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**BRIEFING PAPER**

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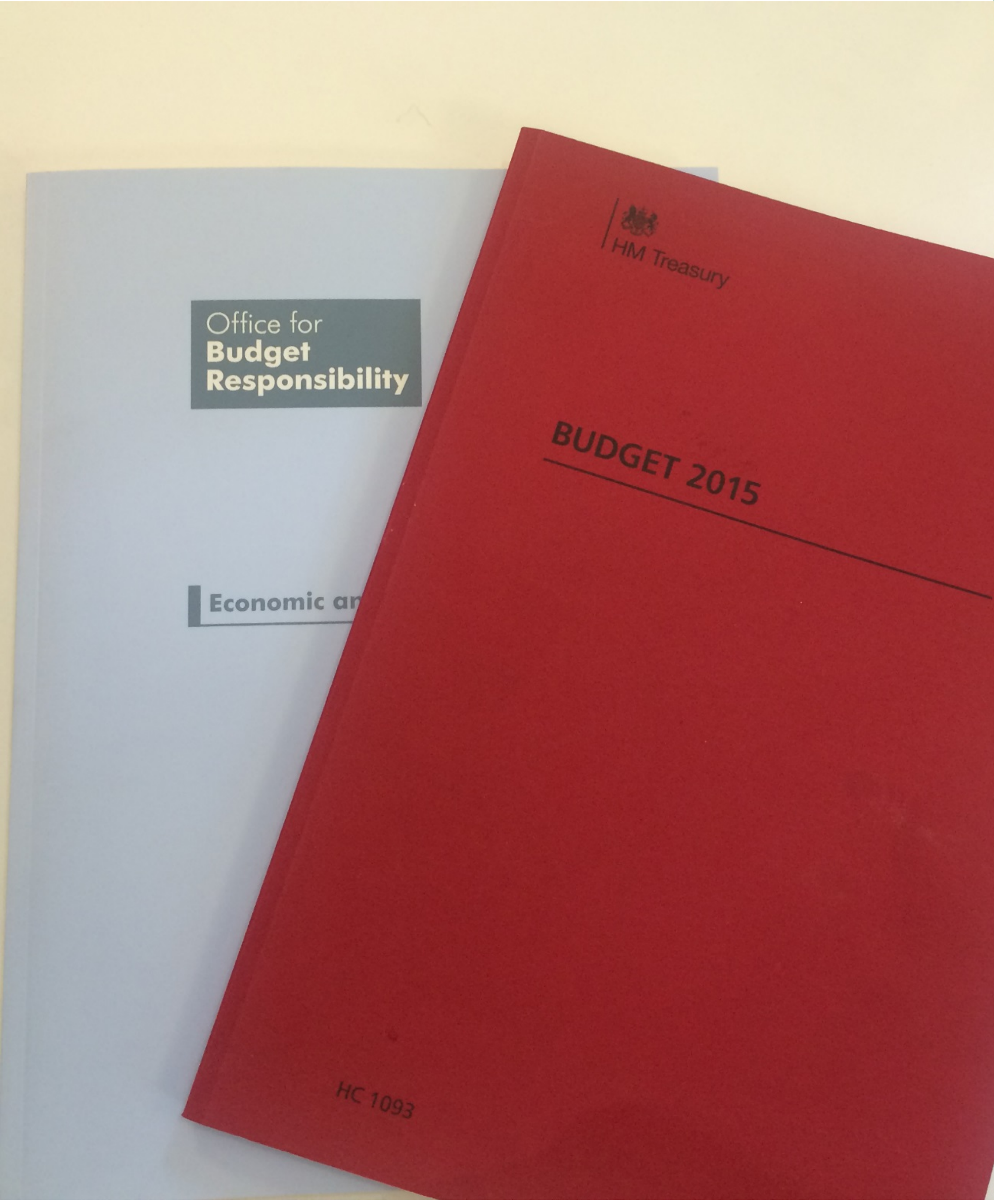
# Background to the July 2015 Budget

By Matthew Keep



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# Summary

The July 2015 Budget, the first under a Conservative Government since 1996, comes at a time when the UK economy is generally performing strongly. GDP growth in 2014 was at its highest since before the recession, the proportion of people in work has reached record levels, and in 2016 unemployment looks set to return to its pre-crisis level. Economic growth is expected to remain healthy in 2015, despite a slowdown in Q1.

The combination of low inflation, driven by the fall in oil prices, and improvements in earnings has recently led to average earnings growing in real terms for the first time since the start of the recession.

The Eurozone, and the intensification of Greece's debt crisis, continues to be a risk to economic growth. At home, the sustainability of growth is dependent on productivity improving from its current period of stagnation.

The public sector remains some way off a budget surplus: the budget deficit - the difference between what the public sector spends and receives in taxes - is forecast to be £75 billion in 2015/16. The Conservative's manifesto said that reduced welfare spending and departmental spending would contribute £25 billion towards reducing the deficit. The Budget offers the Chancellor the opportunity to explain further where the £12 billion of welfare reductions are to be made.

Public sector debt - the stock of borrowing required for past deficits - looks set to peak, at just over 80% of GDP during the year, and fall thereafter. The Chancellor believes that the debt to GDP ratio is too high, and that the only reliable way to reduce it is to run budget surpluses. Alongside the Budget, the Chancellor looks set to introduce a new rule to ensure governments do just this: the new fiscal rule will require UK governments to run a budget surplus during 'normal economic times'.

The Budget offers the chance for the Conservatives to deliver some of their manifesto commitments. On taxation, potential candidates include raising the tax-free personal allowance, introducing a main residence allowance for Inheritance Tax, and introducing legislation to prevent increases in income tax, National Insurance and VAT.

On pensions, the Chancellor may look to make savings by reducing pension tax relief to high earners, as was proposed in the Conservative Party's manifesto.

The Chancellor may look to make further announcements about the northern powerhouse, if recent Budgets and Autumn Statements are anything to go by.

The Finance Bill 2015 will be published on 15 July. The Commons Library Briefing, The Budget and the annual Finance Bill, discusses the way that Parliament debates the Budget and scrutinises the Finance Bill.

The Library will publish Economic Indicators on 7 July – the day before the Budget.

# 1. Economic situation

**Summary**

In 2014 GDP growth of 3.0% was the highest since before the recession in 2006. Growth slowed in the first quarter of 2015, but is expected to pick-up again over the rest of the year boosted by accelerating earnings growth and low inflation. Growth is entirely driven by domestic demand, with net trade remaining a drag on growth. Risks to the outlook come from productivity growth failing to improve as expected and the effects of the Greek crisis on the Eurozone economy.

Inflation is currently near 0%, mainly due to the fall in the oil price and lower food prices. With the oil price decline over the second half of 2014 soon to drop out of the annual inflation calculation and spare capacity in the economy being used up, inflation is expected to pick-up in the coming months. The falling unemployment rate and strengthening wage increases has turned attention to when the Bank of England might raise interest rates from their historic low of 0.5%, although this is not expected until at least the end of this year.

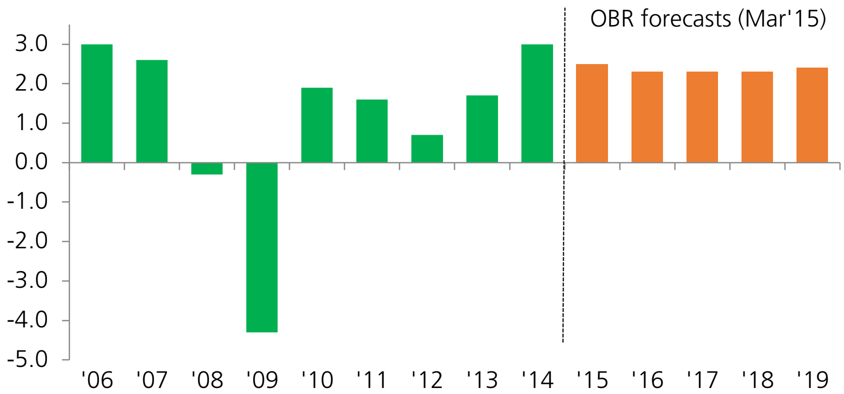
The labour market continues to improve with falling unemployment and a record-high proportion of the working-age population in work. Earnings growth, for so long failing to keep pace with inflation, has started to pick up in recent months. Combined with the effects of low inflation, real earnings growth has been rising for the first time since the recession.

## 1.1 Growth and economic conditions

The economy grew at its fastest rate in the post-recession period in 2014. GDP growth of 3.0% was underpinned by a combination of growth in consumer spending (up by 2.6%) and investment (up by 8.6%).

**GDP growth in 2014 highest since 2006**

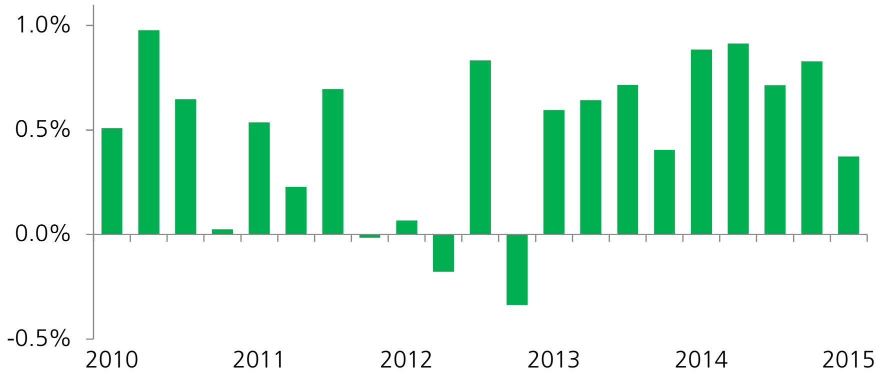
% change in real GDP on previous year




Source: ONS, series IHYQ

On a quarterly basis, growth averaged 0.7% in 2013 and 2014 as the recovery finally took hold. Latest estimates for the first quarter of 2015 show that growth slowed to 0.4% as construction output fell and the services sector (which makes up nearly four-fifths of the economy) experienced a slowdown, especially in the business service and finance sector.

**Recovery in real GDP growth has been sustained since early 2013**
% change in real GDP on previous quarter

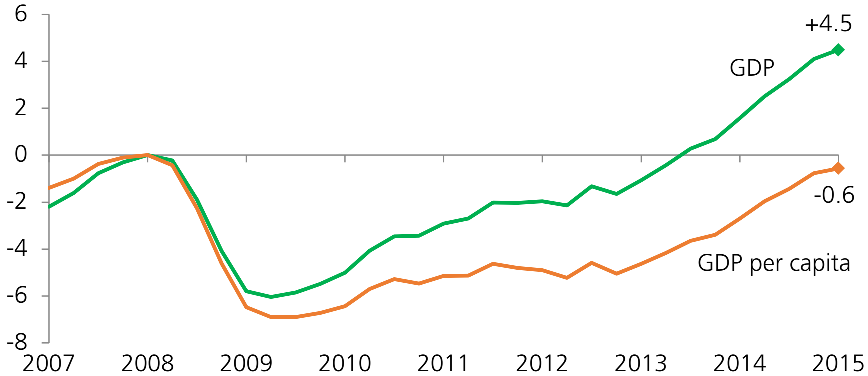



Source: ONS, series IHYQ

### Box 1: GDP per head still below pre-recession level

Before the recession, GDP and GDP per head peaked in Q1 of 2008. Overall GDP surpassed this level in Q3 2013 and was 4.5% above the pre-recession peak in Q1 2015. However, if you adjust for the growth in population, GDP in Q1 2015 is still 0.6% below the pre-recession peak of seven years earlier.

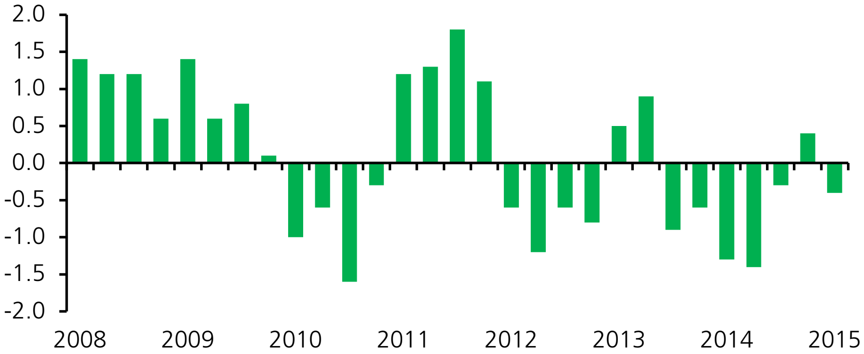
**GDP above pre-recession levels but GDP per capita still below**
% change in real terms from Q1 2008 (pre-recession peak)




Economic growth is being supported by domestically-generated expenditure. This was the case in the latest quarter as well. Consumer spending increased by 0.9% in Q1 2015 compared with the previous quarter, while investment rose by 2.0%. Government expenditure on goods and services rose by 0.9%. The reason overall GDP growth slowed was due to growth in imports exceeding the growth in exports during the quarter.

Quarterly trade data is volatile but data over the past years show a similar trend, as the chart below shows. If the growth in the volume of imports exceeds the growth in the volume of exports, then net trade subtracts from GDP growth. With net trade acting as a drag on growth, it has been domestic demand alone that has been driving the economic expansion in recent years.

