Budget 2014: a summary (updated)

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Section Economic Policy and Statistics

The 2014 Budget was presented by the Chancellor of the Exchequer to Parliament on 19 March 2014. At the same time the Office for Budget Responsibility published its updated forecasts in its *Economic and fiscal outlook*. This note provides a summary of both along with detailed analysis of changes on pensions, savings, the welfare cap and disputed tax.

Separate Library notes give related information, see: *Budget 2014: background briefing* (SN/EP/06828, 14 March 2014), *Economic Indicators, Budget Update* (RP14/15, 17 March 2014) and *Unemployment by Constituency, March 2014* (RP14/17, 19 March 2014).

Contents

1 Budget policy measures at a glance

- **Personal allowance** increased to £10,500 for 2015/16, from £10,000 in 2014/15, for those born after 5 April 1948. Transferable tax allowance for married couples to be 10% of personal allowance.
- **ISAs** (Individual Savings Account) changed to 'New ISA' (NISA) with a single total limit of £15,000 for any mix of cash and stocks and shares from 1 July 2014.
- The **10% starting tax rate for savings income to be abolished** – from 2015/16, the first £5,000 of savings income above the personal allowance will subject to 0% tax.
- **Greater flexibility in the use of defined contribution (DC) pension pots**, including allowing people to draw down some or all their pension at their marginal income tax rate (instead of a 55% rate) from April 2015. Some restrictions will be relaxed from 27 March 2014.
- NS&I to introduce **new fixed-rate savings bonds for people aged 65 or over**, available from January 2015.
- Extension of the **Help to Buy equity loan scheme** from 2016/17 to 2019/20 – the scheme offers buyers a loan of 20% of the value of new-build homes priced up to £600,000.
- Various **changes to duties** including 1p off a pint of beer; freezing of duties on ordinary cider and spirits; continuation of tobacco duty rises of 2% above RPI from 2015/16; reduction in bingo duty to 10%; and increased duty on fixed odds betting terminals.
- Abolishing the separate higher **air passenger duty** bands that apply to flights over 4,000 miles from Britain, merging them with the band that applies to flights over 2,000 miles, from 1 April 2015.
- **Reductions to overall public spending** (TME) by £2 billion a year from 2016/17.
- A rolling **'welfare cap'** to be introduced for forecast spending on benefits and tax credit. The cap will initially be set at the level of the current OBR forecast for 2015/16 to 2018/19, with a 2% margin. Spending on the state pension and unemployment benefits is exempt from the cap.
- The **annual investment allowance** for business investment in plant and machinery temporarily doubled, £250,000 to £500,000, from April 2014 to Dec 2015, after which it is due to return to £25,000.
- Doubling **UK Export Finance's direct lending programme** to £3billion and cutting the associated interest rates.
- Extending **Apprenticeship Grant for Employers** in 2014/15 and 2015/16 – the programme funds small businesses taking on young people.
- A **cap on the Carbon Price Support Rate** from 2016/17 to 2019/20 – this tax is designed to raise the price of carbon above a certain minimum level. The cap is expected to reduce the increase in the cost of energy due to the tax.
- Funding to repair **flood defences** and **potholes**.
- Additional measures on **HMRC debt recovery and tax avoidance**, including a requirement that tax on certain disputed schemes is paid to HMRC upfront, ahead of the resolution of the associated legal disputes.

2 Forecasts for the economy and public finances at a glance

The Office for Budget Responsibility (OBR) has published the following forecasts for the economy and the public finances:

- **Economic growth:** GDP will grow by 2.7% in 2014, and by 2.3% in 2015. The economy is forecast to grow by over 2.0% in each year of the forecast period (up to 2018/19) but by slightly less than was previously forecast in the last two years of the period.

- **Inflation:** The CPI annual inflation rate will be 1.9% in 2014, before meeting the Bank of England's target of 2.0% in each of the remaining years in the forecast period.

- **Labour market:** Employment levels are forecast to be 30.4 million in 2014, rising to 31.4 million in 2018. The unemployment rate is forecast to be 6.8% in 2014, falling to 5.4% in 2018.

