of severe austerity, internal devaluation and structural reform can be implemented in the face of recession, falling wages and rising unemployment, particularly when such measures have yet to significantly improve Spain, Portugal, Greece or Italy's competitiveness, or bring them much closer to fiscal sustainability.

Eurozone and UK GDP is expected to remain below pre-recession peaks until the end of 2014
Real GDP, selected economies, indexed, Q4-2007=100; Outturn Q4-2007 to Q4-2012 and European Commission forecasts Q1-2013 to Q4-2014



This austerity will mean the public sector continues to act a constraint on growth throughout the eurozone in 2013, while in the private sector, weak confidence among households and firms will depress lending, and subdue investment and private consumption. As a result, many forecasters are predicting a mild recession in 2013 in the eurozone, following a 0.6% fall in output in 2012.

In the **United States**, the economic recovery has remained on track despite a slight contraction in output in the final quarter of 2012. In a symbolically important development, the Dow Jones surpassed its pre-financial crisis peak for the first time on 5 March. Consumer spending is buoyant, house prices continue to rise, and the job market is strengthening. Business investment, an important driver of the recovery since 2009, looks set to be supplemented with residential investment (i.e. housing construction), as the property market shows signs of emerging from a five-year stagnation. Growth will also be boosted by the Federal Reserve's announcement in December 2012 that interest rates would be kept low and bond purchases (i.e. quantitative easing) would continue until unemployment fell below 6.5%, in effect explicitly prioritising its 'maximum employment' over its 'stable prices' objective.

While monetary policy is supporting growth, fiscal policy is now acting as a restraint, with the expiry of certain temporary tax cuts at the start of 2013, and considerable uncertainty about future spending, thanks to the patchwork approach to fiscal policy that has prevailed since the Democrats lost control of the House of Representatives in 2010. In the New Year, a partial compromise was reached on the so-called 'fiscal cliff' that prevented certain tax increases coming into effect; and later in the month, a crisis over the government's borrowing authority (the 'debt ceiling') was delayed for several months. But an agreement over the 'sequester', the across-the-board cuts that were originally intended as an incentive for the Joint Select Committee on Deficit Reduction to reach agreement on long-term spending cuts in November 2011, has yet to be reached. The effects of the 'sequester', which began on 1 March, will accrue gradually, becoming more significant the longer a deal is delayed beyond this point. Without a deal, $85bn will be cut from federal spending by 31 October (roughly 0.9% of US GDP over the seven-month period), and $1.2tn of cuts are set to take effect over the next decade.

The direct effect of the cuts, together with the uncertainty generated in the absence of any agreement on the sequester, and on medium-term fiscal policy more generally, will affect US growth during 2013. The independent Congressional Budget Office estimates that, if no deal is reached on the sequester, GDP growth during 2013 will be 0.6 percentage points lower, and employment 0.75m lower, than if none of the $85bn cuts were to occur.[7]

In **Japan**, the new government elected in December 2012 has promised radical policy to combat almost twenty years of weak growth and deflation. In the face of a public debt burden of 240% of GDP, a fiscal stimulus worth $117bn has been implemented, and the government has put pressure on the Bank of Japan to adopt looser monetary policy, including an increase in the inflation target from 1% to 2%. Growth projections have been revised upwards in response: most forecasters now expect growth of 1.5%-2%, following a slight contraction in 2012.

In the **emerging and developing economies**, growth is expected to rise from 5.1% to 5.5% in 2013, but a return to the 'miracle' rate of expansion seen in emerging economies during 2010-11 is unlikely, partly due to weakness in demand in advanced economies. In China in particular, a rebalancing of the economy away from investment towards domestic consumption, acknowledged as necessary by the authorities, mean the days of double-digit growth may be numbered for the foreseeable future.

7 Congressional Budget Office blog, *Automatic Reductions in Government Spending – aka Sequestration*, 28 February 2013

Implications for the UK

With domestic demand weak, confidence low and credit conditions tight, exports are expected to make an important contribution to growth in the UK over the coming years. Most of the UK's exports to the eurozone go to 'core' countries (40% to France and Germany alone) that have performed far more strongly than the beleaguered periphery in the past, but which have recently started to see the effects of the crisis. Growth in Germany is expected to slow in 2013; in France, it is expected to remain close to zero; while Italy's economy will continue to contract.

The recent fall in sterling will add to inflation pressures, but could boost exports

Sterling effective exchange rate, daily from 1-Jan 2007, indexed, 2005=100

All this may mean a continued decline in the share of UK goods exports going to the eurozone, and it is no surprise that the Government wishes to cultivate 'alternative' export markets in the Commonwealth and emerging economies.[8]

Progress in resolving the eurozone crisis, and comparatively favourable developments in the US, together with seemingly greater tolerance by the Bank of England for above-target inflation, and the loss of the UK's AAA rating, have all contributed to a depreciation of sterling to its lowest level for over eighteen months. This is likely to assist with a rebalancing of the economy towards net exports, although in the past, the competitiveness boost from sterling depreciation has been offset by rising unit labour costs in the UK relative to other countries.

Despite the changing relationship between the eurozone and the rest of the EU implied by imperatives of the crisis response, and more vocal euroscepticism in the UK, the eurozone and UK economies for the time being will remain financially closely intertwined. Strong links through trade and the financial sector mean that, were the eurozone crisis to continue or worsen, it could further stifle the UK's faltering recovery.

The UK's financial institutions are no longer heavily exposed to peripheral eurozone sovereign debt: total outstanding lending to the Greek, Irish, Portuguese, Italian and Spanish governments stood at $13.3bn at the end of September 2012, down from $43.8bn three years before. UK banks have scaled back their exposure across other sectors too; total exposure to these countries across all sectors stood at $331bn at the end of September 2012, down from a peak of $636bn in mid-2008.

But UK banks are also indirectly exposed to the eurozone periphery through their lending to other banks that do have significant exposure to these countries, most notably in France and

[8] See, for instance, HL Deb 7 Mar 2013 c1708 and HL Deb 6 Dec 2012 c796

Germany. Reflecting these financial linkages, 78% of respondents to the Bank of England's Systemic Risk Survey identified sovereign risk (for most, this meant the risk of a country defaulting and possibly leaving the euro) as among the most important threat to UK financial stability, up from 69% in the first half of 2012, and higher than any other risk factor. Uncertainty and the risk of losses posed by UK financial institutions' exposure to the eurozone is also, according to the Bank, resulting in higher funding costs for banks, and hence tighter lending conditions for businesses and individuals.