**Net trade (exports minus imports) contribution to GDP growth**
%-points, quarter compared with same quarter a year before




Source: ONS, Quarterly national accounts Q1 2015, fig 10

## Outlook and forecasts

Most economists expect the slowdown in Q1 2015 to be temporary and for growth to have picked up in Q2.[1] The National Institute of Economic and Social Research (NIESR) estimated that GDP grew by 0.6% in the three months to May.[2]

The falling rate of inflation over the past year to around 0% (see section 1.3) has largely been down to the fall in the oil price over the second half of 2014, as well as lower food prices. This has boosted the amount of income households have to spend.

Signs of rising earnings growth (see section 1.4) will provide a further boost to household incomes, which is expected to support healthy growth in consumer spending. Consumer confidence has also risen with the GfK measure at a 15-year high in June.[3]

In March, the Office for Budget Responsibility (OBR) forecast consumer spending to rise by 2.6% in 2015, similar to the Bank of England's latest forecast of 2¾% made in May.[4] This is expected to support GDP growth of around 2.5% in 2015 – the latest consensus of independent forecasts, and similar to the Bank of England's latest forecasts in May and the OBR's in March.

The main risks to the outlook come from productivity growth failing to pick up (see section 1.2) and knock-on effects from the Greek crisis (see box 2).

## International economic outlook

Global growth in the first quarter of 2015 was weak, partly due to the US economy stagnating. International growth over the rest of the year is expected to improve, with the US expected to shrug off the weak first quarter data and grow by around 2% in 2015 as a whole, buoyed by an

[1] "UK economy Q1 GDP growth improved to 0.4 per cent", fastFT, *Financial Times* online, 30 Jun 2015
[2] "June 2015 GDP Estimates: GDP Growth of 0.6% in three months to May", NIESR, 10 Jun 2015
[3] "UK consumer confidence surges to 15-year high in June - GfK", Reuters, 30 Jun 2015
[4] OBR, *Economic and fiscal outlook*, Mar 2015, table 3.6 and Bank of England, *Inflation Report*, May 2015, table 5.D

improving labour market and rising household disposable income (boosted by lower oil prices over the past year).

Lower energy prices and weaker currencies have helped the Japanese and Eurozone economies grow a little faster than previously expected. This, combined with the introduction of quantitative easing by the European Central Bank, is expected to lead to the Eurozone growing by the most since 2011, although the deterioration in the Greek debt crisis threatens this relative positive outlook (see box).

### Box 2: Greece crisis – potential impact on the UK

The long-running debt crisis took a surprising turn when the Greek Prime Minister announced on 26 June that Greece would hold a referendum on Sunday 5 July (after this briefing was published) on whether to accept or reject the last proposal from the creditor institutions. Since that announcement, Greece has missed a debt repayment to the IMF, seen its bailout agreement expire and had to introduce capital controls. These events have increased the likelihood of Greece leaving the Eurozone ('Grexit').

The direct impact on the UK economy of Grexit would probably be small. Greece, for instance, accounts for only 0.6% of total UK exports and its economy accounts for less than 2% of total Eurozone GDP.[5] The UK, however, would likely be affected indirectly via the financial markets and via the wider Eurozone economy. Although British banks exposure to Greece is relatively small, the UK's large financial sector could still be impacted via contagion in the wider Eurozone financial system.

The UK exports 39% of its goods and services to the Eurozone and many businesses have deep connections with it. Falling business and consumer confidence could knock the Eurozone back into recession. Confidence in the UK may also be hit given the uncertainty, potentially causing businesses to hold back investments and consumers to rein in spending.

In May, the Bank of England Governor Mark Carney noted that the Bank is not complacent about risks to the UK economy resulting from "an intensification of the Greek crisis", but believed there would only be a "modest impact on GDP growth".[6] More recently, since Greece imposed capital controls, Mr Carney has noted that the outlook for UK financial stability has worsened as a result of recent events. He emphasised that the UK's direct exposure was small but that the main risks lie with knock-on effects from the Eurozone as a whole and from business confidence.[7]

On 29 June, the Chancellor stated that the government is monitoring the situation and has taken steps to limit the impact of Grexit:

> […] the Prime Minister chaired a meeting attended by the Governor of the Bank of England, myself, the Foreign Secretary and others to co-ordinate our response. Britain's attitude to the developing Greek crisis is clear: we hope for the best, but we prepare for the worst.[8]

For more analysis and background, see the Library briefing on the Greek debt crisis.

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5 ONS, *Pink Book 2014*, table 9.3; data for 2013 (latest available) and Eurostat, national accounts figures for 2014 [accessed 22 Jun 2015]

6 Bank of England Inflation Report Q&A,13th May 2015, page 24

7 Governor's opening remarks and press conference, Bank of England, *Financial Stability Report*, 1 July 2015

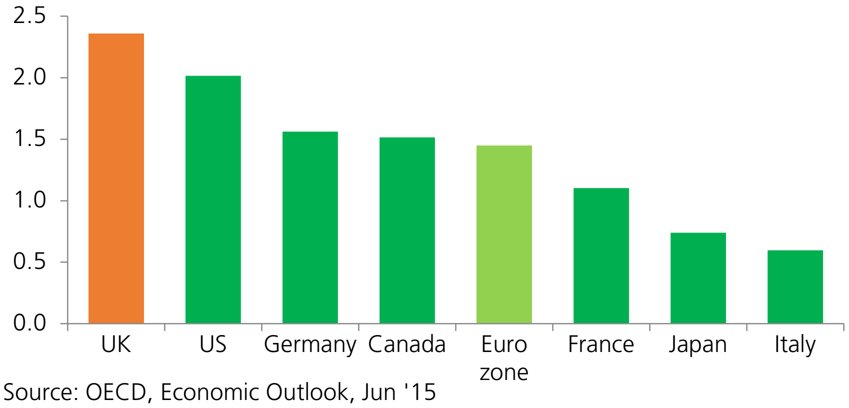
8 Chancellor's statement to the House on 29 Jun 2015 (HC deb 29 Jun 2015, c1205)

The contribution of emerging economies to world growth is diminishing largely due to the slowing of the Chinese economy (still forecast to grow by around 7%), as well as weakness in other large emerging economies such as Brazil and Russia.

Latest OECD forecasts from June point to the UK experiencing the fastest growth rate in the G7 for the second year in succession in 2015.

**UK forecast to have highest growth rate in G7 in 2015**

OECD GDP growth forecast from June 2015




Source: OECD, Economic Outlook, Jun '15

## 1.2 Productivity

Productivity – how much is produced for a given input (such as an hour's work) – is directly linked to living standards, with a country's ability to improve its standard of living over time almost entirely dependent on productivity growth.

Productivity is also crucial in determining long-term growth rates of an economy. In other words, stronger productivity growth leads to stronger GDP growth. This, in turn, increases tax revenues and lowers government budget deficits. Of course, lower productivity growth results in the opposite: lower GDP growth and higher budget deficits.

Productivity – as measured by output per worker - was growing at its historical average rate of around 2% per year in the decade prior to the 2008/2009 recession. During the recession productivity fell sharply, as we'd expect, with output falling faster than hours worked.

However, since then productivity has not rebounded as we'd expect to see in an economic recovery. Indeed, productivity fell in 2012 (-0.7%) and 2013 (-0.9%), and rose very modestly in 2014 (+0.3%).[9]

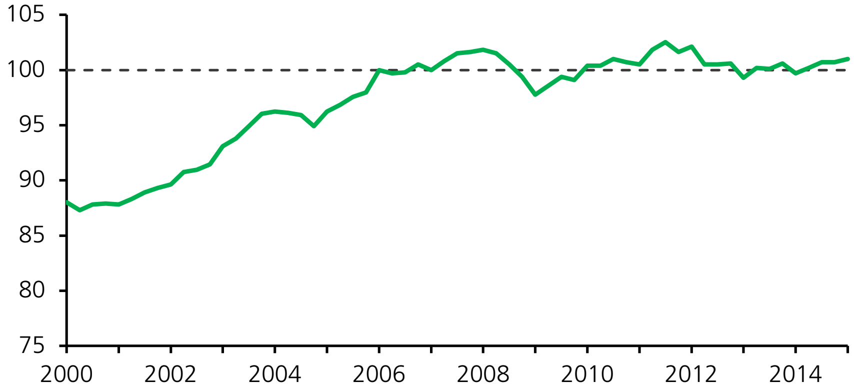
The level of labour productivity in Q1 2015 was still 0.8% lower than it was seven years earlier in Q1 2008 (pre-recession peak level).[10] The ONS has described the stagnation in productivity over this period as "unprecedented in the post-war period".[11]

9 Recent trends in UK productivity are also summarised in the Library Economic Indicator page on Productivity and in the latest quarterly Office for National Statistics (ONS) release

10 For more on the reasons behind the "productivity puzzle" see the Bank of England's article "The UK productivity puzzle" from the Bank's Q2 2014 Quarterly Bulletin and this Library note from May 2013.

11 ONS, *Labour Productivity, Q4 2014*, 1 April 2015

**Productivity (GDP per hour) has stagnated since 2007**
Index where Q1 2007 level = 100




Forecasts predicting a return to 'normal' pre-recession rates of productivity growth have been made for at least two years, and have consistently proven to be overoptimistic.

Nevertheless, the Office for Budget Responsibility's (OBR's) central forecast made in March 2015 anticipates a return to 'normality': "Growth is … supported by our assumption that productivity growth picks up towards its historical average rate".[12]

In May 2015, the Bank of England stated that, while "believing that productivity growth will pick up gradually over coming years towards pre-crisis average rates", it had downgraded its forecasts for 2015 and 2016.[13] On 13 May 2015, the Bank's Governor, Mark Carney, summarised near-term forecasts thus: "Productivity is projected to grow only modestly in the year ahead".[14]

All these forecasts are usually prefaced with the caveat that there is considerable uncertainty surrounding these expectations. What can be predicted is that, with the proportion of people in work at historic highs, there is only limited room for growth in the economy to be driven by hiring more people. For growth to continue for much longer at its current pace of 2.5-3.0% a year, the productivity of existing employees will need to improve. If this does not happen, then we can expect growth to slow and the public finances to deteriorate compared with current expectations.[15]

12 OBR, *Economic and fiscal outlook*, March 2015, p53, para 3.48
13 Bank of England, *Inflation Report*, May 2015, p46
14 Bank of England, Inflation report press conference: Opening remarks by the Governor, 13 May 2015
15 Further information and analysis on productivity can be found in the Library Briefing, *Productivity in the UK*

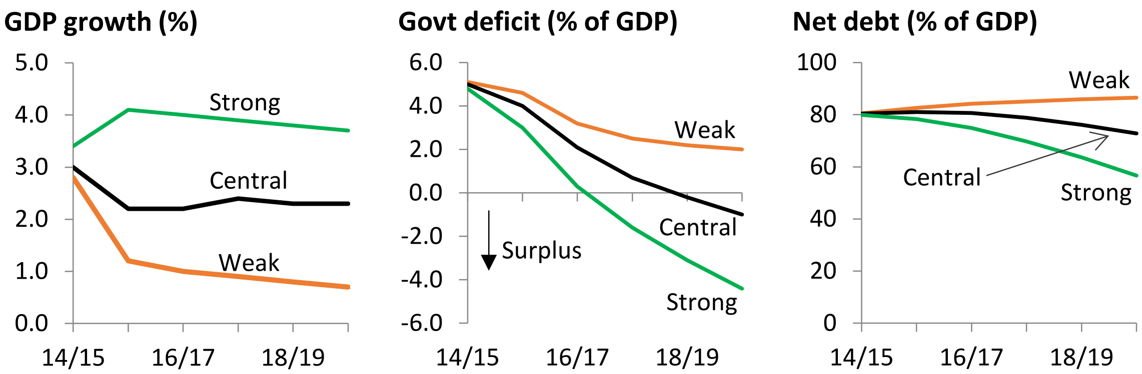
**Box 3: How productivity affects the economy and public finances**

To illustrate the importance of productivity to the economy, the Office for Budget Responsibility (OBR), in December 2014 produced some forecasts based on three differing assumptions of productivity growth.[16] These were:

(i) a **weak** productivity scenario – essentially a continuation of recent weakness – with productivity growth of 0.5% per year;

(ii) the OBR's **central** scenario, where productivity growth gradually rises back to its historic rate of 2%; and

(iii) a **strong** productivity scenario where productivity growth of 4% is recorded (similar to a few years in the early 1970s and early 1980s).

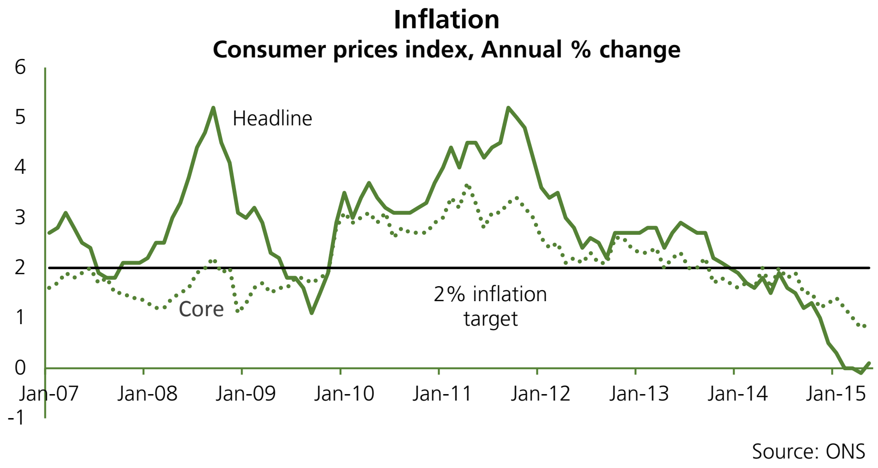



The charts above show how faster productivity growth leads to stronger GDP growth. This, in turn, leads to higher tax revenues, which results in a lower government budget deficit and a reduced debt-to-GDP ratio. The differences are stark: the weak productivity scenario results in GDP growth of just 0.7% by 2019/20, compared to growth of 2.3% in the OBR's central scenario and of 3.7% under the strong productivity scenario.