- **Budget deficit:** Underlying public sector borrowing (excluding special factors) will total £108 billion in 2013/14, falling through the forecast period, before a surplus of £5 billion is recorded in 2018/19. As a percent of GDP, the budget deficit is forecast to be 6.6% in 2013/14.

- **Government debt:** Total government debt in 2013/14 is forecast to be £1.3 trillion or 74.5% of GDP. Debt is forecast to peak as a percentage of GDP in 2015/16 at 78.7% before falling to 74.2% in 2018/19.

- **Fiscal targets:** The fiscal mandate is forecast to be met. The government is not on course to meet the supplementary debt rule (falling debt as a percent of GDP in 2015/16).

3 OBR forecasts for the economy

The OBR published its *Economic and Fiscal Outlook, March 2014* on the same day as the 2014 Budget. It contains independent official forecasts for the economy and the public finances up to 2018/19.

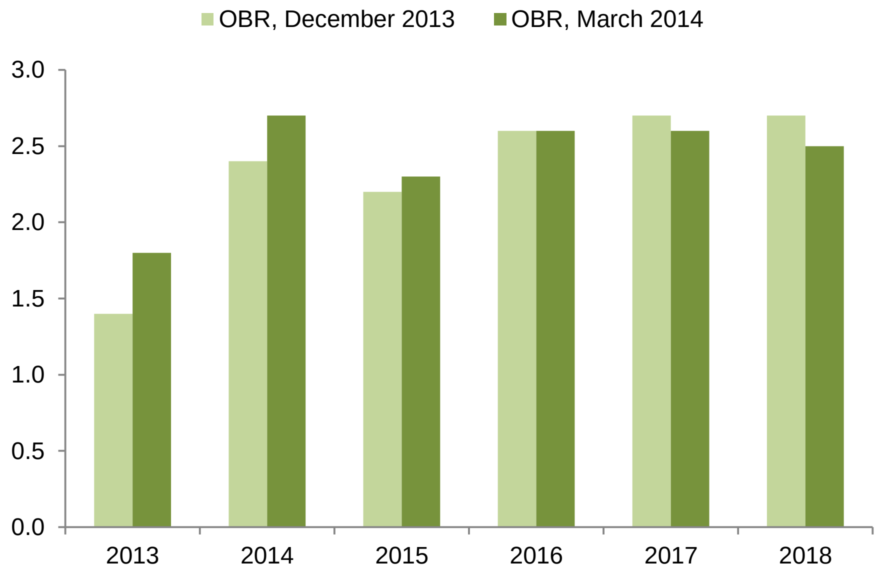
3.1 GDP growth

The OBR forecasts that the UK economy will grow by 2.7% in 2014, up from 2.4% forecast in the Autumn Statement in December 2013. Growth of over two percent a year is forecast for each year in the forecast period.

OBR forecasts of GDP growth (%)

	2013	2014	2015	2016	2017	2018
OBR, December 2013	1.4	2.4	2.2	2.6	2.7	2.7
OBR, March 2014	1.8	2.7	2.3	2.6	2.6	2.5

GDP growth: OBR forecasts
Annual % change, real terms



3.2 Inflation

Inflation has fallen in recent months, prompting the OBR to revise down its forecast for CPI inflation to 1.9% in 2014. At the time of the Autumn Statement, the OBR forecast inflation of 2.3% in 2014.

The OBR now forecasts that inflation will meet the Bank of England's target of 2.0% inflation in 2015 and for the rest of the forecast period.

OBR forecasts of CPI inflation (% change on previous year)

	2013	2014	2015	2016	2017	2018
OBR, December 2013	2.6	2.3	2.1	2.0	2.0	2.0
OBR, March 2014	2.6	1.9	2.0	2.0	2.0	2.0