In the worst case scenario of a disorderly eurozone breakup, the linkages between the eurozone and the UK would, in the view of many, precipitate a banking crisis in the UK and the requirement for urgent recapitalisation, possibly using public funds.

3 The Bank of England's remit

There has been speculation that there may be a change in the Bank of England's remit which the Chancellor is required to set out in each Budget.[9] In the past, this has been something of a formality with the 2% inflation target being re-affirmed in recent years.

The Government's deficit reduction strategy allows limited scope for the economy to be boosted through changes in tax and spending. A change in the remit could allow monetary policy to do (even) more to support the economy. For example, *The Economist* is in favour of linking monetary policy to nominal GDP (GDP unadjusted for inflation). Specifically, it argues that the Bank of England should not tighten policy until nominal GDP is 10% higher than its current level.[10]

The debate over the Bank's remit comes just a few months before Mark Carney replaces Sir Mervyn King as Governor of the Bank. In evidence to the Treasury Committee in February, Dr Carney said that the bar for a change in the remit should be set high but nevertheless there should be a short debate about the monetary policy framework and then "either a reconfirmation of the existing framework or a change."[11]

Commenting on Dr Carney's appearance before the Treasury Committee, the BBC's Stephanie Flanders said:

> You couldn't listen to his hours of testimony and not come away with the impression that he expects and wants the Bank of England to do more to support the recovery. Also, that he has in mind a longer list of potential tools than the current leadership of the Bank.
>
> What kind of tools? There was a long list. But the larger point was that he thinks "doing more" means thinking beyond creating more money.
>
> […]
>
> Listening to the future governor yesterday, I couldn't help thinking that he might change the attitude to economic policy in the UK, by reminding us that what we're living through is not just "exceptional" - a word he used a lot today - but worth getting worked up about.
>
> Put it another way: he may have no burning desire to change the Bank's formal target, but you can't help thinking Governor Carney will raise the bar for the economy more generally.
>
> […]
>
> The director of the IFS, Paul Johnson, said this week that we shouldn't lose our sense of "shock and awe" at what we've been living through. To judge by his testimony, Mark Carney hasn't lost it yet.
>
> Perhaps he will conclude, like Sir Mervyn King, that there is not much that the central bank, or anyone else, can do to make this process of economic rebalancing any easier, or shorter. But he doesn't seem to be quite there yet.

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[9] For example, "Osborne to hand Carney more powers" *Financial Times*, 6 March 2013

[10] "Shake 'em up Mr Carney: British monetary policy [leader], *The Economist*, 2 February 2013

[11] Treasury Committee, *Appointment of Dr Mark Carney as Governor of the Bank of England*, [Uncorrected oral evidence], 7 February 2013, Q53

We've spent months debating the finer points of Mark Carney's monetary policy philosophy and the difference it might make. We may have missed the most important thing separating him from every other senior policy maker in the UK, and the best reason for the chancellor to import him.

Governor Carney has not spent the last five years living in the UK; he's been living in a country that's been doing a lot better. That might end up making quite a difference.[12]

[12] *Governor Carney: Same remit, new ambition*, Stephanie Flanders, BBC website, 8 February 2013

4 The public finances

4.1 Borrowing

The Government has repeatedly said that it has cut the deficit by a quarter. The deficit fell from £158 billion in 2009/10 to £121 billion in 2011/12 – a fall of 24%. Assessing the trend in borrowing in 2012/13 is more complicated because borrowing in 2012/13 is affected by a number of special factors.

In the 2012 Autumn Statement, the Chancellor said:

> There are those who have been saying that the deficit was going up this year—indeed, I think I heard it in Prime Minister's questions—but any way you present these figures, this is not what the OBR forecasts show today. It says that the deficit is coming down—coming down this year and every year of this Parliament.[13]

Whether borrowing increases slightly or decreases slightly is of marginal economic significance. In any case, data are always subject to revision so a small increase or decrease may be reversed as data are revised. Nevertheless, the issue is important in the political debate.

The main special factors affecting borrowing in 2012/13 are:

- **Royal Mail pension**: The transfer of the Royal Mail pension reduces the headline borrowing figure in 2012/13 by £28 billion. This took place in April 2012.

- **The Special Liquidity Scheme (SLS)**: there was a £2.3 billion transfer of the final profits of the SLS to the Government which also has the effect of reducing borrowing.

- **Interest payments on Quantitative Easing (QE)**[14]: So far, the Government has received £3.8 billion from this source, also reducing the headline measure of borrowing. In December, the OBR forecast that these payments would reach £11.5 billion in 2012/13 with further annual payments of between £6.6 billion and £12.3 billion between 2013/14 and 2016/17.[15]

- **4G auction**: in December, the OBR forecast that the 4G auction would raise £3.5 billion. This scores as a capital receipt (in effect, negative capital spending) and so reduces borrowing. The OBR noted that this estimate was subject to particular uncertainty. In the event, the 4G auction raised less than this at £2.34 billion. Other things equal, this will increase the OBR's forecast for borrowing in 2012/13 by £1.16 billion.

- **Bradford & Bingley and Northern Rock Asset Management**: these have been reclassified to the central government sector. These effects are relatively small in comparison to the factors above.

The Chancellor's claim was supported by the OBR's Autumn Statement which forecast borrowing of £120.3 billion in 2012/13 once the Royal Mail, QE and Bradford and Bingley and Northern Rock factors were removed. This was a fall of just over £1 billion compared with

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13 HC Deb 5 December 2012 c873

14 Also referred to as the Asset Purchase Facility (APF)

15 OBR, Economic and fiscal outlook, December 2012, Table 1.3, p14. Since the OBR's December report, the ONS has said that not all the QE interest payments will reduce the headline net borrowing figure. There is a cap of £9.1 billion which applies to the QE interest payments and SLS. This means that only a further £3.0 billion is available to reduce borrowing and transfers above this will not reduce headline borrowing.

2011/12. However, the OBR included the expected revenues from the 4G auction. There is arguably a case for excluding these as well as they are a one-off factor and doing so would mean an increase in borrowing this year, even on the OBR's Autumn Statement forecasts.

It now looks less likely that borrowing will fall this year. The 4G auction raised around £1 billion less than expected. Over the course of the financial year so far (April 2012 to January 2013) government borrowing has been £7.5 billion higher than over the same period of the previous year, once the Royal Mail, SLS and QE factors are removed.