## 1.3 Inflation and monetary policy

Inflation is currently very low with a negative inflation rate of -0.1% recorded in April 2015. The latest figure, for May 2015, saw inflation of +0.1%. Inflation has fallen steadily over the last year, down from 1.9% in June 2014. The fall in inflation is largely due to the fall in the oil price and lower food prices. Core inflation, which excludes energy, food, alcohol and tobacco, has also fallen over the last year but by less than the headline figure. Core inflation was 0.9% in May 2015 compared with 1.9% in August 2014.

[16] OBR, *Economic and fiscal outlook*, December 2014




Inflation is forecast to remain low for the rest of this year before increasing closer to the Bank of England's 2% inflation target in 2016. In March, the OBR forecast inflation of 0.2% in 2015, rising to 1.2% in 2016 and 2.0% in 2019, as a result of an increase in the oil price, spare capacity in the economy being used up and the recent fall in the oil price dropping out of the calculation.[17]

The Bank of England's Monetary Policy Committee (MPC) has kept the base rate at the historically low level of 0.5% since March 2009. While the headline rate of inflation is currently very low, this is largely due to temporary factors. The MPC tends to place relatively little weight on these focusing more on the underlying drivers of inflation. With unemployment falling and wage increases strengthening, attention is turning to when interest rates might begin to rise.

No member of the MPC has voted for an increase in interest rates this year, although 2 of its 9 members (Martin Weale and Ian McCafferty) voted for a 0.25% increase at a number of meetings in 2014. There are, however, signs that that this consensus may soon come to an end. One member the MPC, Martin Weale, suggested recently that rates might need to increase as soon as August[18] while Andy Haldane, another MPC member, recently gave a speech arguing against an early increase in interest rates.[19] A recent article in the *Economist* said that rates "could rise as early as November"[20] and the *Financial Times* said that rates are "unlikely to rise at least before the autumn".[21] Mark Carney, Governor of the Bank of England, said in May that when interest rates do rise, they are likely to do so at a "gradual pace" and to a "limited extent."[22]

[17] Office for Budget Responsibility, Economic and Fiscal Outlook, March 2015, Table 3.6
[18] "Bank of England hawk says prepare for rate rise", *Financial Times*, 23 June 2015
[19] "BoE's Haldane rejects calls for early rise in interest rates", *Financial Times*, 29 June 2015
[20] "Cruising for now", *Economist*, 27 June 2015
[21] "Bank of England hawk says prepare for rate rise", *Financial Times*, 23 June 2015
[22] Bank of England, Q & A on Inflation Report, 13 May 2015, p2

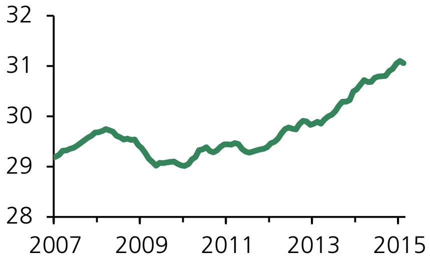
# 1.4 Labour market

## Employment

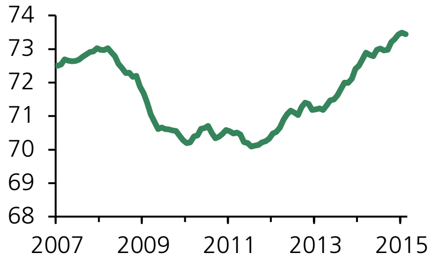
Employment in the UK has reached record highs in recent months. The employment rate was 73.4% in February-April 2015 with 31.05 million people in employment. Prior to the recession, the employment rate stood at 73.0% in March-May 2008.[23]

The employment rate increased by 0.7% points over the year to February-April 2015. The number of employees increased by 545,000, whilst the number of those self-employed fell by 91,000 after a large increase in self-employment in 2013.

**UK employment level**
Millions



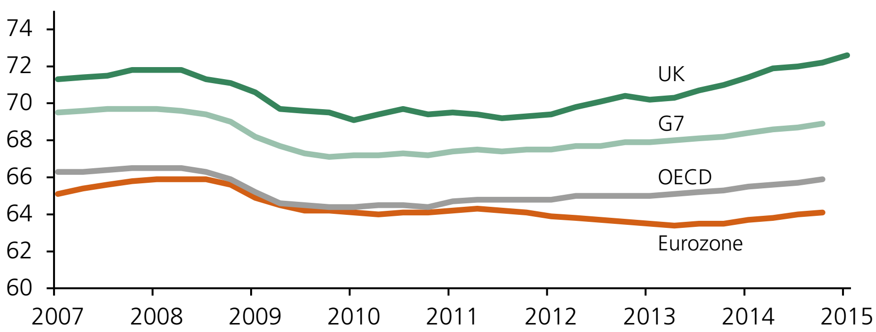

**UK employment rate**
% aged 16-64 in work




As employment has increased, unemployment has continued to fall back towards pre-recession levels. 1.81 million people were unemployed in February-April 2015, down 349,000 on the previous year. Over the same period the unemployment rate fell from 6.6% to 5.5%, the OBR's latest forecasts from March 2015 suggest that unemployment will return to the pre-crisis rate of 5.2% in 2016

The UK employment rate remained higher than the average for the G7, OECD and Eurozone, based on OECD figures. Since mid-2009, the UK has had the fourth highest employment rate in the G7, having been overtaken by Germany and Japan whilst remaining below Canada. The UK, Japan and USA all saw strong employment growth over the last year.

**Employment rates**
% of people aged 15-64 in work



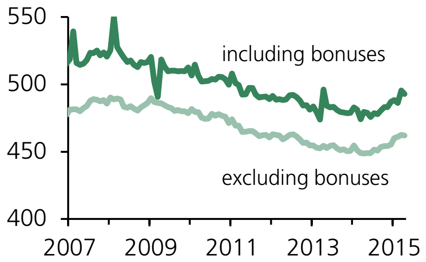

[23] All data in this section are taken from ONS *Labour Market Statistics, June 2015* unless otherwise stated.

## Earnings

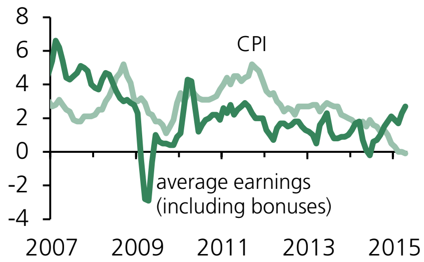
Since the second half of 2014 earnings have been growing consistently for the first time since the start of the recession, partly as a consequence of low inflation.

Both total pay (including bonuses) and regular pay (excluding bonuses) grew by 2.7% in February-April 2015 compared with the same period in the previous year, whilst prices fell by 0.1% in April 2015, as measured by CPI. .

**Real average weekly earnings**
April 2015 prices




**Inflation and earnings**
% change on previous year




The OBR's latest forecasts from March 2015 predicted average earnings would grow by 2.3% in 2015, then 3.1% in 2016. Although real earnings growth is expected to rise over the medium term owing to improvements in productivity, the forecasts suggest that real earnings will not be above the pre-crisis peak until the end of 2018.

## 1.5 Household incomes

Median household income remained broadly flat in real terms between 2011/12 and 2013/14. This followed a sharp fall in average household incomes between 2009/10 and 2011/12, which reflected decreases in real median earnings. [24]

Real median household income in 2013/14 was about the same as in 2012/13, as real terms falls in earnings and various benefit amounts were offset by an increase in employment rates. This is based on RPI inflation – using certain other inflation indices, there was a small increase in real incomes in 2013/14. [25]

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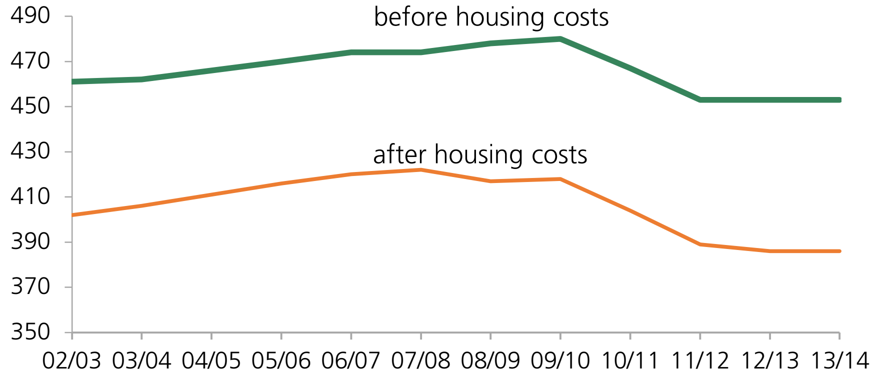
24 Source: DWP, *Households below average income, 2013/14*, 25 June 2015. Household income refers to income after taxes and benefits. Figures are 'equivalised' to take account of differences in household size and composition, taking an adult couple with no children as the reference point, since a smaller household can enjoy the same standard of living as a larger one on a lower level of income. For example, equivalisation adjusts the income of a single person upwards so their income can be compared to that of a couple. Income can be measured both before or after housing costs have been deducted; both measures show a similar trend in median income (as shown in the chart).

25 The RPI measure of inflation lost its status as a National Statistic in January 2013 owing to flaws in the calculation method, which mean it tends to show a higher rate of inflation than other measures. DWP's *Households below average income* publication continues to use RPI as its measure of inflation as currently there are no suitable alternatives with appropriate indices for deflating income on both a before and after housing costs basis.

**Real median household incomes**
equivalised £ per week, 2013/14 price (RPI adjusted)




## 1.6 Trade and current account deficit

The UK's current account balance – the trade balance plus the balance in income and transfers moving into and out of the UK – has deteriorated in recent years. In 2014, the current account deficit was £106 billion, equivalent to 5.9% of GDP. This is the highest since records began in 1948.

The main reason for the rise in the current account deficit is not the trade balance (the difference between exports and imports); the trade deficit is a relatively modest 2% of GDP. The reason for the widening current account deficit is that the return on foreign investments – in the form of profits, dividends and interest receipts/payments, known as the primary account – has fallen in recent years. The primary account ran a surplus every year between 2000 and 2011, peaking at 2.3% of GDP in 2005. It went into deficit in 2012 and the deficit had reached 2.5% of GDP by 2014.

**Current account and trade balance, % GDP**


Source: ONS

It is unclear whether this is a temporary change or a more permanent structural effect. In March, the OBR forecast that the current account deficit would fall to 2.3% of GDP in 2019. This is based on the assumption that the deterioration in the primary account is temporary. The OBR note that there is significant uncertainty about this.

# 2. The public finances

**Summary**

The budget deficit - the difference between what the public sector spends and receives in taxes and other revenues - is forecast to be £75 billion in 2015/16. During the last Parliament the deficit, as measured by public sector net borrowing, fell from £154 billion in 2009/10 to £89 billion in 2014/15.

As a result of the financial crisis, public sector net debt - the stock of borrowing – rose from just under 40% of GDP in 2007/08 to over 80% of GDP in 2014/15. The Office for Budget Responsibility (OBR) forecast the debt to GDP ratio to fall, albeit slightly, in 2015/16, and continue to do so over the forecast period.

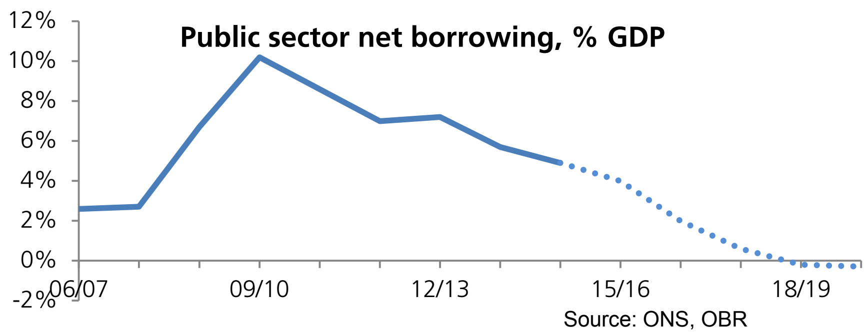
The Budget will present updated plans for public spending and a new set of OBR forecasts for the public finances up to 2020/21.

Alongside the Budget, the Chancellor is set to reveal more about how he plans to ensure UK governments do not borrow during 'normal economic times'. The new budget surplus rule is likely to be set out in a revision to the UK's fiscal framework contained within the Charter for Budget Responsibility.