3.3 Employment and unemployment

OBR forecasts: employment and unemployment

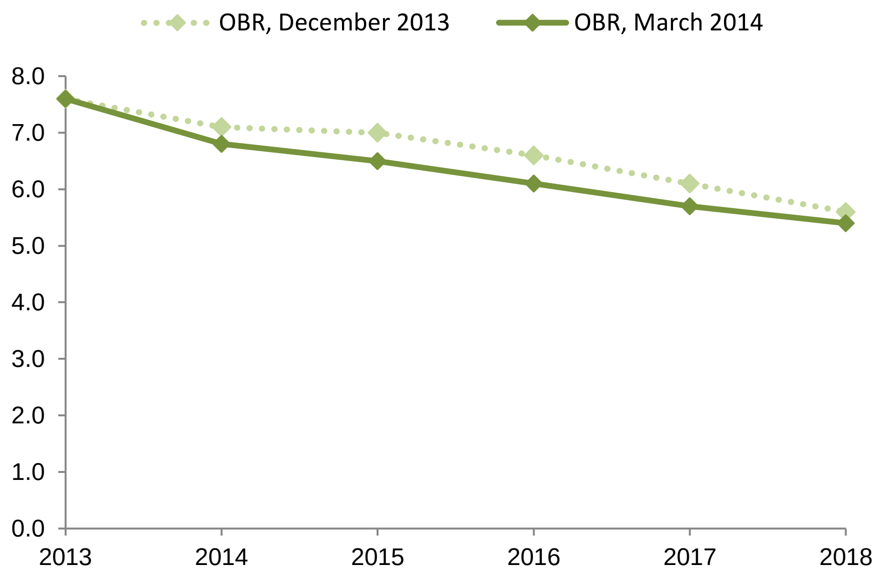
	2013	2014	2015	2016	2017	2018
Employment, millions						
December 2013	29.9	30.2	30.4	30.7	30.9	31.2
March 2014	29.9	30.4	30.6	30.9	31.2	31.4
ILO unemployment rate, %						
December 2013	7.6	7.1	7.0	6.6	6.1	5.6
March 2014	7.6	6.8	6.5	6.1	5.7	5.4
Claimant count, millions						
December 2013	1.43	1.27	1.23	1.18	1.13	1.10
March 2014	1.42	1.20	1.13	1.06	0.98	0.94

The employment level is forecast to be 30.4 million in 2014, rising to 31.4 million by 2018. These forecasts are slightly higher than the forecasts made at the time of the Autumn Statement.

OBR forecasts for the unemployment rate have been revised down sharply since the Autumn Statement. In 2014, the OBR forecasts an unemployment rate of 6.8%, falling to 6.5% in 2015, 0.5 percentage points below the rate forecast in the Autumn Statement. The unemployment rate is forecast to fall to 5.4% in 2018.

The claimant count is forecast to fall below one million in 2017 for the first time since 2008.

Unemployment rate: OBR forecasts
ILO measure, %



4 OBR forecasts for the public finances

OBR forecasts: public finances

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Net borrowing*, £ billion						
December 2013	111	96	79	51	23	-2
March 2014	108	96	75	45	17	-5
Net borrowing*, % GDP						
December 2013	6.8	5.6	4.4	2.7	1.2	-0.1
March 2014	6.6	5.5	4.2	2.4	0.8	-0.2
Net debt, £ billion						
December 2013	1,269	1,365	1,451	1,515	1,554	1,573
March 2014	1,258	1,355	1,439	1,497	1,530	1,548
Net debt, % GDP						
December 2013	76	78	80	80	78	76
March 2014	75	77	79	78	77	74

Note: *borrowing figures are for the 'underlying' measure of borrowing which exclude a number of one-off or temporary measures. These include the transfer of the Royal Mail pension fund to the public sector in 2012/13 and the ongoing transfers from the Bank of England's Asset Purchase Facility to the Exchequer (which are assumed to be reversed at a later date).