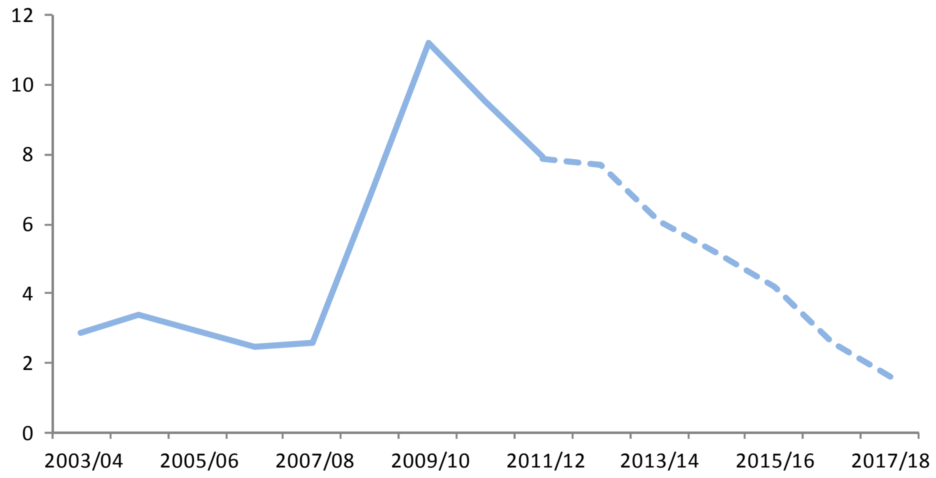
The IFS are now suggesting that borrowing is likely to increase this year:

> … borrowing is now on course to be almost £7 billion higher this year than the OBR forecast in December. Therefore borrowing is more likely to be slightly higher rather than slightly lower than last year's level, although much uncertainty remains and things could still change in the final two months of the year.[16]

The outlook for borrowing in the medium term

Both the OBR and the IFS forecast that borrowing will fall in the medium term. The OBR forecast borrowing of 6.1% of GDP next year falling to 1.6% by 2017/18. The IFS's baseline forecast, based on the OBR's assumptions for the economic outlook, is similar.

Public sector net borrowing
% of GDP



Source: ONS, OBR. Borrowing in 2012/13 affected by a number of special factors (see text).
Figures in chart are same are same as in table

16 Institute for Fiscal Studies, *IFS analysis of today's public finance figures*, 21 February 2013

Public sector net borrowing

		Outturn £ billion	OBR forecast £ billion	IFS forecast £ billion	Outturn % GDP	OBR forecast % GDP	IFS forecast % GDP
2006/07		33.1	..	..	2.5	..	..
2007/08		36.7	..	..	2.6	..	..
2008/09		97.5	..	..	6.9	..	..
2009/10		158.9	..	..	11.2	..	..
2010/11		141.0	..	..	9.5	..	..
2011/12		121.0	..	..	7.9	..	..
2012/13	(a)	..	120.3	126.7		7.7	8.1
2013/14		..	99	103.4		6.1	6.4
2014/15		..	88	92.7		5.2	5.5
2015/16		..	73	73.0		4.2	4.1
2016/17		..	49	48.0		2.6	2.6
2017/18		..	31	30.0		1.6	1.5

Sources: Outturns - ONS Statistical Bulletin, Public sector finances, January 2013, 21 February 2013
OBR forecasts - OBR Economic and fiscal outlook, December 2012, Table 4.32. See also note below on 2012/13
IFS baseline forecasts - IFS Green Budget 2013, Tables A6 and A7. See also note below on 2012/13

Notes: (a) Borrowing figures for 2012/13 include a range of one-off factors which reduce borrowing. See text for details.
OBR figure excludes Royal Mail, QE, B&B and NRAM (Economic and fiscal outlook, Dec 12, Table 1.3, p14)
IFS figure is that quoted in IFS Analysis of public finance figures published on 21 February 2013.
This excludes the Royal Mail and QE effects and takes account of the lower than expected 4G receipts
OBR figure used to convert this into % of GDP

The forecast for borrowing would be affected if economic conditions changed. The IFS present two scenarios. In the optimistic scenario, growth picks up to 2.4% or more from 2013/14 onwards leading to borrowing of 0.7% of GDP in 2017/18. In a more pessimistic scenario, the economy contracts in 2014/15 and 2015/16 leading to an increase in borrowing. On this scenario, borrowing is 7.4% of GDP in 2017/18.

Structural borrowing

A distinction is often drawn between the “cyclical” and “structural” elements of the budget deficit:

- Cyclical elements of the deficit refer to the effect of the economic cycle on the level of government borrowing. In a recession, government borrowing tends to increase as tax receipts are reduced and spending on unemployment benefit increases. The reverse happens when the economy is growing strongly. These effects are sometimes known as the economy’s “automatic stabilisers”.

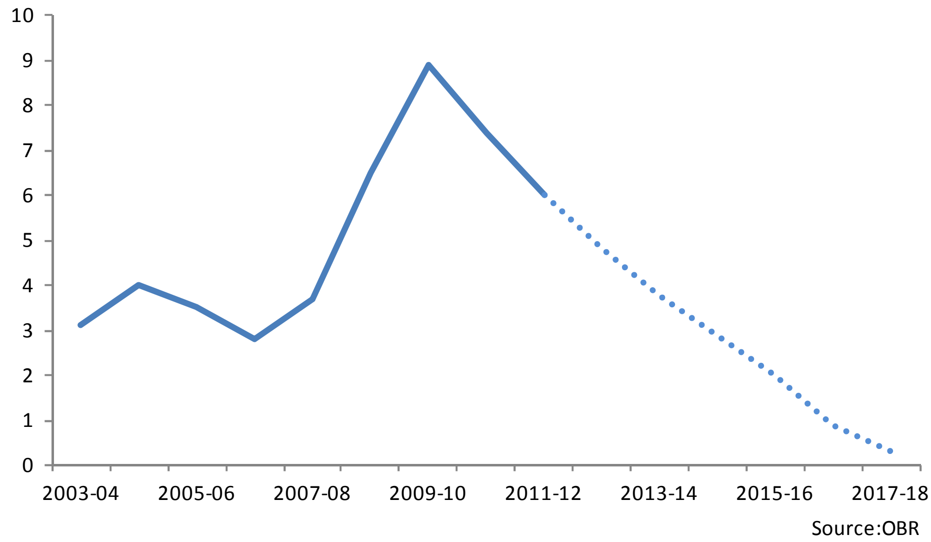
- Structural elements of the deficit refer to underlying or persistent elements of government borrowing which are unrelated to the economic cycle. The structural deficit is measured by cyclically-adjusted measures of borrowing.