## 2.1 Public sector net borrowing

Public sector net borrowing is the difference between the government's spending and its revenues. Borrowing has fallen considerably since the very high levels it reached during the financial crisis. Borrowing was £154 billion in 2009/10. It fell to £89 billion last year.[26]

In March 2015, based on the Coalition Government's plans, the OBR forecast borrowing to fall until a small surplus is reached in 2018/19. At this point public sector revenues will exceed spending for the first time since 2000/01. The Conservative Party's manifesto for the 2015 General Election broadly endorsed the Coalition's deficit reduction plan.[27]

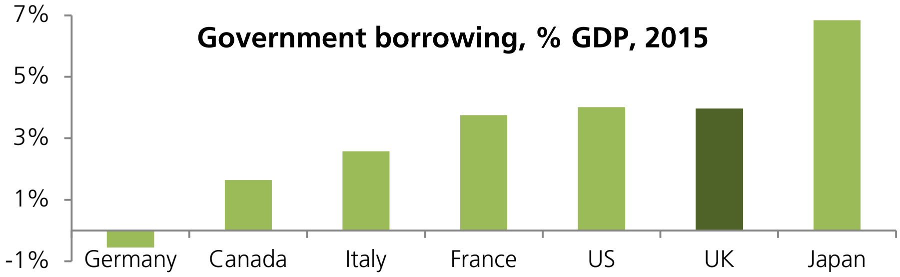



### International comparisons

Despite the fall in UK government borrowing over recent years, it remains high by international standards. The OECD forecast that borrowing in the UK will be 4% of GDP in 2015, similar to that of

[26] These figures are in nominal terms. Borrowing as a share of GDP is shown in the chart.
[27] The Conservative Party Manifesto 2015

France and the US, but higher than in Italy, Canada or Germany. Amongst G7 countries only Japan is expected to have significantly higher borrowing than the UK.[28]




## 2.2 Structural borrowing

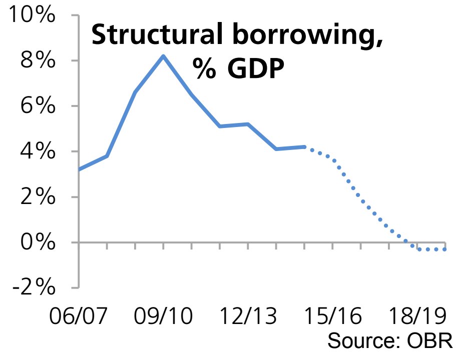
A distinction is often drawn between the "cyclical" and "structural" elements of government borrowing:

- 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 benefits 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 are the underlying or persistent part of government borrowing which are unrelated to the economic cycle. The structural deficit is measured by cyclically-adjusted measures of borrowing.[29]

Adjusting borrowing for the position in the economic cycle gives an estimate of underlying or '**structural borrowing**'. Put another way, structural borrowing is the level of borrowing we would expect to see if the economy was running at full potential.

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 measured by the OBR through the output gap. This is particularly difficult 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.

The structural deficit is estimated to have been around 3-4% of GDP immediately before the financial crisis. It increased to just over 8% of GDP in 2009/10. The OBR forecasts structural borrowing of 3.7% of GDP in 2015/16.




The difference between the actual level of economic output and what could be achieved if the economy were operating at full potential is known as the '**output gap**'. A negative output gap suggests that the economy is operating below its potential level and has idle resources. A positive output gap suggests that the economy is operating above potential or overheating.

[28] OECD. Economic Outlook Annex Tables, June 2015

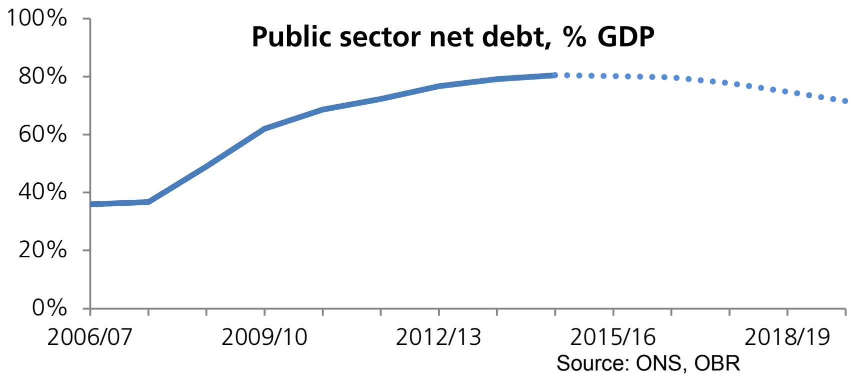
[29] There are various cyclically adjusted measures of borrowing. The figures in this section are for cyclically-adjusted net borrowing.

Decreases in subsequent years will, according to the OBR, see the structural deficit reach surplus in 2018/19.

## 2.3 Public sector net debt

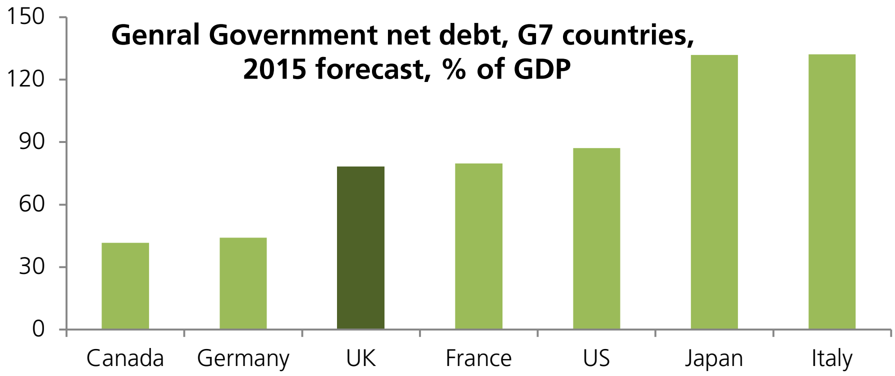
Public sector net debt is the overall level of government indebtedness, built up over many years. Broadly speaking, the deficit determines the path of debt as public sector net debt is the accumulated level of government borrowing.

Before the financial crisis, public sector net debt was around 36-37% of GDP. As a result of the crisis, debt increased sharply reaching 80.5% of GDP at the end of 2014/15. In March 2015 the OBR forecast that the debt to GDP ratio will begin to fall in 2015/16.




### International comparisons

Compared with the other G7 countries, the forecast level of UK government debt is similar to the US and France, well below Italy and Japan but well above Canada and Germany.[30]



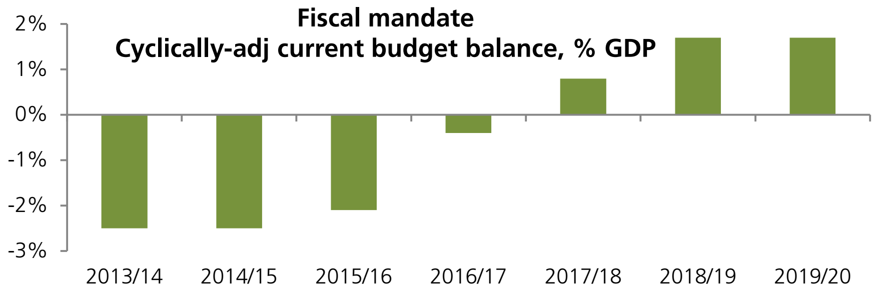

## 2.4 The fiscal rules

The OBR measures performance against the government's fiscal rules. The Coalition Government revised its fiscal rules in December 2014.[31] The fiscal mandate now requires the cyclically-adjusted current budget to be balanced by the third year of the forecast period.[32]

[30] OECD. Economic Outlook Annex Tables, June 2015
[31] An update to the Charter for Budget Responsibility was published and laid before Parliament in December 2014. It was approved by the House on 13 January 2015
[32] HM Treasury. Charter for Budget Responsibility: Autumn Statement 2014 update, December 2014

The current balance is the difference between government revenue and current, rather than capital, expenditure. Focusing on the current budget therefore protects public sector investment. The rule uses a measure of the budget balance, adjusted for the economic cycle. This allows flexibility to run a deficit during recessions and a surplus during booms.

In the March 2015 Budget the OBR forecast the Coalition Government to be on course to meet the mandate – a surplus of 0.8% of GDP was forecast for the cyclically-adjusted budget in 2017/18.




Note: negative figures indicate deficit, positive indicate surplus. Source: OBR

Along with the fiscal mandate, the Coalition Government updated the supplementary debt rule in December 2014. The revised debt rule requires the debt to GDP ratio to fall in 2016/17 – the previous debt rule required this to happen in 2015/16. In March, the OBR forecast that the current debt rule will be met – in fact the forecast suggests that the original debt rule would have been met: that is, the debt to GDP ratio is forecast to fall in 2015/16.

**Box 4: Welfare Cap**

The Welfare Cap was introduced in Budget 2014 and limits the amount that can be spent by Government on certain social security benefits.

Currently the cap covers around 55% of welfare spending, excluding pensions and Jobseekers Allowance payments, but including tax credits, child benefit and disability benefit.

In the first Budget of each Parliament, the Government is required to state what will be within the scope of the Cap, and what the Cap level will be for the forthcoming five years.

Performance against this is then assessed by the OBR, which reports in each Autumn Statement whether or not relevant welfare spending has met or exceeded the level of the Cap

Note that the Welfare Cap is not to be confused with the *Household Benefit Cap* (introduced in 2013) which limits the amount of benefits that a household can receive.

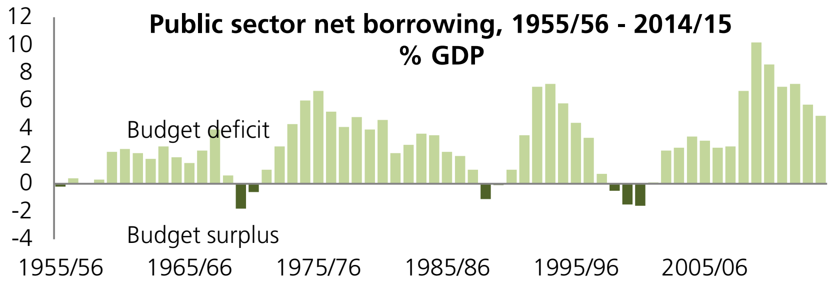
## 2.5 Budget surplus: A further rule?

A budget surplus is achieved when the public sector spends less than it receives from taxes and other receipts.

In its manifesto for the 2015 General Election, the Conservative Party stated that it would introduce the principle that UK governments should always run a budget surplus in 'normal economic times'. The OBR would monitor the principle.[33]

Following the election, the Chancellor returned to the budget surplus in his annual Mansion House speech.[34] He said that the new rule will be added to the UK's fiscal framework, as set out in the Charter for Budget Responsibility, at the time of the Budget. The Chancellor said that running a budget surplus will 'bear down on debt and prepare for an uncertain future'.

A presumption of budget surplus would be a break from recent tradition in the UK: over the past six decades budget deficits have been the norm. Since 1955/56 the UK's public sector budget has been in surplus in only eight years; the last surplus was recorded in 2000/01. OBR forecasts suggest that the UK is set to return to surplus in 2018/19.



source: ONS. Public Sector Finances

### How might the rule work?

The Chancellor offered more clues as to how the rule may work in a pre-election speech to the Royal Economic Society.[35] The Government will define what constitutes 'normal times' – potentially based on a rate of economic growth or an assessment of whether the economy is operating close to full capacity, as measured by the output gap. The OBR will assess whether the economy is outside of 'normal times'.

As Robert Chote, Chairman of the OBR point outs, defining 'normal times' is not straightforward. No one can estimate the output gap or what the sustainable growth rate of the economy is with total confidence.[36]

33 The Conservative Party Manifesto 2015, page 9
34 Annual Mansion House speech by Chancellor of the Exchequer, RT Hon George Osborne MP, 10 June 2015
35 Speech by Chancellor of the Exchequer to the Royal Economic Society, 14 January 2015, 10 June 2015
36 Robert Chote Chairman of the OBR, speaking notes for fiscal sustainability and welfare trends report 2015, 11 June 2015.

The new rule may not spell the end for the forward looking fiscal mandate (see section 5.4): an intermediate goal, much like the fiscal mandate, would run alongside the budget surplus rule.[37]

The budget is still some way off surplus: a deficit of £75 billion is forecast for 2015/16. How the budget surplus rule will be introduced against this backdrop is not yet clear.

## Opinion

The Chancellor believes that the current level of UK public sector debt is too high and running a budget surplus is the only reliable way to reduce it. High levels of debt are too risky, he argues, and damaging for the UK: they leave the UK vulnerable to future economic shocks and squeeze out other public spending through debt interest payments.[38]

Some commentators have pointed out that the UK can run deficits and allow the ratio of debt to GDP drift down over time. They argue that the value of debt can be eroded over time through economic growth and inflation, as has happened in the past.[39] The Chancellor does not accept this argument, stating that the only reliable way to achieve a fall in debt is to run a budget surplus, particularly when faced with low inflation.

Robert Chote has said that the rule is a "more ambitious goal than governments have in practice achieved over recent decades". He points out that over the last forty years, when a budget surplus was achieved the economy was running above its sustainable level in at least half of the years.[40]

Eventually, argue some, the budget surplus rule will be added to the list of fiscal rules that have come and gone in the past.[41] More direct criticisms of the rule include that it may make governments inflexible to changing economic circumstances and that borrowing will increase amongst households, consumers and business to bring balance.[42] Some

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37 Speech by Chancellor of the Exchequer to the Royal Economic Society, 14 January 2015, 10 June 2015

38 ibid

39 For instance see: IFS Observation How much is too much borrowing? June 2015; Editorial, 'The Guardian view on George Osborne's fiscal surplus law: the Micawber delusion', *The Guardian*, 11 June 2015; Martin Sandbu, 'Free Lunch: Getting fiscal policy right', Financial Times, 19 June 2015

40 Robert Chote Chairman of the OBR, speaking notes for fiscal sustainability and welfare trends report 2015, 11 June 2015.

