A Budget 2015 policy measures

Overview

A.1 Our *Economic and fiscal outlook (EFO)* forecasts incorporate the expected impact of the policy decisions announced in each Budget and Autumn Statement on the public finances. In the run-up to each statement, the Government provides us with draft estimates of the cost or gain from each measure it is considering. We discuss these with the relevant experts and then suggest amendments if necessary. This is an iterative process where individual measures can go through several stages of scrutiny. After this process is complete, the Government chooses which measures to implement and which costings to include in its table of policy decisions. We choose whether to certify the costings as 'reasonable and central', and whether to include them – or alternative costings – in our forecast.

A.2 In this Budget, we have certified all the costings of tax and annually managed expenditure (AME) measures that appear in the Government's policy decisions table as reasonable and central. Table A.1 reproduces HM Treasury's table of policy decisions, with further details set out in Chapter 4 and in the Treasury's *Budget 2015 policy costings document*, which summarises the methodologies used to produce each costing and provides some information on the main areas of uncertainty within each.

A.3 The policy costings scrutiny process was particularly difficult for this Budget as we were not given details of costings for a large proportion of significant policy measures until just before our deadlines.

Uncertainty

A.4 At past Budgets and Autumn Statements, we have used our annex in the Treasury's policy costings document to highlight costings that were particularly uncertain. In our December 2014 *EFO*, we introduced a more systematic and transparent assessment of the uncertainty around each costing, building on an approach developed by the Australian Parliamentary Budget Office. It is important to stress that all the costings remain central estimates and that any uncertainty lies on both sides: the measures could raise or cost more or less than expected.

A.5 Under our new approach, we assign each certified costing a subjective uncertainty rating, which is shown alongside the relevant costing in Table A.1. These ratings range from 'low' to 'very high'. In order to determine the ratings, we have assessed the uncertainty arising from each of three sources: the data underpinning the costing; the complexity of the modelling required; and the possible behavioural response to the policy change. We take into account the relative importance of each source of uncertainty for each costing. The full breakdown that underpins each rating is available on our website.

Table A.1: HM Treasury table of Budget policy decisions and OBR assessment of the uncertainty of costings

		Head	£ million					Uncertainty
			2015-16	2016-17	2017-18	2018-19	2019-20	
Personal tax								
1	Personal Allowance: increase to £10,800 in 2016-17 and to £11,000 in 2017-18 with full gains to higher rate taxpayers	Tax	0	-960	-1,480	-1,585	-1,680	Medium
Savings and pensions								
2	Savings tax: allowance and ISA flexibility	Tax	-15	-1,030	-565	-640	-765	Medium-high
3	Help to Buy: ISA	Spend	-45	*-230*	*-415*	*-640*	*-835*	Very high
4	Annuities: secondary market	Tax	0	+535	+540	-130	-120	Very high
5	NS&I bonds for people aged 65 and over: extension	Spend	-80	-	-	-	-	Medium-high
6	Pensions guidance: extending availability	Spend	-20	-	-	-	-	N/A
7	Pensions: lifetime allowance to £1m from 2016-17, and index with inflation from 2018-19	Tax	+60	+300	+420	+550	+590	Medium-high
Duties								
8	Fuel Duty: cancel September 2015 RPI increase	Tax	-140	-240	-245	-250	-250	Medium-low
9	Alcohol Duty: 1p off a pint of beer and 2% off cider duty	Tax	-85	-80	-85	-85	-85	Medium-low
10	Alcohol Duty: reduce spirits duty by 2%, and freeze wine duty	Tax	-100	-95	-100	-100	-105	Medium-low
Investment and growth								
11	Oil and gas: investment allowance and 10% cut to Supplementary Charge	Tax	-230	-270	-190	-200	-75	Very high
12	Oil and gas: 15% cut to Petroleum Revenue Tax	Tax	0	-125	-115	-85	-10	Very high
13	Oil and gas: support for seismic surveys	Spend	-20	-	-	-	-	N/A
14	Energy intensive industries: bring forward compensation for Feed-in Tariffs	Spend	-25	-	-	-	-	N/A
15	Exports and investment: UKTI China and trade missions	Spend	-15	-	-	-	-	N/A
16	Regional growth	Spend	-15	-	-	-	-	N/A
17	Creative industries: extend support	Spend	-5	-	-	-	-	Medium-high
18	Support for technological innovation	Spend	-20	-	-	-	-	N/A
19	Telecommunications	Spend	-15	-	-	-	-	N/A
20	Venture capital schemes: qualifying criteria	Tax	0	-5	-5	-15	-10	Medium
21	Enterprise Zones	Tax	*	*	-5	-5	-5	Low
22	Financial transactions adjustment[1]	Spend	+490	-	-	-	-	N/A