The distinction is important as the “headline” borrowing figures may mask underlying trends unless the economy’s position in the economic cycle is taken into consideration. Estimating how much of the deficit is cyclical and how much is structural is far from easy. This requires an assessment of where the economy is in the economic cycle. It can be difficult to determine where the economy is in relation to its “trend” level of output. This is particularly the case when the economy is coming out of recession as it requires a calculation of how much of the lost output is purely cyclical and how much is permanent. These problems mean that estimates of the structural deficit need to be treated with a degree of caution.

This means that changes in the economy's trend or potential level of output can have significant consequences for the structural measures of borrowing.

The structural deficit was around 3-4% of GDP immediately before the financial crisis. It increased to nearly 9% of GDP in 2009/10. The OBR forecasts structural borrowing of 4.8% of GDP this year (excluding Royal Mail). It is then forecast to fall to 0.3% of GDP by 2017/18.

OBR estimates of structural borrowing
% of GDP



International comparisons of public sector borrowing

Recent OECD forecasts suggest that UK government borrowing will remain high by international standards. In 2014, UK government borrowing is forecast to be 6.0% of GDP. This is higher than all other G7 economies, except Japan, and higher than both the Eurozone and OECD average.[17]

[17] The OECD figures show borrowing increasing in 2013. This is presumably because the OECD figure for 2012 includes the effect of the Royal Mail pension transfer.

OECD forecasts of government borrowing (a)
% GDP

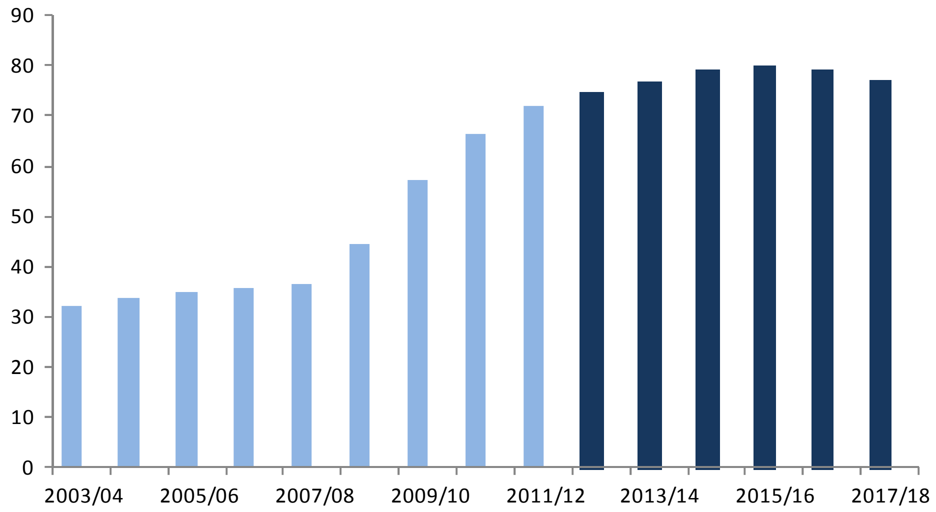
	2012	2013	2014
UK	**6.6**	**6.9**	**6.0**
Canada	3.5	3.0	2.5
France	4.5	3.4	2.9
Germany	0.2	0.4	0.7
Italy	3.0	2.9	3.4
Japan	9.9	10.1	7.9
US	8.5	6.8	5.2
Eurozone	3.3	2.8	2.6
OECD	5.5	4.6	3.6

Source: OECD Economic Outlook, No. 92, November 2012
(a) general government financial balance

4.2 Debt

Public sector net debt was around 35% of GDP immediately before the financial crisis. It has grown rapidly since then and is expected to be 75% of GDP in 2012/13. Both the OBR and IFS forecast that it will peak at around 80% of GDP in 2015/16.

Public sector net debt
% of GDP



Sources: ONS, OBR

Public sector net debt

	Outturn £ billion	OBR forecast £ billion	Outturn % GDP	OBR forecast % GDP	IFS forecast % GDP
2006/07	497.8	..	35.8	..	..
2007/08	527.2	..	36.4	..	..
2008/09	624.0	..	44.5	..	..
2009/10	828.7	..	57.1	..	..
2010/11	1,001.5	..	66.5	..	..
2011/12	1,103.6	..	71.8	..	..
2012/13	..	1,186		74.7	75.0
2013/14	..	1,270		76.8	77.3
2014/15	..	1,362		79.0	79.8
2015/16	..	1,442		79.9	80.6
2016/17	..	1,498		79.2	79.9
2017/18	..	1,534		77.3	77.9

Sources: Outturns - ONS Statistical Bulletin, Public sector finances, January 2013, 21 February 2013
OBR forecasts - OBR Economic and fiscal outlook, December 2012, Table 4.32
IFS baseline forecasts - IFS Green Budget 2013, Table A7

International comparisons of public debt

The OECD's forecasts suggest that the UK's level of government debt, as a percentage of GDP, will be similar to the OECD average but higher than the Eurozone average. By 2014, UK government debt is forecast to be similar to that of the US and France, below Italy and Japan but higher than Canada and Germany.[18]

[18] OECD figures are for gross debt. Figures for the UK published by the ONS are for net debt (ie they net off liquid financial assets).

OECD forecasts of government debt (a)
% GDP

	2012	2013	2014
UK	**105.3**	**110.4**	**113.9**
Canada	85.8	85.5	86.0
France	105.1	108.2	109.7
Germany	87.6	86.2	85.1
Italy	127.0	129.6	131.4
Japan	214.3	224.3	230.0
US	109.8	113.0	114.1
Eurozone	100.6	102.5	103.4
OECD	108.7	111.4	112.5

Source: OECD Economic Outlook, No. 92, November 2012
(a) general government gross financial liabilities

4.3 The fiscal rules

The rules

In his first Budget, the Chancellor announced a "fiscal mandate":

> To achieve cyclically adjusted current balance by the end of a rolling five year period[19]

The current balance is a measure of government borrowing, excluding investment spending. There are a number of arguments for excluding investment spending from fiscal rules. First, it allows such spending to be protected. The 2011 Budget said that the fiscal mandate would focus on the current budget "to protect the most productive public investment expenditure."[20] In the past, public investment has sometimes been cut severely during times of public expenditure restraint.

Second, focusing on the current budget allows borrowing for the purpose of investment. This is often justified on the grounds that while future generations will pay for the borrowing, they will also get benefits from this spending.