41 For instance see: Martin Sandbu, 'Free Lunch: Getting fiscal policy right', Financial Times, 19 June 2015; Chris Giles 'Osborne is wearing the wrong hair shirt, Financial Times, 19 June 2015; Editorial 'Of fiscal follies: The Chancellor's overreaching plan to abolish budget deficits fails the first test of common sense', Independent, 10 June 2015

42 Phillip Inman, 'Academics attack George Osborne budget surplus proposal', The Guardian, 15 June 2015; Martin Sandbu, 'Free Lunch: Getting fiscal policy right', *Financial Times*, 19 June 2015; Editorial 'Of fiscal follies: The Chancellor's overreaching plan to abolish budget deficits fails the first test of common sense', *Independent*, 10 June 2015; Jeremy Warner, Somewhere over the rainbow there may be something called a budget surplus, *Daily Telegraph*, 10 June 2015

argue that the rule should allow borrowing for investment. Such an approach would target a surplus in the current budget.[43]

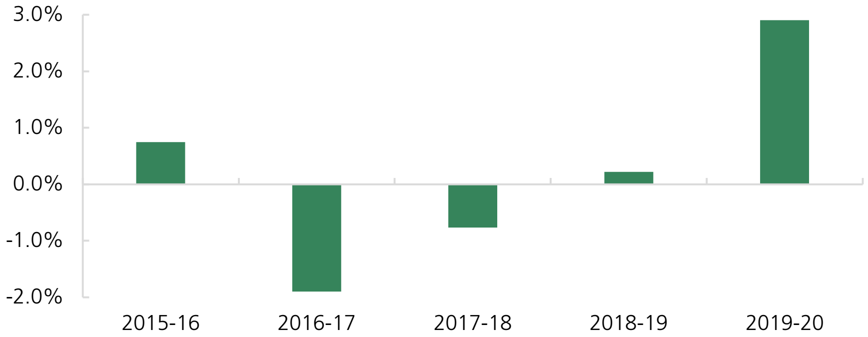
[43] Martin Sandbu, 'Free Lunch: Getting fiscal policy right', *Financial Times*, 19 June 2015; Martin Wolf, 'Osborne is mistaken to apply Victorian values to fiscal policy,' *Financial Times*, 12 June 2015

# 3. Public spending

The July Budget will outline the overall path for public spending over the 2015 to 2020 Parliament. Detail on how the changes to spending will be apportioned between departments will be announced in the Spending Review which is expected in autumn 2015.

In the March 2015 Budget, the Coalition Government set out its spending plans to 2019/20.

**Current spending, March 2015 Budget plans**
*Real terms annual % change*




These plans showed day-to-day spending falling until 2017/18 before rising in 2018/19 and 2019/20. The Office for Budget Responsibility described this pattern of spending as a "rollercoaster profile", with falls in current spending during the early years of the Parliament, followed by rises later on.[44]

The plan set out in the Conservative Partly manifesto broadly follows this pattern, with £25 billion spending reductions planned by 2017/18, and spending rising initially in line with inflation and then in line with GDP in the years after that, if a budget surplus has been achieved.[45]

## 3.1 Spending reductions for 2015/16 already announced

The Government is committed to reducing spending by £25 billion by 2017/18, as stated in the Conservative Party manifesto and re-stated by the Chancellor in his remarks opening the Queen's Speech debate on the economy.[46]

These spending reductions will be divided so that £12 billion will come from reductions in welfare spending (see section 5), and the remaining £13 billion will come from reductions in departmental spending.

[44] OBR, *Economic and Fiscal Outlook*, March 2015, p 5
[45] Conservative Party, *2015 Manifesto*, April 2015, pp 8,9
[46] HC Deb 04 June 2015 c803

On the 4th June 2015, the Chancellor announced that £3 billion (or 23%) of the departmental savings would occur "in-year": that is, departmental budgets for 2015/16 would be reduced by £3 billion.[47] The Treasury have published details of the reductions by department, as set out in the following table.

**In-year departmental spending reductions for 2015/16**
*Announced 4th June 2015*

| Department | Spending reduction (£ millions) |
|---|---|
| Transport | 545 |
| Defence | 500 |
| Education non-schools | 450 |
| Business, Innovation and Skills | 450 |
| Justice | 249 |
| CLG Communities | 230 |
| Department of Health non NHS | 200 |
| Work and Pensions | 105 |
| Environment, Food and Rural Affairs | 83 |
| HM Revenue and Customs | 80 |
| Energy and Climate Change | 70 |
| Home Office | 30 |
| Culture, Media and Sport | 30 |
| Foreign and Commonwealth Office | 20 |
| Cabinet Office | 17 |
| HM Treasury | 7 |
| Total | 3,066 |

Source: HM Treasury Press release, *Chancellor announces measures to bring down debt,* 5 June 2015

Further details of some of the spending reductions have been published, notably in articles from the Financial Times[48] and the Guardian[49]:

- **Transport (£545 million reduction)** – Around £345 million of this will come from selling land around Kings Cross that is currently owned by the Ministry of Transport. The majority of the remainder will mainly come from reducing the departmental contingency fund by £124 million. Transport for London's budget will be reduced by £30 million, and funding originally planned for cycling will be reduced by £24 million.
- **Defence (£500 million reduction)** – Military operations and spending on equipment are excluded from this reduction, with savings coming from civilian budgets.
- **Education (£450 million reduction)** – Pre-election pledges by the Prime Minister to protect schools spending mean that any reduction in the Department for Education budget will be focused on pre-school spending, and post-16 schooling. The central Department has also announced some efficiency savings.
- **Business Innovation and Skills (£450 million reduction)** – Reductions are expected to focus on the Further Education budget.

[47] HM Treasury Press release, *Chancellor announces measures to bring down debt*, 5 June 2015
[48] Financial Times, *Osborne to speed cuts for smoother 'rollercoaster' deficit plan*, 4 June 2015
[49] Guardian, *Osborne's £4.5 billion savings plan: what's being cut?* 4 June 2015

- **Justice (£249 million reduction)** – Some reductions are due to come from an underspend in legal aid, and a reduction in capital spending on prisons.
- **Communities and Local Government (£230 million reduction)** – The majority of this will be the result of a reallocation of public health funds originally assigned from the Department of Health to the Department for Communities and Local Government (DCLG). The remainder will also come from the central department in the form of efficiency savings and some land sales.

Departmental spending limits for years after the current financial year (2015/16) will be announced in the Comprehensive Spending Review, expect.

# 4. Taxation

## 4.1 Personal allowance

### Approach of the Coalition Government

In May 2010, the new Coalition Government announced that in its first Budget it would introduce a substantial increase in the personal tax allowance, a first step to its longer-term objective to raise the allowance to £10,000.[50] All taxpayers are eligible for this tax-free allowance – which represents the amount of income someone may earn before paying any income tax. The allowance was set at £6,475 for 2010/11, and in his Budget speech on 22 June 2010, the Chancellor, George Osborne, confirmed that it would rise to £7,475 from April 2011, at a cost of £3.5 billion in 2011/12.

At this time Mr Osborne stated that the allowance would continue to rise "during the rest of this Parliament."[51] In turn, the allowance went up by £630 for 2012/13, by £1,135 for 2013/14, and by £560 to reach £10,000 from April 2014. It is estimated that by 2014/15 these successive increases in the personal allowance resulted in 2.7 million people not having to pay tax on their income, at an annual cost of around £10.7 billion.[52] By comparison the Coalition Government's decision in its first Budget to increase the standard rate of VAT to 20% was estimated to raise about £13.5 billion in the same year.[53]

Individuals of working age are liable to pay National Insurance contributions (NICs) on their earnings as well as income tax. In the past the point at which individuals start to pay NICs has been aligned with the point at which they start to pay income tax. However, this threshold has not been increased in line with the rise in the personal allowance, so that one section of those individuals 'lifted out' of income tax will still be paying NICs.[54]

In his 2014 Budget the Chancellor announced a further £500 rise in the allowance from April 2015. Subsequently in his Autumn Statement in December 2014 Mr Osborne announced that the allowance would be set at £10,600 for 2015/16. In previous years most, if not all, of the potential benefit for higher rate taxpayers has been 'clawed back' by cutting the higher rate threshold – the level above which individuals start to pay the 40% rate on their income. In his 2014 Budget Mr Osborne had proposed that this threshold – the sum of the personal allowance and the basic rate limit – would rise by 1% for 2014/15, and

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50 HMG, *The Coalition: our programme for government*, 20 May 2010 p30
51 *Budget 2010*, HC 61 June 2010 p40 (Table 2.1 – item 12); HC Deb 22 June 2010 c179
52 *Budget 2013*, HC 1033, March 2013 para 1.166-71; The Institute for Fiscal Studies Green Budget, February 2014 p151.
53 *Budget 2010*, HC 61 June 2010 (Table 2.1 – item 1).
54 The Institute for Fiscal Studies estimated that 1.0 million individuals would pay NICs but not income tax in 2013/14 (*IFS Green Budget 2013*, February 2013 p190)

by 1% for 2015/16. As a consequence most higher rate taxpayers would receive a tax cut of an equivalent size to basic rate taxpayers.[55]

However, in his 2014 Autumn Statement the Chancellor announced that the threshold would rise by 1.2% for 2015/16 – in line with inflation – so that the full gains of the last increase in the personal allowance would be passed on to higher rate taxpayers. Overall it was estimated that 3.4m working age individuals would have been taken out of income tax over the Parliament. The tax saving over this period was estimated to be £825 for a typical basic rate taxpayer, and £676 to a typical higher rate taxpayer, in cash terms.[56]

Finally, in his 2015 Budget Mr Osborne proposed that the allowance would be increased by £200 for both 2016/17 and 2017/18, with increases in the basic rate limit in both years to ensure the full gain of these increases was passed on to higher rate taxpayers.[57]

Over this period the Coalition Government's approach to increasing the personal allowance was generally welcomed, although critics have pointed out that many households to have benefited from these tax cuts have been adversely affected by other tax changes – such as the increase in the standard rate of VAT – as well as reforms to tax credits and social security benefits.[58] It has also been pointed out that further increases in the allowance will not benefit those on the lowest incomes at all, and that there is a case to increase the employee NICs threshold instead.[59] Finally, there has been some debate about this approach to reducing the tax paid by those on lower incomes, in comparison with the proposal by the then Labour leader, Ed Miliband, first made in early 2013, that, rather than amending income tax allowances or thresholds, a Labour Government would introduce a 10p starting rate of tax.[60]

## Recent developments

In its manifesto for the 2015 General Election the Conservative Party stated that in government it would continue to increase the personal tax allowance so that it reached £12,500 by 2020, and to pass legislation to permanently align the allowance with the National Minimum Wage:

> Over the last five years, we have cut people's taxes wherever possible. We have raised the tax-free Personal Allowance to £10,600 from £6,475: over 26 million people are now keeping more of their hard-earned money and 3 million of the lowest paid are paying no Income Tax at all …

[55] HC Deb 19 March 2014 c792

[56] *Autumn Statement*, Cm 8961, December 2014 para 1.216

[57] The personal allowance will be £10,800 in 2016/17, and £11,000 in 2017/18. The higher-rate threshold will be £42,700 and £43,000 in these years. (*Budget 2015*, HC 1093, March 2015 p54).

[58] For example, see the exchange of views when provision for the allowance in 2011/12 was debated at the Committee stage of the Finance Bill in May 2011 (Public Bill Committee (Finance Bill), *Second sitting*, 10 May 2011 cc50-56).

[59] For example, "Chapter 7: Policies to help the low paid", *The IFS Green Budget*, February 2014

[60] Labour Party press notice, *Speech by Ed Miliband : Rebuilding Britain with a One Nation economy*, 14 February 2013. For a longer history see, See also, *Income tax : increases in the personal allowance (2010-2015)*, Commons Briefing Paper 6569, 17 June 2015

> A Conservative Government will not increase the rates of VAT, Income Tax or National Insurance in the next Parliament. Instead, we will ease the burden of taxation by raising the tax-free Personal Allowance – the amount you can earn before you start paying tax – to £12,500.
>
> This will cut Income Tax for 30 million people and take everyone who earns less than £12,500 out of Income Tax altogether. That means by the end of the decade, one million more people on the lowest wages will be lifted out of Income Tax, and people who work for 30 hours a week on the increased National Minimum Wage will no longer pay any Income Tax at all.
>
> We will pass a new law so that the Personal Allowance automatically rises in line with the National Minimum Wage. The new Tax Free Minimum Wage law will be applied from the first Budget after the General Election. The change will update the 1977 'Rooker-Wise' amendment which forced governments to uprate tax thresholds in line with inflation, meaning the Personal Allowance will now increase more quickly.[61]

Following the Election, the new Conservative Government confirmed these plans in the Queen's speech. The Cabinet Office's Briefing Notes, published alongside the Speech, noted, "Legislation will be brought forward to ensure people working 30 hours a week on the National Minimum Wage do not pay income tax … The Government has a commitment to raise the personal allowance to £12,500. This will go further and ensure that in the future, individuals working 30 hours at the national minimum wage will not pay income tax."[62]

At present the NMW is £6.50; someone working 30 hours a week would earn £195. The Conservative Manifesto said, "we accept the recommendations of the Low Pay Commission that the National Minimum Wage should rise to £6.70 this autumn, on course for a Minimum Wage that will be over £8 by the end of the decade."[63] If the NMW was £8 in 2020, someone working 30 hours a week would earning £240 a week. If the personal allowance were set at £12,500 in 2020/21, this would be equivalent to £240 pw.