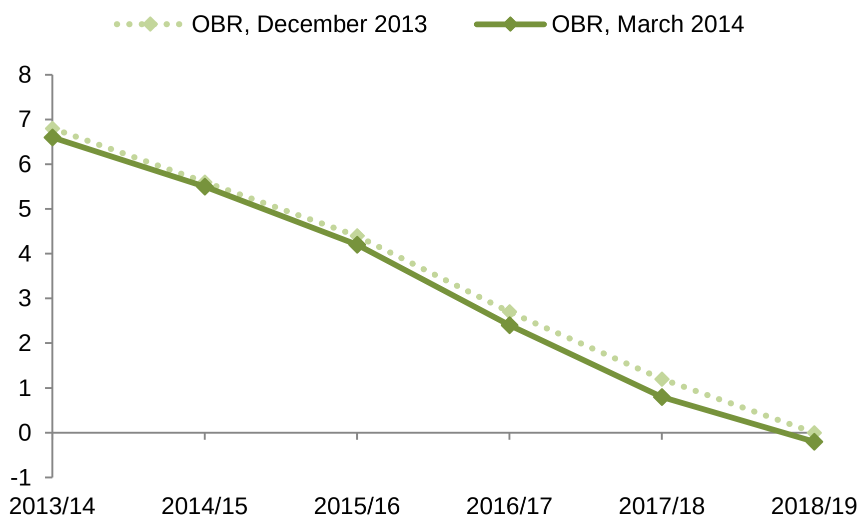
4.1 Public sector borrowing

The OBR forecasts that the underlying level of public sector borrowing (the budget deficit, excluding one-off or temporary measures), will total £108 billion in 2013/14, down from their forecast at the time of the Autumn Statement of £111 billion. The deficit will fall steadily through the forecast period and a surplus of £5 billion is forecast for 2018/19.

As a percentage of GDP, borrowing is forecast to fall from 6.6% in 2013/14 to 0.8% in 2017/18 before a small surplus is recorded in 2018/19.

Public sector borrowing: OBR forecasts
% of GDP

Positive figure indicates budget deficit; negative number a surplus

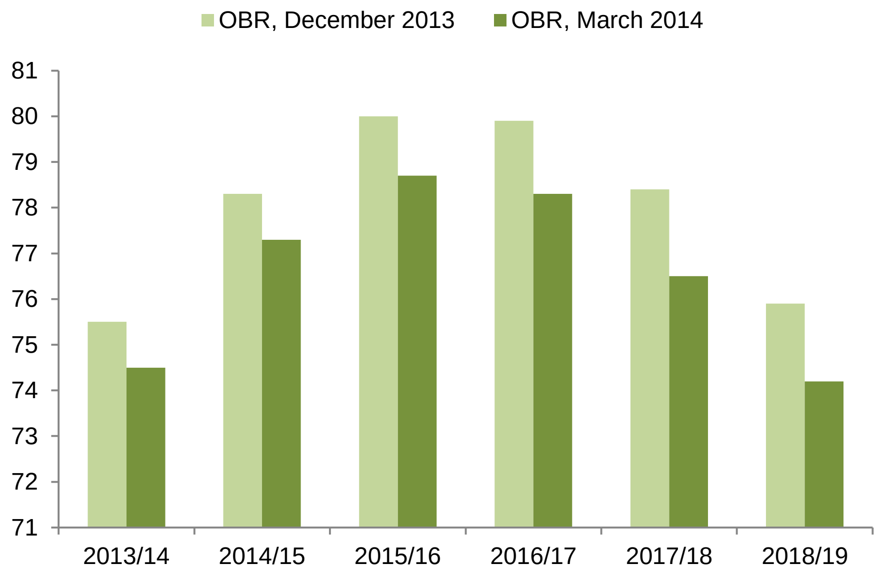


4.2 Public sector debt

Forecasts of government debt were revised down for each year of the forecast period. In 2013/14, debt is forecast to total £1.3 trillion, rising to £1.5 trillion in 2016/17.

As a percentage of GDP, debt is forecast to be 74.5% in 2013/14, rising to a peak of 78.3% in 2016/17 before falling to 74.2% in 2018/19.

Public sector net debt: OBR forecasts
% of GDP



4.3 Fiscal rules

Fiscal mandate

The fiscal mandate requires that the cyclically adjusted current balance – a measure government borrowing, adjusted for the state of the economy – be in surplus by the end of a rolling five year period. The OBR forecasts that the cyclically adjusted current balance will be +1.5% in 2018/19, meaning that the government is on track to meet this target.

OBR forecasts: Cyclically adjusted current balance, % GDP

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
December 2013	-2.9	-2.0	-1.4	-0.2	0.7	1.6
March 2014	-2.8	-2.2	-1.5	-0.2	0.7	1.5

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

Supplementary target

The supplementary target requires that public sector net debt falls as a share of GDP between 2014/15 and 2015/16. The OBR forecasts that debt will rise by 1.4 percentage points in this period (from 77.3% to 78.7% of GDP). This means that the government is on course to miss this target.