The fiscal mandate also looks at a cyclically-adjusted measure of the deficit. This means that the mandate takes into account the fact that government borrowing fluctuates with the economic cycle. As a result, the mandate focuses on the structural, or underlying, element of the deficit.

In addition to the borrowing target, there is a supplementary target for government debt. This requires public sector net debt to be falling as a percentage of GDP at a fixed date of 2015/16.

Compliance with the borrowing rule

In December, the OBR concluded that the Government was on course to meet the fiscal mandate. The cyclically-adjusted current budget was forecast to move into surplus in 2016/17.

19 The end of the five year period is currently 2017/18.
20 HM Treasury, Budget 2011, para 1.25

The borrowing rule has some built-in flexibility both in that it is measured at the end of a rolling-five year period and because it is measured adjusted for the economic cycle. This means that there is a greater chance that it will be broken if more of the downturn is attributed to structural factors. The more this is the case, a greater proportion of the deficit will be due to structural factors and less to the economic cycle. This, in turn, will increase cyclically-adjusted measures of borrowing and leave the Government less room for manoeuvre again its borrowing rule. It is, therefore, not so much changes in the growth forecasts, as the OBR's view on the structural position of the economy, which is relevant to the Government's chances of meeting its borrowing target.

Compliance with the borrowing rule therefore depends not just on the performance of the economy but also on the output gap. Both the OBR and the IFS present scenarios of weaker economic growth which would lead to the borrowing rule being breached.

Compliance with the debt rule

The debt rule required public sector net debt to be falling as a percentage of GDP at a fixed date of 2015/16. The Autumn Statement forecasts showed that the rule would be breached as debt increased from 79.0% to 79.9% of GDP in 2015/16. The IFS Green Budget forecasts also see debt peaking in 2015/16.

The Chancellor decided simply to allow this breach to occur: he did not announce any change to the rule or any further fiscal tightening to ensure the rule is met. In the Autumn Statement, the Chancellor said:

> But the OBR assesses in its central forecast that we do not meet the supplementary objective that aims to have debt falling by 2015-16. The point at which debt starts to fall has been delayed by one year, to 2016-17, and the OBR's central forecast is that net debt will be 74.7% this year, then 76.8% next year, 79% in 2014-15, and 79.9% in 2015-16, before falling to 79.2% in 2016-17 and 77.3% in 2017-18.
>
> In short, the tougher economic conditions mean that while our deficit is forecast to go on falling, instead of taking three years to get our debt falling, it is going to take four. Confronted with this news, some say we should abandon our deficit plan and try to borrow more. They think that by borrowing more, we can borrow less. That would risk higher interest rates, more debt interest payments, and a complete loss of Britain's fiscal credibility. We are not taking that road to ruin.
>
> Then there are those who say that despite all that has happened in the world this year, we should cut even more now to hit the debt target. That would require £17 billion of extra cuts a year. Let me explain why I have decided not to take this course.
>
> We have always argued that we should let the automatic stabilisers work. We have not argued that we should chase down a cyclical or temporary deterioration in the economy, particularly one that our own independent body says is largely driven by problems abroad. That is also the judgment of the International Monetary Fund, the OECD and the Governor of the Bank of England.[21]

21 HC Deb 5 December 2012 c874

5 Taxation

It is an annual tradition that in the days before the Budget commentators will make predictions of the content of the Chancellor's speech.[22] Unlike last year, there has been little speculation over what the Chancellor will include in this year's Budget – although at the time of the Autumn Statement in December 2012, the Government confirmed that there would be a further increase in the income tax personal allowance for the coming tax year.[23]

All individuals are entitled to a personal allowance which they can set against their liability to income tax. Income tax legislation requires that the personal allowance – as well as the other main tax allowances and tax thresholds – should rise each year in line with inflation, unless Parliament determines otherwise.[24] Over the last twenty years the general pattern has been for the allowance to be increased in line with this rule, or by more than inflation.[25]

In the Coalition Agreement, the Government stated that setting the personal allowance at £10,000 was a long-term objective, and that making increases in the allowance each year would be given priority over other tax cuts. (Further detail on progress towards the tax policies set out in the Coalition Agreement is in Appendix 3 to this note.) The allowance has been increased significantly above inflation in each of the Coalition's three budgets.

Income tax personal allowance (£)

	Level (£)	Increase (£)
2010/11	6,475	0
2011/12	7,475	1,000
2012/13	8,105	630
2013/14	9,440	1,335

Source: HMRC
Note: 2013 Budget announced the 2013/14 allowance as £9,205. This was increased by a further £235 in the 2012 Autumn Statement

It is estimated that these increases will lift 2.2 million people out of income tax and cut the amount of tax paid by over 24 million taxpayers. The total Exchequer cost of these changes over the last three years will be about £9 billion in 2013/14.

To date these increases in the personal allowance appear to have been generally welcomed, although critics have pointed out that many households to have benefited from this tax cut will have been affected by other tax changes – such as the increase in VAT – as well as reforms to tax credits and social security benefits. In addition, those whose incomes are too low to pay income tax do not benefit from the increase in the allowance. More recently there has been some debate about the Government's approach to reducing the tax paid by those on lower incomes when, in February this year, the Labour leader, Ed Miliband, made a speech in which he stated that a Labour Government would introduce a 10p starting rate of tax.

[22] For a general description of the Budget and the legislative process for implementing the measures set out in the speech see, *The Budget and the annual Finance Bill*, Library standard note SN813, 14 November 2012.

[23] HM Treasury, Autumn Statement 2012 para 1.144. See also, HM Treasury, *Tables confirming tax and tax credit rates and thresholds for 2013/14*, December 2012

[24] *Direct taxes: rates and allowances 2012/13,* Library Research paper 12/15, 2 April 2012 p5

[25] HL Deb 7 January 2010 c121WA. HM Revenue & Customs give historical details on the structure and parameters of income tax at: http://www.hmrc.gov.uk/statistics/tax-structure.htm

6 Appendix 1: Links to further information

HM Treasury

Budget 2013

Budget 2012

2012 Autumn Statement

Public finance databank

Office for Budget Responsibility

Economic and fiscal outlook, December 2012

Economic and fiscal outlook, March 2012

Monthly commentary on the public finances

Institute for Fiscal Studies

Green Budget 2013

Monthly commentary on the public finances

House of Commons Library

Economic indicators (a special Budget edition will be published on 19 March)

External users can access this from (see under "Research Papers") http://www.parliament.uk/topics/Economic-situation.htm