This commitment, and its impact across the income distribution, was discussed in the Institute for Fiscal Studies' assessment of the parties' tax and spending plans, published during the Election; part of this is reproduced below:

> The proposed increase in the personal allowance would ensure that an individual working for 30 hours a week at the National Minimum Wage in 2020–21 would not pay income tax on their earnings. (This assumes a National Minimum Wage of £8 an hour in April 2020: the Conservative manifesto says that the National Minimum Wage is 'on course' to reach this level by this point.) That is in fact also true now.
>
> After 2020–21, the Conservatives have said they would increase the personal allowance in line with the National Minimum Wage rather than CPI inflation as at present (they would pass a 'Tax Free Minimum Wage law' to change the default for increasing the

61 Conservative Party, *2015 General Election Manifesto*, April 2015 pp25-7
62 Cabinet Office, the Queen's Speech 2015 Briefing Notes, May 2015 p21
63 Conservative Party, *2015 General Election Manifesto*, April 2015 pp19-21

> personal allowance), increasing the cost of the policy over time. Linking increases in the personal allowance to increases in the minimum wage might be justified by a desire to ensure that fiscal drag does not increase the number of income tax payers over time or that those earning the minimum wage do not pay income tax (though only if they do not work for more than 30 hours per week and do not have any taxable income from other sources). It is to be hoped that such a rule would not lead to government rejecting proposed increases to the minimum wage on the grounds that to do so would be expensive in terms of lost tax revenue.
>
> More importantly, those working for 30 hours per week at the National Minimum Wage would still be paying National Insurance contributions (which effectively act as a second income tax on earned income). It is curious that the coalition has introduced significant real increases in the personal allowance but has not announced any increases in the primary threshold (the point at which employee NICs start to be payable), despite this being significantly lower than the personal allowance at £155 per week or £8,060 a year for full-year workers.
>
> Increasing the primary threshold would help more low earners – both those who work for the full year and earn between £8,060 and £10,600, and those who work for part of the year but whose incomes are less than £10,600 for the whole year. It would also do more to strengthen work incentives: since NICs only apply to earned income, the tax cut on earned income would be larger for a given exchequer cost. The ongoing emphasis on income tax and neglect of NICs highlights the absurdity of continuing to have two similar but separate taxes given that National Insurance is not a true social insurance scheme.[64]

## 4.2 The Tax Lock

In its 2015 General Election manifesto the Conservative Party also stated that, in government, it would "not increase the rates of VAT, Income Tax or National Insurance in the next Parliament."[65] In a speech the Conservative leader David Cameron confirmed that this 'tax lock' also meant that there would not be any extension to the scope of VAT, or an increase in the ceiling to NICs.[66] In its manifesto the Labour Party stated in government it would "not increase the basic or higher rates of Income Tax or National Insurance. Nor will we raise VAT", though it would reverse the Coalition Government's decision to cut the additional rate of income tax from 50p to 45p.[67]

In its analysis of the parties' tax and spending proposals the IFS noted that these commitments did not discount increases in these taxes through other measures:

> The Conservatives' manifesto … contains a number of pledges not to raise certain taxes or cut certain pensioner benefits. They have pledged not to increase the rates of income tax, National

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64 *Taxes and Benefits: The Parties' Plans - IFS Briefing Note BN172*, April 2015 pp13-15. For a longer discussion of the case for merging the two taxes see, *National Insurance contributions: an introduction*, CBP 4517, 10 June 2014.

65 Conservative Party, *The Conservative Party Manifesto*, April 2015 p27

66 "Cameron pledges to ban tax rises until 2020", *Financial Times*, 29 April 2015. Mr Cameron also publicised this commitment on Twitter.

67 Labour Party, *2015 General Election Manifesto*, April 2015 p18, p27

> Insurance contributions (NICs) or value added tax (VAT) during the next parliament. Note, however, that this does not rule out raising revenue from these taxes in other ways …
>
> Like the Conservative Party, Labour has pledged *not* to implement certain kinds of tax rises or certain kinds of cuts to pensioner benefits. In particular, their manifesto rules out increases to the basic and higher rates of income tax or rates of National Insurance; and it rules out increasing rates of VAT, as well as extending the VAT base to include food, children's clothes, books, newspapers or public transport fares. This does not rule out raising more revenue from these taxes in other ways: they could, for example, change income tax or National Insurance thresholds, or implement further restrictions to income tax relief on pension contributions. These could affect many of the same people, via the same tax, as the hypothetical tax rises that they have ruled out.[68]

Writing in the *Financial Times*, the paper's economics editor, Chris Giles, argued that such pledges were "positively dangerous":

> Britain's income tax already bears the hallmarks of commitments not to increase the main rates. Labour and Tory-led governments since 2000 have complicated the levy, introducing higher rates over large slices of income, necessary to remove the financial benefits of child benefit and the personal allowance from richer people.
>
> Income taxation is further complicated by national insurance, an income tax in all but name, from which pensioners are exempt and which uses a different definition of income: all of which encourages the tax avoidance industry that politicians say they abhor. When individuals arrange their affairs quite legitimately to avoid taxation, it is no surprise productivity suffers as they waste time minimising tax bills rather than doing something more productive.[69]

In the Queen's speech the Government confirmed that legislation would be brought forward to ensure "there are no rises in income tax rates, value-added tax or National Insurance for the next five years." The Cabinet Office's Briefing Notes provide this commentary (p21):

> The purpose of the legislation is to:
>
> - Ensure there are no rises in income tax rates, VAT rates or National Insurance contributions (NICs) rates for individuals, employees and employers.
> - Ensure that the NICs upper earnings limit (the point at which the Employee NICs rate reduces to 2%) is no higher than the income tax higher rate threshold (the point at which income tax increases to 40%).
> - Ensure there will be no extension of the scope of VAT.

To date no further details have been published.

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68 *Taxes and Benefits: The Parties' Plans - IFS Briefing Note BN172*, April 2015 p12, p29. See also, "Triple tax lock puts other revenue sources in spotlight", *Financial Times*, 28 May 2015.

69 "The battle for Britain's most reckless tax pledge", *Financial Times*, 8 April 2015; see also, "Cameron's pledges unwise or costly or both, says Lawson", *Financial Times*, 29 April 2015

## 4.3 Inheritance tax

Inheritance tax (IHT) is levied on the value of a person's estate at the time of their death. The tax is charged at 40% above the tax-free threshold, which is £325,000 for 2015/16. In 2013/14 the tax raised £3.4 billion; receipts are forecast to be £4.2 billion in 2015/16.[70] It is estimated that the tax was paid on 28,000 estates in 2013/14, representing 4.9% of all deaths.[71]

HM Revenue & Customs (HMRC) publishes estimates of the number of taxpayers across all national taxes. Provisional figures for the number of estates to be liable to pay IHT at death are 22,000 in 2012/13, rising to 35,000 in 2014/15.[72]

HMRC publish data relating to the composition of estates, the use of reliefs and the tax due on estates. These figures are subject to some delay.[73] The most recent figures are for 2011/12, published in July 2014.[74]

When calculating the taxable value of a person's estate, transfers made out of someone's estate within seven years of their death are included. There are some gifts which one can make in the last seven years of one's life which do not attract tax. In addition certain gifts are exempt from tax irrespective of their size, and irrespective of whether they are made during one's life, or made under the terms of one's will.[75]

From the late 1990s there was a steady growth in receipts from inheritance tax and the numbers of estates liable to pay it, strongly linked with the growth in house prices. By the middle years of the decade commentators were predicting that very many more families would have to make provision to pay for the tax in future, though even at this point, at the peak of the UK housing market, only 6% of all estates at death were liable for IHT. In 2007 the Labour Government responded to these concerns by introducing a new transferable allowance for spouses and civil partners. The cost of the new relief was considerable – about £1 billion in 2008/09 – though less than the Conservative Opposition's proposal for a new £1m tax-free threshold – which, at the time, was estimated to cost £3.1 billion. By comparison, total receipts from the tax in 2007/08 were £3.8 billion.[76]

Subsequently receipts from this tax dropped quite sharply, with the onset of the recession and the associated slump in house prices. In

70 OBR, *Economic & Fiscal Outlook*, Cm 9024, March 2015 (Table 4.5)
71 "Chapter 10: Options for increasing tax", *Green Budget*, Institute for Fiscal Studies, February 2015 p242
72 HMRC, *Statistics: Numbers of taxpayers and registered traders*, April 2015. The number of taxpaying estates at death last peaked in 2006/07 at 34,000.
73 There is a six month lag from date of death to when tax becomes due and subsequent time lags while the data from tax returns is prepared for analysis on HMRC's databases.
74 These are collated on Gov.uk.
75 For more details see, *Inheritance tax: reliefs*, Commons Briefing Paper SN573, 19 June 2015.
76 *Pre-Budget Report*, Cm 7227 October 2007 p164; HC Deb 23 April 2007 c987W; HMRC, *HMRC tax and NICs statistics*, June 2015 p4

addition public debate about the tax system has moved on, with relatively little attention being paid to IHT.

In its agreement published after the election, the Conservative-Liberal Democrat Coalition Government made a number of tax proposals including a 'substantial' increase in the income tax personal allowance from April 2011. The agreement went on to state that the new Government would "further increase the personal allowance to £10,000, making real terms steps each year towards meeting this as a longer-term policy objective", and that it would "prioritise this over other tax cuts, including cuts to Inheritance Tax."[77] The new Government's first Budget in June 2010 did not contain any proposals for reforming IHT, and over the five year Parliament the tax was left largely unchanged. In its 2011 Budget the Government announced that the tax-free threshold would be frozen at £325,000 until April 2015,[78] and in the 2013 Budget it confirmed that the threshold would remain frozen at this level until April 2018.[79]

Recently there has been more interest in the tax and speculation as to its possible reform.[80] In its manifesto for the 2015 General Election the Conservative Party stated that in government, "we will take the family home out of tax for all but the richest by increasing the effective Inheritance Tax threshold for married couples and civil partners to £1 million, with a new transferable main residence allowance of £175,000 per person."[81]

Some further details were reported in the press – for example, in the BBC's report of the announcement of this policy:

> If the Conservatives win the general election, then from April 2017 parents would each be offered a further £175,000 "family home allowance" to enable them to pass property on to children tax-free after their death.
>
> This could be added to the existing £325,000 inheritance tax threshold, bringing the total transferable tax-free allowance from both parents in a married couple or civil partnership to £1m. The full amount would be transferable even if one spouse had died before the policy came into effect, the Conservatives say, and so would benefit existing widows and widowers. For properties worth more than £2m, the new allowance would be gradually reduced so that those with homes worth more than £2.35m would not benefit at all.[82]

The Institute for Fiscal Studies gave an explanation of how the allowance would be tapered, in their assessment of the parties' manifesto proposals on tax and spending:

> This new allowance will be tapered away from those leaving more than £2 million, with the allowance reduced by 50p for every £1

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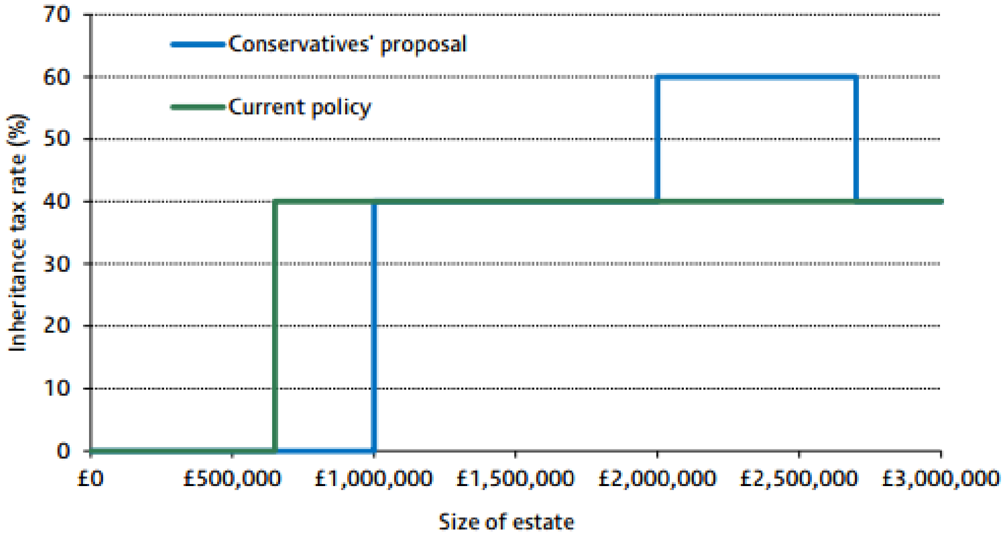
77 HM Government, *The Coalition: our programme for government*, 20 May 2010 p30
78 *Budget 2011*, HC 836 March 2011 para 2.58
79 *Budget 2013*, HC 1033 March 2013 para 2.76
80 For example, "Death to the death tax?", *IFS Observations*, Institute for Fiscal Studies, 4 April 2014; "House prices to push up death duty", *Financial Times*, 16 August 2014;
81 *The Conservative Party Manifesto 2015*, April 2015 p67
82 "*Election 2015: Tory inheritance tax plan 'about values'*"', *BBC News*, 12 April 2015

> of estate worth more than £2 million. This means that those leaving more than £2.7 million will not be able to benefit from the new allowance. This figure is for those who have two main residence allowances --- one from each partner in a marriage or civil partnership --- which would be worth up to £350,000. Since this is tapered at a rate of 50%, it means the allowance is exhausted at £700,000 above the £2 million point at which the new allowance starts to be tapered away. For those with a single allowance, the benefits will extend to those with estates worth up to £2.35 million.