5 Policy focus – changes to defined contribution pensions

In defined contribution (DC) pension schemes, individuals build up a pension fund using contributions, investment returns and tax relief. At the moment most people (75%) who reach retirement age with DC pension savings use them to purchase an annuity.[1] An annuity provides a guaranteed income for life and the individual no longer bears the investment risk. The main exceptions to the requirement to buy an annuity are:

- People with small amounts of pension saving (such as a single pot that does not exceed £2,000, or total pension saving of less than £18,000) may have the option from age 60 to take all of it in the form of a lump sum.
- There is also the option of "income drawdown", which allows the individual to draw from their fund while leaving the rest of it invested. However, except where the individual can show that they have other pension income of at least £20,000, there is a cap on the amount they can draw down each year – equal to 120% of an equivalent annuity.[2]

The annuities market does not always work well for consumers. Four-fifths of consumers who purchase an annuity from their existing provider could get a better deal on the open market.[3]

Budget 2014 announced a number of changes that will take effect soon – these will be in the *Finance Bill 2014* and have generally been welcomed:

> From 27 March the current rules on how people access their pension will be changed. The minimum income requirement for flexible drawdown will be reduced from £20,000 to £12,000. The amount of total pension wealth, all of which an individual can take as a lump sum, will be increased from £18,000 to £30,000. The maximum size of a small pension pot which can be taken as a lump sum, regardless of total pension wealth, will also be increased from £2,000 to £10,000, and the number of personal pots that can be taken under these rules will be increased from two to three. The capped drawdown limit will also be raised from 120% to 150% of an equivalent annuity.[4]

The Government also announced a consultation on more radical changes to take effect from April 2015. Under the new system, individuals age 55 and over would be able to withdraw their savings at a time of their choosing, subject to their marginal rate of income tax. Those approaching retirement are to receive free and impartial face-to-face guidance. These proposals have proved more controversial. The fact that savers will be able to choose what to do with their own pension saving has been welcomed by some.[5] However, concerns raised include: the risk that people exhaust their savings prematurely; that a proliferation of new products may make retirement decisions more complicated and increase the risk of fraud; that annuities may increase in price for those who still want to buy them; and that proposals for 'risk-sharing' schemes may no longer be viable.[6]

For more detail, see the Library notes *Pension lump sums* (SN02181) and *Pensions: ending the requirement to annuitise* (SN00712).

Djuna Thurley – Business and Transport section

[1] HM Treasury, Freedom and choice in pensions, March 2014

[2] Money Advice Service website – Income drawdown [accessed 21 March 2014]

[3] FSCP, Annuities: Time for Regulatory Reform, December 2013; FCA TR14/2 Thematic Review of Annuities

[4] See, for example, HC Deb 20 March 2014 c953 [Gregg McClymont]; TUC, Pension changes go in wrong direction 20 March 2014; Age UK, welcome help for savers but no gains for the poorest pensioners, 19 March 2014; Quote from HM Treasury, Freedom and choice in pensions, 19 March 2014, para 1.11

[5] Financial Times, A watershed moment for pensions and savings,19 March 2014 (£); Pensions Advisory Service, Budget 2014, 19 March 2014; LITRG, Pensioners put in greater control over their own cash 20 March 2014

[6] See, for example, IFS, Budget 2014: pensions and savings policies, 20 March 2014; NAPF comments on 2014 budget, 19 March 2014; 'A brave new work for Britain's savers, *Financial Times,* 21 March 2014 (£); TUC Pension changes go in wrong direction 20 March 2014; HC Deb 20 March 2014 c953 [Gregg McClymont]

6 Policy focus – savings

Measures that affect or influence private savings are some of the most significant in the Budget. The new rules for pensions will have the widest impact but changes to ISAs and new savings products for pensioners from National Savings are also significant.

Individual savings accounts: ISAs are very popular with individual savers – they shelter income from tax and are administratively simple. The Budget reforms widen the range of eligible investment and increase the amount that can be invested each year.

The eye catching development is the proposal to ***extend qualifying ISA investments to include peer to peer (P2P) lending***. This would be a fairly dramatic change to the options open to investors and could be a potentially game changing moment for the P2P lenders.