House of Commons Treasury Committee

Report on Autumn Statement 2012

7 Appendix 2: Economic and public finance data since 1979

Economic data, 1979-2017

	Real GDP growth %	Inflation RPI %	Inflation CPI %	ILO Unemployment % Q4
1979	2.8	13.4	..	..
1980	-2.0	18.0	..	..
1981	-1.3	11.9	..	..
1982	2.2	8.6	..	..
1983	3.8	4.6	..	..
1984	2.9	5.0	..	..
1985	3.9	6.1	..	..
1986	4.3	3.4	..	..
1987	5.2	4.2	..	..
1988	5.6	4.9	..	..
1989	2.6	7.8	..	..
1990	1.8	9.5	..	..
1991	-1.8	5.9	..	..
1992	0.9	3.7	..	10.4
1993	3.1	1.6	..	10.3
1994	4.6	2.4	..	9.0
1995	3.2	3.5	..	8.3
1996	3.1	2.4	..	7.8
1997	3.9	3.1	..	6.5
1998	3.5	3.4	1.6	6.1
1999	3.2	1.5	1.3	5.8
2000	4.2	3.0	0.8	5.2
2001	2.9	1.8	1.2	5.2
2002	2.4	1.7	1.3	5.1
2003	3.8	2.9	1.4	4.9
2004	2.9	3.0	1.3	4.7
2005	2.8	2.8	2.1	5.2
2006	2.6	3.2	2.3	5.5
2007	3.6	4.3	2.3	5.2
2008	-1.0	4.0	3.6	6.4
2009	-4.0	-0.5	2.2	7.8
2010	1.8	4.6	3.3	7.8
2011	0.9	5.2	4.5	8.4
2012	0.2	3.2	2.8	7.8
2013	1.2	3.0	2.5	8.3
2014	2.0	2.6	2.2	8.2
2015	2.3	3.1	2.0	7.9
2016	2.7	3.4	2.0	7.4
2017	2.8	3.7	2.0	6.9

Sources: ONS (series ABMI, CZBH, D7G7, MGSX)
OBR Economic and fiscal outlook, Dec 2012, Table 3.5 and Economy Supplementary tables

Public finance data 1979-80 to 2017-18 - outturns and OBR forecasts (December 2012)

	Public sector net borrowing		Structural deficit	Public sector net debt	
	£ billion	% GDP	% GDP	£ billion	% GDP
1979-80	8.5	4.1	4.2	98.2	44.0
1980-81	11.5	4.8	3.3	113.8	46.1
1981-82	6.0	2.3	0.3	125.2	46.1
1982-83	8.5	3.0	1.2	132.5	44.8
1983-84	11.7	3.8	2.5	143.6	45.1
1984-85	12.3	3.7	3.1	157.0	45.1
1985-86	8.8	2.4	2.3	162.5	43.2
1986-87	8.1	2.0	2.3	167.8	40.9
1987-88	4.4	1.0	2.0	167.4	36.6
1988-89	-6.3	-1.3	0.6	153.7	30.4
1989-90	-1.0	-0.2	1.0	151.9	27.5
1990-91	5.8	1.0	0.8	151.1	26.0
1991-92	22.6	3.7	2.4	165.8	27.2
1992-93	46.7	7.4	5.8	201.9	31.4
1993-94	51.0	7.6	6.3	249.8	36.5
1994-95	43.3	6.1	5.6	290.0	40.1
1995-96	34.7	4.6	4.0	322.1	41.9
1996-97	27.1	3.4	3.2	347.2	42.1
1997-98	5.8	0.7	1.7	352.0	40.4
1998-99	-4.5	-0.5	0.7	350.7	38.2
1999-00	-15.6	-1.7	-0.5	344.4	35.7
2000-01	-40.0	-4.1	-2.7	311.1	30.8
2001-02	0.8	0.1	0.6	314.3	29.8
2002-03	26.0	2.4	2.2	346.0	30.9
2003-04	33.3	2.9	3.1	381.5	32.2
2004-05	41.1	3.4	4.0	422.1	33.9
2005-06	37.9	3.0	3.5	461.7	35.1
2006-07	33.1	2.5	2.8	497.8	35.8
2007-08	36.7	2.6	3.7	527.2	36.4
2008-09	97.5	6.9	6.5	624.0	44.5
2009-10	158.9	11.2	8.9	828.7	57.1
2010-11	141.0	9.5	7.4	1,001.5	66.5
2011-12	121.0	7.9	6.0	1,103.6	71.8
2012-13	120.3	6.9	4.8	1,186.0	74.7
2013-14	99	6.1	3.8	1,270	76.8
2014-15	88	5.2	2.9	1,362	79.0
2015-16	73	4.2	2.0	1,442	79.9
2016-17	49	2.6	0.9	1,498	79.2
2017-18	31	1.6	0.3	1,534	77.3

Sources: ONS, OBR and HM Treasury

Notes: figures exclude temporary effects of financial sector interventions and Royal Mail transfer

2012-13 borrow ing figures exclude Royal Mail, QE, B&B and NRAM

8 Appendix 3: Progress on tax measures in the Coalition Agreement

The Coalition Government set out its priorities for taxation in its agreement, published in May 2010. On its overall approach the agreement stated: "the Government believes that the tax system needs to be reformed to make it more competitive, simpler, greener and fairer. We need to take action to ensure that the tax framework better reflects the values of this Government."[26]

In their first Budget in June 2010, the Coalition Government announced that it would introduce two Finance Bills in 2010: the first, in a matter of days, limited to its key priorities (such as raising the standard rate of VAT to 20%), the second, in the autumn, given over to a series of technical measures announced by its Labour predecessor in the March 2010 Budget, but postponed until after the Election.[27] The first of these Bills had its second reading on 6 July, and was scrutinised by a Committee of the Whole House over 3 days of debate, and received Royal Assent at the end of that month. In turn the second of these Bills had its second reading on 11 October, and received Royal Assent – as the *Finance (No3) Act 2010* – on 16 December 2010.