The authors went on to express some scepticism over how desirable this approach was in relieving the burden of the tax – suggesting that a simpler and fairer alternative would be to increase the nil rate threshold from its current level (£325,000):

> Figure 2.3 shows the marginal rate of IHT faced by a widowed individual with a home worth at least £350,000 by the size of their total estate, before and after the change (assuming their estate is to be bequeathed to their children and/or grandchildren and that the individual received a full unused allowance on the death of their spouse).

Figure 2.3. Inheritance tax schedule for widowed individual with a main residence worth at least £350,000




Note: Assumes that the individual inherited a full unused IHT allowance from their deceased partner and that they wish to leave their main residence to their children and/or grandchildren.

> The new effective IHT rate of 60% that kicks in at £2 million is due to the tapering back of the new allowance. Why the IHT rate should go 0%, 40%, 60% and then return to 40% is difficult to justify. A preferable policy – in that it would have been much simpler and arguably fairer and would not have created the distortions listed above – would have been simply to increase the existing threshold from £325,000. [83]

To date the new Government have not published any details of how they will take this proposal forward.

[83] *Taxes and Benefits: The Parties' Plans - IFS Briefing Note BN172*, April 2015 pp18-20

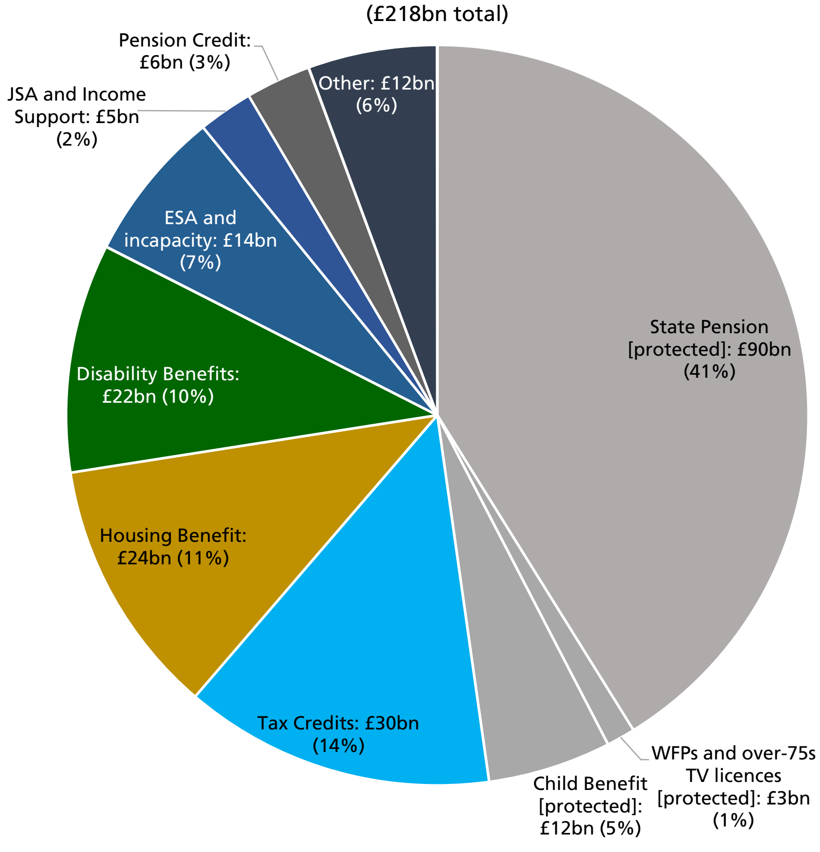
# 5. Additional welfare savings

The Conservative Party's election manifesto said that, over the next two years, it would "find £12 billion from welfare savings, on top of the £21 billion of savings delivered in [the 2010] Parliament."[84]

The IFS estimates that measures already announced – freezing most working-age benefits for two years, reducing the household benefits cap from £26,000 to £23,000, and removing Housing Benefit from under 21s on Jobseeker's Allowance – would save around £1.2 billion a year (with the benefits freeze accounting for £1.0 billion).[85] This leaves additional savings of around £10 billion in today's terms[86] from other, as yet unidentified measures.

**UK Benefit and tax credit expenditure, 2015/16**

(£218bn total)




Source: DWP Benefit expenditure and caseload tables; HMRC; OBR

Total expenditure on social security and tax credits is forecast to be £218 billion in 2015-16. The Government is committed to the State Pension "triple lock" and has also pledged to "maintain all current pensioner benefits including Winter Fuel Payments, free bus passes, free prescriptions and TV licences."[87] If Child Benefit also "stays as it is"[88]

84 Conservative Party, *2015 Manifesto*, April 2015, p8
85 Robert Joyce, *Benefit cuts: where might they come from?* IFS Observations, 26 May 2015
86 Assuming the target is £12 billion nominal savings by 2017-18
87 Conservative Party, *2015 Manifesto*, April 2015, p67. Winter Fuel Payments are however to be withdrawn from pensioners living in warmer EEA countries, as previously announced

for the duration of the Parliament, at least 48% of the total welfare budget would be protected.[89]

Total spending on "unprotected" areas of welfare is forecast to be £113 billion in 2015-16. The main elements are tax credits (£30 billion), followed by Housing Benefit (£24 billion), disability benefits (£22 billion) and incapacity benefits/ESA (£14 billion).

Media reports suggest that a number of options have been considered including further benefit freezes, limiting welfare benefits by family size, changes to Statutory Maternity Pay and industrial injuries benefits, restricting Carer's Allowance to those on Universal Credit, taxing disability benefits, cutting tax credits; and changes to Employment and Support Allowance, including abolishing the "Work-Related Activity Group" and a new test to replace the Work Capability Assessment.[90] To achieve the full £10 billion of savings, a combination of measures would almost certainly be necessary.[91]

Attention has focused on reports that the Government might reduce the per-child element of Child Tax Credit (CTC) to its original 2003-04 level (adjusted for inflation).[92] This would save around £5 billion, but low-income families would lose up to £845 a year per child. 4 million families receive CTC, of whom 2.7 million are in work.[93] Analysis by the Resolution Foundation suggests that almost two-thirds of the cut would be borne by the poorest 30% of households.[94] The IFS estimates that reducing the CTC child element to its original level would increase relative child poverty by about 300,000 (or 2.5 percentage points).[95]

Over half of all unprotected spending is on "legacy" benefits and tax credits which are to be replaced by Universal Credit (UC). Any reduction in spending on these benefits would presumably also feed through to UC.

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88 "David Cameron: child benefit safe with me for five years," *Telegraph*, 2 May 2015; HC Deb 3 June 2015 c581

89 It is not clear whether Pension Credit is one of the "pensioner benefits" to be maintained

90 See for example "Election 2015: Conservative benefit cut options leaked," BBC News, 28 March 2015; "Revealed: hitlist of welfare cuts facing Britain's next chancellor," *Guardian*, 5 May 2015; "Sickness benefit shake-up considered," BBC News, 2 July 2015

91 For detailed analysis of the options see James Browne and Andrew Hood, "Options for reducing spending on social security," in the *IFS Green Budget*, February 2015

92 "George Osborne considering £5bn cuts to child tax credits," BBC News, 11 June 2015

93 HMRC, *Personal tax credits: provisional statistics: April 201*5, p8

94 David Finch, *Assessing the proposal to cut £5 billion from Child Tax Credit*, Resolution Foundation, 14 June 2015

95 Robert Joyce, *Benefit cuts: where might they come from?* IFS Observations, 26 May 2015

# 6. Pensions

## 6.1 Introduction

The UK tax treatment of pensions follows an "exempt, exempt, taxed (EET) model":

- (Exempt). Pension contributions by individuals and employers receive tax relief and employer contributions are exempt from national insurance contributions. The main limits on the amount of tax-relieved pension saving an individual can build up are the annual and lifetime allowances.[96]
- (Exempt). No tax is charged on investment growth from pension contributions; and
- (Taxed). Pensions in payment are taxed as other income, but individuals are able to take up to 25% of their pension fund as a lump sum on retirement.[97]

The main pension tax legislation is set out in Part 4 of the *Finance Act 2004*. This provides for the tax treatment of payments into and out of pension schemes. Payments made outside the rules ('unauthorised payments') attract additional tax charges. The payments that can actually be made in a particular case will depend on pension scheme rules.

**Box 5: Two main types of pension scheme**

**Defined contribution (DC)** schemes in which people build up a pension fund using contributions, investment returns and tax relief. The amount of a person's fund will depend upon the level of contributions paid and investment income achieved.

**Defined benefit (DB)** schemes promise to pay pension benefits based on fixed factors, typically salary and length of service.

## 6.2 Pension flexibilities

April 2015 saw the introduction of major reforms, giving people with DC pension savings much greater choice about when and how they draw on them. Further developments expected in this area may include: the launch of a consultation on barriers to accessing savings flexibly and; a response to a consultation launched by the previous government on proposals to allow existing annuity holders to sell their income to a third party.

### Legislation

Prior to the March 2014 Budget, three-quarters of people with DC pension savings used them to purchase an annuity, with an average-

96 See HC Library Briefing Paper SN05901 *Restricting pension tax relief* (18 March 2015).

97 HM Treasury, Removing the requirement to annuitise by age 75, July 2010, para 2.3; Bill 97-EN, page 2

sized pension pot of £35,600.[98] This was strongly encouraged by pension tax legislation, which applied a 55% tax charge on lump sum withdrawals except in limited circumstances.[99]

In Budget 2014, the Government announced that from 6 April 2015 it would allow people aged 55 and over more flexibility about when and how to draw their DC pension savings, and allow them to do so at their marginal rate of income tax, rather than the 55% rate.[100] Accordingly, the *Taxation of Pensions Act 2014* enabled individuals to do one, or a combination of, the following:

- Take their pension savings as cash (in one or more lump sums) – an uncrystallised funds pension lump sum or (UFPLS);
- Buy an annuity;
- Designate funds to a flexible drawdown arrangement, from which they can make withdrawals while leaving the rest invested[101]

In the case of a lifetime annuity or flexi-access drawdown, there will normally be the option of a 25% tax-free lump sum at the time of taking the pension. For UFPLS, 25% of each withdrawal will be tax free. Other than this, withdrawals will be taxed at the individual's marginal rate.[102] To help people navigate the expanded range of options available, a guidance service – Pension Wise – has been established.[103]

## In practice

The legislation enables providers to make flexible payments.[104] It does not require them to do so.[105] If a provider does not offer a particular option, an individual has the right to move to a scheme which does.[106]

On 16 June 2015, the Chancellor of the Exchequer described the reforms as a 'real success'. Some 60,000 people have made use of the new flexibilities, transferring £1 billion out of their funds.[107] However, the Government has also expressed frustration that "some firms still appear to be dragging their feet."[108] On 17 June 2015, the Chancellor said a consultation would be launched in July looking at: options to address any excessive exit penalties and at making the process for transferring from one scheme to another quicker and smoother.[109]

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98 HM Treasury, *Freedom and choice in pensions*, March 2014; ABI, *The UK Annuity Market: Facts and Figures*, February 2014
99 *Finance Act 2004*
100 HC Deb 19 March 2014 c793
101 *Taxation of Pensions Act 2014*, Schedule 1
102 *Taxation of Pensions Act 2014*, Schedule 1 (62); See Pension Wise – Tax you pay on your pension
103 *Pension Schemes Act 2015*, section 47 and Schedule 3
104 Taxation of Pensions Act 2014, Schedule 1, para 79. Explanatory Notes, para 179; For more detail, see HC Library Briefing RP 14-57 *Taxation of Pensions Bill* p47
105 HM Treasury, Freedom and choice in pensions, Cm 8835, March 2014, para 2.14 and Box 3.B
106 PQ 2224, 2228 and 2229 [pensions] 18 June 2015
107 HC Deb 16 June 2015 c179
108 Iain Duncan Smith: I'll make sure the pension freedoms work, *The Telegraph*, 13 June 2015
109 HC Deb 17 June 2015 c309-10; HM Treasury, Chancellor presses industry on pension freedoms, 17 June 2015

On 1 July 2015, the Financial Conduct Authority (FCA) said that in the first three months, many of the people looking to access their pensions flexibly had "smaller pots, typically under £50,000." Many had taken them as cash. [110] While evidence pointed to the "overall majority of consumers having been able to take advantage of the new flexibilities," the FCA was aware of some situations where this may not have been the case." It has asked providers for information on any barriers consumers may be experiencing.[111]

For more detail, see HC Library Briefing SN06891 Pension flexibilities (1 July 2015).

### Secondary annuities market

People who have already purchased an annuity do not currently have the option to exit from that arrangement. At present the purchase of a lifetime annuity is a one-off and generally irreversible purchase.[112] In its last Budget before the 2015 General Election, the Coalition Government proposed allowing people in receipt of an annuity to sell that income to a third party, subject to agreement from their annuity provider. This would allow them to "enjoy flexibility in how they access the value of their annuity, without interfering with binding contractual requirements."[113] A consultation - Creating a secondary annuity market -was launched on 18 March 2015, to run for twelve weeks. Initial responses revealed some support for the proposals but also concerns about whether such a market could work well for consumers.[114]

For more detail, see HC Library Briefing SN 6552 Pensions: annuities (29 June 2015), section 6.