P2P platforms bring together lenders and borrowers (individuals or small firms) and cut out the traditional middleman of the bank. The companies that run these platforms – such as Zopa – provide the online interface between borrowers and lenders and use algorithms to determine the risk parameters of the loan. Although the industry can point to impressive rates of growth they remain marginal lenders. Their relatively attractive rates are not yet sufficient to convert millions of individuals from 'savers' to 'lenders' and to overcome the lack of deposit protection enjoyed by bank customers. Many potential P2P investors are higher rate tax payers and the Budget proposal would therefore radically increase their post-tax returns. This combined with the general familiarity of the ISA wrapper could persuade many more people to consider a P2P investment.

The Zopa blog issued post Budget is not shy about its claims:

> By lending through Zopa with an ISA, UK savers will be able to make at least 2.5 times more interest than the sub 1.6% cash ISAs from banks with the same tax free benefit. Unlike other riskier stocks and shares ISAs, a more reliable and predictable Zopa ISA would allow every saver to become a millionaire under 30 years at the current rate of 5% if they used their full ISA allowance and would double their savings to £2m by saving for a further 11 years. Meaning that by 2044 you could be a **Zopa millionaire with over £649,000 in interest alone!**

Various questions about this move remain. First, the practicalities of the scheme have yet to be worked out. Second, tax relief will be given to existing lending, thus there is a 'deadweight' loss in the measure. Last, what regulatory responsibilities and fund protection implications should follow if P2P lending is popularised by its ISA status?

Currently ISAs are split between solely cash accounts and stocks and shares ISAs. The overall investment limit for 2012-13 is £11,520, of which only up to half can be invested in a cash ISA. The Budget proposes that ***the ISA limit is raised to £15,000*** from 1 July 2014 additionally however, it also proposed to ***end the distinction between cash and stocks and shares ISAs*** in which case the allowance for cash in ISAs will rise by nearly £10,000.

National Savings: Record low interest rates have reduced incomes from savings. Pensioners who are reliant on savings income have been particularly badly hit. While the government cannot generally direct institutions to offer higher interest rate products, it does have the power to set the terms of national savings products. Budget measures include the raising of ***premium bond prizes*** and the issue of ***savings bonds above market interest rates*** for people aged over 65. More precise details will be set out in the Autumn Statement.

Tim Edmonds – Business and Transport section

7 Policy focus – welfare cap

Budget 2014 sets a limit on the amount that can be spent certain aspects of welfare between 2015/16 and 2018/19. The operation of the cap is outlined in an updated *Charter for Budget Responsibility.*

What will be capped? The cap will cover roughly 55% of welfare spending, including spending on housing benefit, incapacity benefit and tax credits. It will not cover the state pension or Jobseekers Allowance.

How is the cap set? The cap will normally be set by the Treasury on or before the first Budget of each Parliament for a five year period. Each year after that the cap will be set for an additional year, so that it always covers a five year period. The Treasury may change the level of the cap or the items within the scope of the cap but must seek the approval of the House of Commons. Budget 2014 set the cap at the level of relevant welfare spending that the OBR expects to see up to 2018/19.

Level of the welfare cap set out in *Budget 2014*, *£ billions*

	2015/16	2016/17	2017/18	2018/19
Welfare cap	119.5	122.0	124.6	126.7

Source: HM Treasury, *Budget 2014*, 19 March 2014, Table A.1, p87

Note: a 2% margin above the cap allows for forecast fluctuations each year

How do we know if the cap is met? The cap is a limit on the amount that is forecast to be spent, not the actual amount spent. At the time of each Autumn Statement, the Treasury will report on performance against the cap as assessed in the OBR's forecasts. If any of the forecasts are higher than the cap for years after the first forecast year, then the cap will be judged to have been exceeded.

So, in the Autumn Statement 2014, the OBR will publish forecasts of expenditure in 2015/16 and subsequent years, revealing whether relevant spending comes in under or exceeds the level set out in the table above.

If spending within the scope of the welfare cap is forecast to be above the level of the cap but within a pre-set margin (currently 2%), and this is due to forecast changes rather than discretionary policy action, then the cap is not deemed to be breached.

What happens if the cap is exceeded? If the cap is judged to have been exceeded, then the Government must propose new policy measures intended to reduce spending, increase the cap or explain why a breach of the cap is justified. They must seek House of Commons approval within 28 sitting days.