Although HM Revenue & Customs have often published individual draft clauses to be included in a future Finance Bill, many tax practitioners have argued that far too little of the annual Bill is released in draft form, and the timetable for Parliamentary scrutiny for tax legislation is too short to avoid mistakes being made. Alongside the June 2010 Budget the Government published a paper on its approach to tax policy, proposing that in future nearly all of the Finance Bill would be realised in draft three months before formal publication, subject to certain exceptions.[28] In December 2010 the Treasury published a large amount of draft legislation constituting the majority of the clauses to be included in the Finance Bill after the 2011 Budget; in a statement the Exchequer Secretary David Gauke announced "this practice will become an established feature in the tax policy making cycle." Alongside the draft clauses the department published a series of 'tax information and impact notes', which, as the Minister explained, set out "for each draft clause, the proposed change, why we seek the change and what we expect the impacts to be."[29] This timetable has applied in subsequent years. Draft legislation for the *Finance Bill 2013* was published on 11 December 2012,[30] and the Government has confirmed that following the Budget this year on 20 March, the final Bill will be published a few days later, on 28 March 2013.[31]

The Treasury collate details on its tax consultations, while HM Revenue & Customs have pages for each Budget and further updates.

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26 HM Government, *The Coalition: our programme for government*, May 2010 p30

27 *Budget 2010* HC 61 June 2010 para 2.118. The Budget report itemises these measures in section 2b (pp 54-60).

28 ie, straightforward changes to rates, allowances and thresholds; revenue protection measures; and areas where forestalling presents a significant risk (HM Treasury, *Tax policy making: a new approach*, June 2010 para 2.11).

29 HC Deb 9 December 2010 c29WS; see also, HC Deb 15 March 2011 c5WS.

30 HC Deb 11 December 2012 cc15-18WS. This draft legislation is collated here: http://www.hm-treasury.gov.uk/finance_bill_2013.htm

31 HC Deb 13 December 2012 c449; HC Deb 7 February 2013 c21WS

This table gives a checklist of tax measures in the Coalition agreement, indicates if they have been implemented in either of the Government's first three Budgets and if not, whether the Government has given some other indication of how and when this measure might be taken forward.[32]

Coalition agreement	**Budget 2010 HC 61 June 2010**	**Budget 2011 HC 836 March 2011**	**Budget 2012 HC 1853 March 2012 & subsequent developments**
"We will announce in the first Budget a substantial increase in the personal allowance from April 2011, with the benefits focused on those with lower and middle incomes" p30	Personal allowance to be increased by £1,000 to £7,475 from April 2011, with corresponding reduction in basic rate limit (para 1.93-4).	Confirmation of £1,000 rise in personal allowance (para 1.127). Provision made in s3 of *Finance Act 2011*.	Not applicable.
"We will further increase the personal allowance to £10,000, making real terms steps each year towards meeting this as a longer-term policy objective. We will prioritise this over other tax cuts, including cuts to Inheritance Tax" p30		Personal allowance to rise by £630 to £8,105 from April 2012, with corresponding reduction in basic rate limit (para 1.127). Confirmation that the inheritance tax nil rate band would remain frozen from 2011/12 to 2014/15 – a decision announced by Labour Government in its March 2010 Budget (para 2.58).	Personal allowance to rise by £1,100 to £9,205 from April 2013, with cut in basic rate limit (para 1.73). In Autumn Statement announcement that allowance to be £235 more, and set at £9,440 from April 2013 (Cm 8480 para 1.144), with corresponding cut in basic rate limit. For background see Library Standard Note SN6569.
"The increase in employer National Insurance thresholds proposed by the Conservatives will go ahead in order to stop the planned jobs tax" p30	All rates of NICs to rise by 1% from April 2011, as proposed by Labour Government in March 2010 Budget, while employer threshold to rise by £21 a week in real terms (para 1.66).		Legislation to effect this change - the *National Insurance Contributions Act 2011* - received Royal Assent on 22 March 2011. For details see, Library Research papers 10/76 & 10/83.
"We will … ensure that provision is made for Liberal Democrat MPs to abstain on budget resolutions to introduce transferable tax allowances for married couples without prejudice to the coalition agreement" p30	No mention in Budget, nor any consultation launched.	No mention in Budget, nor any consultation launched.	No mention in Budget, nor any consultation launched. For background discussion see, Library standard note SN4392.

[32] See also, HM Government, *The Coalition – Mid-term Review: programme for Government update*, January 2013 p1, pp8-9, p28, p31, p95, pp109-112

Coalition agreement	Budget 2010 HC 61 June 2010	Budget 2011 HC 836 March 2011	Budget 2012 HC 1853 March 2012 **& subsequent developments**
"We will reform the taxation of air travel by switching from a per-passenger to a per-plane duty, and will ensure that a proportion of any increased revenues over time will be used to help fund increases in the personal allowance" p30	Confirmation the Government would "explore changes to the aviation tax system, including switching from a per-passenger to a per-plane duty" and any major changes to be "subject to public consultation" (para 1.123).	Decision not to proceed with a per-plane duty "given concerns over the legality and feasibility of this approach" (para 1.153-3). Consultation launched on options to simplify rate structure.	Current banding structure to be retained, rates to rise in line with inflation from April 2012, & scope of tax to be extended to business jets from April 2013 (paras 2.158-9). Provision made by s190 & schedule 23 of *Finance Act 2012*. For details see Library standard note SN5094.
"We will seek ways of taxing non-business capital gains at rates similar or close to those applied to income, with generous exemptions for entrepreneurial business activities" p30	Rate of CGT for higher rate taxpayers to rise from 18% to 28% from 23 June 2010, with increase in entrepreneurs relief (para 1.96). Legislation to effect this in s2 & sch1 to *Finance (No 2) Act 2010*.	Additional increase in entrepreneurs' relief from April 2011 (para 2.55). No further changes to tax rates. For details see Library standard note SN5572.	No mention in Budget.
"We will make every effort to tackle tax avoidance, including detailed development of Liberal Democrat proposals" p30	Measures to tackle individual avoidance schemes in *Finance (No2) Act 2010*, and informal consultation on General Anti-Avoidance Rule (GAAR) launched (paras 2.110-6).	Strategy paper, *Tackling Tax Avoidance*, published; measures to tackle individual avoidance schemes (para 1.141-3). Study group, chaired by Graham Aaronson QC, to explore case for GAAR (HM Treasury press notice 04/11, 14 January 2011).	Confirmation that a 'General Anti-Abuse Rule' to be introduced in 2013, following recommendation of Aaronson Report (para 1.194) Consultation launched June 2012, and draft legislation for Finance Bill 2013 published December 2012. For background see Library standard notes SN2956 & SN6265.
"We will increase the proportion of tax revenue accounted for by environmental taxes" p31	No discussion or mention of specific tax increases to ensure this.	No discussion or mention of specific tax increases to ensure this.	Assessment published in July 2012 (HC Deb 16 July 2012 cc95-7WS) – states that "the Government will continue to explore opportunities to further green the tax system over the course of this Parliament."