## 6.3 Restricting tax relief to higher earners

Pension contributions made by individual employees are usually paid out of pre-salary, so tax relief is received at the individual's marginal tax rate. The main limits that apply are the lifetime allowance (LTA) and annual allowance (AA), which were introduced in April 2006 as part of the pension tax simplification regime.[115]

In Budget 2009, the Labour Government said that those on the highest incomes already benefitted disproportionately from tax relief on pension contributions and that this would be exacerbated by the introduction of a new additional tax rate for people with incomes over £150,000 from April 2010. It therefore proposed to restrict the tax relief on contributions to people with incomes over £150,000, with effect from

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110 The new pension flexibilities – update from the FCA, 1 July 2015
111 Ibid
112 FCA, *Retirement income market study: Interim Report*, Executive Summary.
113 HM Treasury, Budget 2015, HC 1093,18 March 2015, paras 1.229-31
114 See, for example, 'Annuity trade-in idea draws mixed reaction', *Financial Times,* 12 March 2015
115 *Finance Act 2004*, Part 4

April 2011.[116] However, representatives of the pension industry were concerned at the complexity of the proposed approach.[117]

In his first Budget speech on 22 June 2010, Chancellor of the Exchequer, George Osborne, announced that he would work with industry on alternatives ways of raising the same revenue.[118] The option chosen was to reduce the AA from £255,000 to £50,000 from April 2011 and the LTA from £1.8 to £1.5 million from April 2012.[119] From April 2014, there was a further reduction in the AA to £40,000 and the LTA to £1.25 million.[120]

However, calls for reform continued, partly fuelled by concerns that the current pension tax system is not effective in encouraging saving particularly among those most at risk of not saving enough for their retirement.[121]

In Budget 2015, the Chancellor announced that the LTA would reduce from £1.25 million to £1 million from 2016-17 and be indexed with inflation from 2018-19.[122] This would be provided for in future legislation.[123]

In its manifesto for the 2015 General Election, the Conservative Party proposed reducing the amount of tax relief on pension contributions for those earning more than £150,000.[124] It appears that the proposed mechanism may be to reduce the annual allowance for those earning more than a certain amount (ie. a different approach to that legislated for by the Labour Government in 2009/10).[125]

For more detail, see HC Library Briefing SN05901 Restricting tax relief to higher earners

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116 HM Treasury, Budget 2009, HC 407, 22 April 2009, para 5.91-2
117 See, for example, "Pension providers warn of unintended consequences," *Financial Times,* 23 April 2009
118 HM Treasury, Budget 2010, HC 61, June 2010, para 1.118
119 HM Treasury, Restricting pensions tax relief through existing allowances: a summary of the discussion document responses, October 2010, para 2.6 to 2.7; *Finance Act 2011,* s66 and 67 and Sch 17 and 18
120 HM Treasury, Annual Statement 2012, Cm 8480, December 2012; *Finance Act 2013,* chapter 4
121 See, for example, Michael Johnson, Retirement saving incentives, Centre for Policy Studies, April 2014
122 HM Treasury, Budget 2015, March 2014, para 1.232
123 HMRC's 'Overview of tax legislation and rates', March 2015, para 2.35
124 The Conservative Party Manifesto 2015
125 IFS, Taxes and Benefits: the Parties' Plans – IFS Briefing Note BN172, April 2015

# 7. What is the northern powerhouse?

The term was first used by the Chancellor George Osborne on 23 June 2014 in a speech at the Manchester Museum of Science and Industry. Pointing to long-standing regional disparities in the UK's economic output, the Chancellor argued "the cities of the north are individually strong, but collectively not strong enough….So the powerhouse of London dominates more and more", going on to say "we need a Northern Powerhouse too" comprised of "a collection of northern cities, sufficiently close to each other that combined they can take on the world." [126]

In subsequent speeches, the Chancellor clarified the idea and defined the three themes that would facilitate the creation of the northern powerhouse:

- investment in the transport network, to ensure greater road and rail connectivity between northern cities;
- investment in science and technology hubs to drive innovation and create high-value employment; and
- devolution of powers to northern cities to create "powerful city governments" accompanied by cultural investment to create strong civic identities.

While the term has not been specifically defined geographically, it is generally used to refer to the areas covered by the Liverpool City Region Combined Authority, Greater Manchester Combined Authority, West Yorkshire Combined Authority, Sheffield City Region Combined Authority, Humber Local Enterprise Partnership and the North East Combined Authority.

The 2014 Autumn Statement and March 2015 Budget both contained commitments to fund the northern powerhouse, including a "transformative package" of £6 billion worth of investment in the northern road network and expanded rail services, the expansion of Enterprise Zones and various investments in science and innovation hubs. There have also been devolution agreements covering the Greater Manchester Combined Authority, the West Yorkshire Combined Authority and the Sheffield City Region Combined Authority.

The Chancellor used his first speech after the election to announce plans for a new Cities Devolution Bill, a new form of City Deal to cover counties and towns as well as opening bids for the creation of new Enterprise Zones. The former Goldman Sachs chief economist Jim O'Neill has also been made a life peer and appointed Commercial Secretary for the Treasury, with special responsibility for the Northern Powerhouse and city devolution. [127]

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[126] Rt Hon George Osborne MP, *Chancellor: 'We need a Northern powerhouse'* 23 June 2014

[127] HM Treasury, Lord O'Neill of Gatley

# Appendix 1: Sources of further information

## HM Treasury

Budget 2015

Budget 2014

Budget 2013

Autumn Statement 2014

## Office for Budget Responsibility

Economic and fiscal outlook, March 2015

Economic and fiscal outlook, December 2014

Economic and fiscal outlook, March 2014

Monthly commentary on the public finances

Public finance databank

## Institute for Fiscal Studies

Post-Budget Briefing 2015

Green Budget 2015

Monthly commentary on the public finances

## House of Commons Library

Economic indicators (a special Budget edition will be published on 7 July)

External users can access this from (see under "Commons Briefing Papers"):

http://www.parliament.uk/topics/Economic-situation.htm

The Budget and the Annual Finance Bill, House of Commons Briefing Paper SN00813, 30 March 2015

**House of Commons Treasury Select Committee**

Inquiry into Budget 2015

Report on Autumn Statement 2014

# Appendix 2: Economic and public finance data 1979-2019

**Economic data, 1979-2019**

| | Real GDP growth % | Inflation RPI % | Inflation CPI % | ILO Unemployment Q4, % |
|---|---|---|---|---|
| 1979 | 3.7% | 13.4% | .. | 5.4% |
| 1980 | -2.2% | 18.0% | .. | 6.8% |
| 1981 | -0.8% | 11.9% | .. | 9.6% |
| 1982 | 2.1% | 8.6% | .. | 10.7% |
| 1983 | 4.2% | 4.6% | .. | 11.5% |
| 1984 | 2.3% | 5.0% | .. | 11.8% |
| 1985 | 3.5% | 6.1% | .. | 11.4% |
| 1986 | 3.2% | 3.4% | .. | 11.3% |
| 1987 | 5.5% | 4.2% | .. | 10.4% |
| 1988 | 5.9% | 4.9% | .. | 8.6% |
| 1989 | 2.5% | 7.8% | 5.2% | 7.2% |
| 1990 | 0.5% | 9.5% | 7.0% | 7.1% |
| 1991 | -1.2% | 5.9% | 7.5% | 8.9% |
| 1992 | 0.4% | 3.7% | 4.3% | 9.9% |
| 1993 | 2.6% | 1.6% | 2.5% | 10.4% |
| 1994 | 4.0% | 2.4% | 2.0% | 9.5% |
| 1995 | 2.5% | 3.5% | 2.6% | 8.6% |
| 1996 | 2.7% | 2.4% | 2.5% | 8.1% |
| 1997 | 2.6% | 3.1% | 1.8% | 6.9% |
| 1998 | 3.5% | 3.4% | 1.6% | 6.2% |
| 1999 | 3.2% | 1.5% | 1.3% | 6.0% |
| 2000 | 3.8% | 3.0% | 0.8% | 5.4% |
| 2001 | 2.7% | 1.8% | 1.2% | 5.1% |
| 2002 | 2.5% | 1.7% | 1.3% | 5.2% |
| 2003 | 4.3% | 2.9% | 1.4% | 5.0% |
| 2004 | 2.5% | 3.0% | 1.3% | 4.8% |
| 2005 | 2.8% | 2.8% | 2.1% | 4.8% |
| 2006 | 3.0% | 3.2% | 2.3% | 5.4% |
| 2007 | 2.6% | 4.3% | 2.3% | 5.3% |
| 2008 | -0.3% | 4.0% | 3.6% | 5.7% |
| 2009 | -4.3% | -0.5% | 2.2% | 7.6% |
| 2010 | 1.9% | 4.6% | 3.3% | 7.9% |
| 2011 | 1.6% | 5.2% | 4.5% | 8.1% |
| 2012 | 0.7% | 3.2% | 2.8% | 8.0% |
| 2013 | 1.7% | 3.0% | 2.6% | 7.6% |
| 2014 | 3.0% | 2.4% | 1.5% | 6.2% |
| 2015 | 2.5% | 1.0% | 0.2% | 5.3% |
| 2016 | 2.3% | 2.1% | 1.2% | 5.2% |
| 2017 | 2.3% | 2.8% | 1.7% | 5.3% |
| 2018 | 2.3% | 3.1% | 1.9% | 5.4% |
| 2019 | 2.4% | 3.1% | 2.0% | 5.4% |

Sources: ONS (series, IHYP, CZBH, D7G7, MGSX)

OBR, Economic and fiscal policy, March 2015 Table 3.6, and Economy Supplementary Table 1.6

**Public finance data 1979-80 to 2019-20**

| | Public sector net borrowing | | Structural deficit | Public sector net debt | |
|---|---|---|---|---|---|
| | £ billion | % GDP | % GDP | £ billion | % GDP |
| 1979/80 | 8.5 | 3.9% | 4.2% | 98.2 | 45.0% |
| 1980/81 | 11.5 | 4.6% | 3.2% | 113.8 | 45.6% |
| 1981/82 | 6.0 | 2.2% | 0.0% | 125.2 | 45.3% |
| 1982/83 | 8.5 | 2.8% | 0.8% | 132.5 | 43.9% |
| 1983/84 | 11.8 | 3.6% | 2.3% | 143.6 | 43.6% |
| 1984/85 | 12.5 | 3.5% | 3.1% | 157.0 | 44.3% |
| 1985/86 | 9.0 | 2.3% | 2.3% | 162.5 | 41.7% |
| 1986/87 | 8.4 | 2.0% | 2.2% | 167.8 | 40.1% |
| 1987/88 | 4.7 | 1.0% | 2.2% | 167.4 | 35.6% |
| 1988/89 | -6.0 | -1.1% | 0.9% | 153.7 | 29.3% |
| 1989/90 | -0.6 | -0.1% | 1.3% | 151.9 | 26.2% |
| 1990/91 | 6.2 | 1.0% | 0.8% | 151.1 | 24.2% |
| 1991/92 | 23.0 | 3.5% | 2.1% | 165.8 | 25.2% |
| 1992/93 | 47.1 | 7.0% | 5.3% | 201.9 | 29.0% |
| 1993/94 | 51.6 | 7.2% | 5.9% | 249.8 | 33.9% |
| 1994/95 | 43.8 | 5.8% | 5.0% | 290.0 | 37.5% |
| 1995/96 | 35.3 | 4.4% | 3.2% | 322.1 | 39.2% |
| 1996/97 | 27.7 | 3.3% | 2.8% | 347.0 | 39.9% |
| 1997/98 | 5.9 | 0.7% | 1.6% | 358.6 | 39.3% |
| 1998/99 | -4.4 | -0.5% | 0.9% | 357.8 | 37.5% |
| 1999/00 | -14.6 | -1.5% | 0.0% | 349.1 | 34.6% |
| 2000/01 | -16.9 | -1.6% | -0.4% | 316.4 | 30.1% |
| 2001/02 | 0.7 | 0.1% | 0.8% | 323.1 | 29.3% |
| 2002/03 | 26.9 | 2.4% | 2.4% | 354.9 | 30.3% |
| 2003/04 | 31.6 | 2.6% | 3.0% | 393.6 | 31.7% |
| 2004/05 | 43.5 | 3.4% | 4.1% | 448.1 | 34.3% |
| 2005/06 | 41.4 | 3.1% | 3.7% | 490.2 | 35.4% |
| 2006/07 | 36.9 | 2.6% | 3.2% | 526.7 | 36.0% |
| 2007/08 | 40.9 | 2.7% | 3.8% | 558.2 | 36.7% |
| 2008/09 | 100.8 | 6.7% | 6.6% | 724.4 | 49.0% |
| 2009/10 | 153.5 | 10.2% | 8.2% | 956.4 | 62.0% |
| 2010/11 | 134.9 | 8.6% | 6.5% | 1,101.1 | 68.7% |
| 2011/12 | 113.4 | 7.0% | 5.1% | 1,191.0 | 72.3% |
| 2012/13 | 119.7 | 7.2% | 5.2% | 1,299.1 | 76.7% |
| 2013/14 | 98.5 | 5.7% | 4.1% | 1,402.1 | 79.1% |
| 2014/15 | 89.2 | 4.9% | 4.2% | 1,485.6 | 80.5% |
| 2015/16 | 75.3 | 4.0% | 3.7% | 1,532.9 | 80.2% |
| 2016/17 | 39.4 | 2.0% | 1.9% | 1,580.3 | 79.8% |
| 2017/18 | 12.8 | 0.6% | 0.6% | 1,605.6 | 77.8% |
| 2018/19 | -5.2 | -0.2% | -0.3% | 1,617.3 | 74.8% |
| 2019/20 | -7.0 | -0.3% | -0.3% | 1,626.8 | 71.6% |

Source: OBR, ONS
Note: figures exclude public sector banks

**BRIEFING PAPER**

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