How might the cap be breached? The current level of the cap is the expected level of welfare spending, so spending must simply remain at that level (or below) for the cap to be met. However, since the cap is judged on forecast expenditure, significant deteriorations in the macro-economic situation and therefore, an increase in expected welfare expenditure, could mean that the cap is exceeded.

The IFS found that the deterioration of the economy in 2011/12 pushed forecast welfare expenditure more than the 2% margin above what would have been the cap level. This would have triggered policy action or a change to the cap level. So, a deterioration similar to that experienced in 2011/12 could lead to the cap provoking action from future Governments.

Chris Rhodes – Economic Policy and Statistics section

8 Policy Focus – accelerated payments of disputed tax

One major cost of the tax avoidance schemes sold to many tax payers has been the amounts of tax at stake that have held by the individuals concerned while HMRC has sought to challenge these schemes in the courts.[7] As one commentator has noted:

> "even if the scheme is found ultimately to fail, a taxpayer undertaking a scheme [could] … generally secure the benefit of holding the tax whilst the dispute is determined. With 'marketed' schemes the deal was even better, as generally only one taxpayer is litigated – and it is open to so-called 'follower' taxpayers to argue that their fact patterns are different – and therefore they have to sit and wait until HMRC gets around to them."[8]

In December 2013 the Government announced that 'follower' taxpayers would be required to settle with HMRC when the scheme they had used had been struck down in the courts. It also proposed that taxpayers in this situation would have to pay tax 'upfront' – i.e. ahead of their disputes being finally resolved – and that such 'accelerated payments' could also apply to two other categories of taxpayer: those in dispute with HMRC because they have used a scheme notified under the disclosure rules (known as DOTAS), or those using a scheme which HMRC were seeking to frustrate, using the new General Anti-Abuse Rule.[9] In its consultation on these proposals, HMRC noted that there were around "65,000 open cases involving marketed tax avoidance schemes … [and] … over 85 per cent of these cases date back to 2009-10 or earlier … reflecting a market for avoidance products which was very active in earlier years."[10]

In his Budget speech the Chancellor confirmed the introduction of a system of accelerated payments.[11] HM Treasury's estimate of their revenue from the new scheme is as follows:[12]

Exchequer impact of accelerated payments (£ millions)

	2014/15	2015/16	2016/17	2017/18	2018/19
Exchequer impact	+340	+1,230	+1,300	+715	+385

Although other aspects of the Budget have received more attention, some commentators have raised concerns that these proposals are unfair, particularly as they affect taxpayers who used schemes that they understood to be compliant with the law, given that the scheme was disclosed to HMRC some years ago.[13]

Antony Seely – Business and Transport section

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7 HMRC, *Raising the stakes on tax avoidance*, 12 August 2013 para 5.1-2. See also HMRC, *Tempted by tax avoidance? A warning for people thinking about avoidance schemes*, August 2013

8 James Bullock, "Views on the Autumn Statement", *Tax Journal*, 6 December 2013

9 *Autumn Statement*, Cm 8747, December 2013 p74. For more details see, *Tax avoidance: the General Anti Abuse Rule*, Library standard note SN6265, 20 March 2014

10 *Tackling marketed tax avoidance – consultation document*, 24 January 2014 paras 1.1, 2.6

11 For details see, HMRC, *Accelerated payments of tax for avoidance schemes* & *Avoidance schemes: relevant judicial ruling - notice to settle dispute*, 19 March 2014

12 HM Treasury, *Budget 2014: policy costings*, March 2014 p37. The OBR has noted that there is considerable uncertainty over this estimate, as it is "dependent on a large number of assumptions, some of which … concern the behavioural response of those affected." (p67).

13 See, "Anti-avoidance measures attacked", *Financial Times*, 20 March 2014 & "Revenue wins power to raid bank accounts in battle over avoidance", *Times*, 20 March 2014. The latter story highlighted a separate proposal to allow HMRC to recover tax debts directly from debtors' bank accounts in certain circumstances. The Government is to formally consult on this, with a view to introduce legislation in 2015 (*Overview of tax legislation and rates*, 19 March 2014 para 2.30).