Coalition agreement	Budget 2010 HC 61 June 2010	Budget 2011 HC 836 March 2011	Budget 2012 HC 1853 March 2012 & subsequent developments
"We will take measures to fulfil our EU treaty obligations in regard to the taxation of holiday letting that do not penalise UK-based businesses" p31	Consultation to be launched for reform to rules to be implemented from April 2011 (para 2.85). Consultation launched in July (HC Deb 27 July 2010 cc80-82WS). Government response in December.	New tax rules for furnished holiday letting take effect from April 2011; letting and availability thresholds to be increased from April 2012 (para 2.42). Provision made in schedule 14 of *Finance Act 2011*. For details see Library standard note SN5250.	Not applicable.
"We will review the taxation of non-domiciled individuals" p31	Confirmation that Government "will review" this issue (para 2.30).	Reforms to be made from April 2012. No other substantive changes to be made "for the remainder of this Parliament" (para 1.133-6). Consultation launched on non-domicile rules & statutory definition of residence (HMT press notice 60/11, 17 June 2011).	Series of changes to non-domicile rules (para 2.50). Provision in s47 & schedule 12 of *Finance Act 2012*. New statutory residence test to be introduced in 2013 (para 2.51). Draft legislation for Finance Bill 2013 published in December 2012.
"We will introduce a banking levy and seek a detailed agreement on implementation" p9	New levy based on banks' balance sheets to be introduced from 1 January 2011 (para 1.63).	Levy rates to be amended from 2012 to offset cut in main rate of corporation tax (para 1.90). Provision made in s73 & schedule 19 of *Finance Act 2011*. For background see Library standard note SN5251.	Levy rate to rise from 1 January 2013 to offset further reductions in main rate of corporation tax (para 2.116). Further corporation rate cut for 2014 announced in Autumn Statement, with corresponding rise in levy rate (Cm 8480 para 1.130-1).
"We will review IR35, as part of a wholesale review of all small business taxation" p10	Confirmation that Government "remain committed" to doing this (para 1.69). New advisory body, the Office of Tax Simplification (OTS) established, and asked to present review of small business taxation in time for 2011 Budget.	Formal response to OTS report includes decision that IR35 rules to be retained as "abolition would put substantial revenue at risk"; HMRC to overhaul their administration of these rules (para 2.203). IR35 Forum established in May 2011 to monitor department's approach.	Reforms to small business taxation, including new cash basis for unincorporated businesses, following OTS' recommendations (paras 2.130-3). Consultation to amend scope of IR35 re 'controlling persons' (para 2.207); proposals subsequently withdrawn. For details see Library standard note SN5976.

Coalition agreement	Budget 2010 HC 61 June 2010	Budget 2011 HC 836 March 2011	Budget 2012 HC 1853 March 2012 & subsequent developments
"We will reform the corporate tax system by simplifying reliefs and allowances, and tackling avoidance, in order to reduce headline rates" p10	Series of reforms to corporation tax, including cut in main rate by 1% each year from 2011 to 2014 (para 1.61). Rate cut from 28% to 27% for 2011 by s1 of *Finance (No2) Act 2010*. Consultations on Controlled Foreign Company (CFC) regime and taxation of foreign branches.	Further 1% cut in main rate of corporation tax to 26% from April 2011; main rate to be 23% by 2014. New CFC rules to be introduced from April 2012 (para 1.74-5). Provision for cut in tax rate, and changes to rules on foreign branches in s4 & s48 of *Finance Act 2011*. For background see Library standard note SN5945.	Further 1% cut to 22% from April 2014 (para 2.96). New CFC rules to be introduced from 1 January 2013 (para 2.97). Provision in ss5-6 & s180 of *Finance Act 2012*. Announcement of further 1% cut to 23% from April 2013, and 21% from April 2014 in Autumn Statement (Cm 8480 para 1.130).
"We will … refocus the research and development tax credit on hi-tech companies, small firms and start-ups" p10	Intention to consult so as "to review the taxation of intellectual property [&] the support R&D tax credits provide for innovation" (para 1.61). Consultation launched in November; HM Revenue & Customs publish evaluation of R&D credits in December (Research report 107).	Consultation ongoing on both R&D credits, and a 'patent box' regime (para 1.75).	Rate of R&D credits for SMEs to increase from April 2012. Patent box regime to be phased in from April 2013, along with new 'above the line' R&D credit to be introduced at this time (paras 2.98-100). Provision for first two of these measures in ss19-20 of *Finance Act 2012*. Draft provisions for 'above the line R&D credit' for *Finance Bill 2013* published.
"We will review alcohol taxation and pricing to ensure it tackles binge drinking without unfairly penalising responsible drinkers, pubs and important local industries" p13	Informal consultation begun, to report in the autumn (para 1.120). Review published in November 2010 recommends two new duty rates for very high-strength and low strength beers.	New duty rates for high-strength and lower-strength beers from 1 October 2011 (para 1.155). Provision in ss14-15 of *Finance Act 2011*. Duty rates to rise each year by 2% in real terms to 2014/15 – inherited from Labour Government's March 2010 Budget (Table 2.2 : item bt).	Confirmation of policy to increase duty rates each year by 2% in real terms (para 2.135). Provision for rise from March 2012 in s186 of *Finance Act 2012*. For more details see Library standard note SN1373.

Coalition agreement	Budget 2010 HC 61 June 2010	Budget 2011 HC 836 March 2011	Budget 2012 HC 1853 March 2012 & subsequent developments
"We will examine the case for moving to a 'gross profits tax' system for the National Lottery" p14	Confirmation the Government "will review the taxation of the National Lottery" (para 2.99).	Informal consultation completed. Announcement that "no change will be made" (para 2.130).	Not applicable.
"We will work to bring Northern Ireland back into the mainstream of UK politics, including producing a government paper examining potential mechanisms for changing the corporation tax rate in Northern Ireland" p28	Government to "publish a consultation paper in autumn 2010, on rebalancing the Northern Ireland economy" which will, among other things, "examine mechanisms for changing the corporation tax rate" (para 2.108).	Consultation paper published just after Budget (para 1.109 & HC Deb 24 March 2011 c59WS).	Joint Ministerial Working Group considering issues on rebalancing Northern Ireland economy (HM Treasury press notice 51/12, 25 June 2012). Have completed report with regard to devolving corporation tax, and the Government's decision "will be made in due course" (HC Deb 24 January 2013 c449W).