Fairness, evasion and avoidance								
23	Bank Levy: increase to 0.21%	Tax	+685	+925	+925	+920	+920	Medium
24	Corporation Tax: bank compensation payments	Tax	+150	+260	+225	+180	+150	High
25	Evasion: Common Reporting Standard	Tax	-5	+90	+270	+75	+130	Very high
26	Employment intermediaries: travel and subsistence (umbrella companies)	Tax	0	+155	+175	+160	+145	Medium-high
27	VAT: foreign branches	Tax	+25	+95	+90	+85	+90	Medium-high
28	Corporation Tax: contrived loss arrangements	Tax	+95	+170	+170	+150	+130	High
29	Capital Gains Tax: contrived ownership arrangements	Tax	*	+45	+45	+45	+45	High
30	Tobacco: enforcement	Tax	0	+5	+10	+10	+10	Medium-high
31	Accelerated Payments: extension	Tax	0	+290	+175	+70	+20	Medium-high
32	Total fiscal impact of welfare cap measures[2]	Spend	-50	-	-	-	-	Medium
Health, education and security								
33	Mental health	Spend	-305	*-315*	*-325*	*-310*	*-310*	N/A
34	Health innovation	Spend	-10	-	-	-	-	N/A
35	Counter-terrorism and security	Spend	-25	-	-	-	-	N/A
36	Free school meals: small schools	Spend	-20	-	-	-	-	N/A
Transport and environment								
37	Company car taxation: 3 ppt increase in 2019-20	Tax	0	0	0	0	+340	Medium-high
38	Heavy Goods Vehicles: freeze VED and the Road User Levy	Tax	*	*	*	-5	-5	Low
39	Aggregates Levy: freeze in 2015-16	Tax	-5	-5	-5	-5	-5	Low
40	Capital allowances: energy and water efficient technologies	Tax	0	+5	+15	+10	+10	Medium-low
41	Income Tax: extending farmers' profits averaging period to 5 years	Tax	0	-10	-30	-30	-30	Medium
Previously announced								
42	Stamp Duty Land Tax: property funds	Tax	-10	-15	-10	-5	-5	Medium-high
43	Guarantees income	Spend	+500	-	-	-	-	Low
	TOTAL POLICY DECISIONS		**+745**	**+45**	**+230**	**-885**	**-570**	
	Total spending policy decisions		+295	0	0	0	0	
	Total tax policy decisions		+450	+45	+230	-885	-570	

** Negligible*

Note: Costings reflect the OBR's latest economic and fiscal determinants.

Note: Only spending numbers which directly affect borrowing in 2016-17, 2017-18, 2018-19 and 2019-20 are shown. All other spending measures do not affect borrowing as they fall within the Total Managed Expenditure assumption in those years.

[1] This is a neutral reclassification from PSGI to Financial Transactions. See Table 2.2 for offsetting adjustment.

[2] Total fiscal impact of welfare policy decisions, including DWP DEL funding. See Budget 2015: policy costings for further detail on policy decisions, and Budget 2015, Chapter 1 for an update on spending within the welfare cap.

A.6 Table A.2 shows the detailed criteria and applies them to a sample policy measure from this Budget: 'Fuel duty: cancel September 2015 RPI increase'. This is estimated to cost around £250 million a year on average over the forecast period. For this policy we have judged that the most important source of uncertainty will be modelling, followed by data, with the least important being behaviour. The data used to estimate this measure are high quality HMRC administrative data on fuel clearances, so we consider this to be a 'low' source of uncertainty. The likely behavioural response is well documented in external academic papers and in HMRC research: lower post-tax fuel prices would be expected to increase consumption. But this has only a relatively small impact on the costing, so we deem this a 'medium-low' source of uncertainty. The modelling is based on reliable HMRC forecasting models. So we regard this as a 'low' source of uncertainty. Taking all these judgements into account, we have assigned the costing an overall uncertainty rating of 'medium-low'.

Table A.2: Example of assigning uncertainty rating criteria: 'Fuel duty: cancel September 2015 RPI increase'

Rating	Data	Modelling	Behaviour
Very high	Very little data Poor quality	Significant modelling challenges Multiple stages and/or high sensitivity on a range of unverifiable assumptions	No information on potential behaviour
High	Little data Much of it poor quality	Significant modelling challenges Multiple stages and/or high sensitivity on a range of unverifiable assumptions	Behaviour is volatile or very dependent on factors outside the tax/benefit system
Medium-high	Basic data May be from external sources Assumptions cannot be readily checked	Some modelling challenges Difficulty in generating an up-to-date baseline and sensitivity to particular underlying assumptions	Significant policy for which behaviour is hard to predict
Medium	Incomplete data High quality external sources Verifiable assumptions	Some modelling challenges Difficulty in generating an up-to-date baseline	Considerable behavioural changes or dependent on factors outside the system
Medium-low	High quality data	Straightforward modelling Few sensitive assumptions required	Behaviour fairly predictable
Low	High quality data	Straightforward modelling of new parameters for existing policy with few or no sensitive assumptions	Well established, stable and predictable behaviour
Importance	Medium	Low	High
Overall		**Medium-low**	

A.7 In this Budget, we have judged eight measures in the policy decisions table to have 'high' or 'very high' uncertainty around the central costing. These represent 25 per cent of the measures in the Budget by number and 27 per cent by absolute value (in other words ignoring whether they are expected to raise or cost money for the Exchequer). In net terms, they are expected to raise the Exchequer £7.2 billion in total over the forecast period. The reasons we consider the fiscal effects of these measures to be particularly uncertain include:

- **annuities: secondary market:** This costing receives a 'very high' uncertainty rating. The measure will allow current annuity holders to sell their annuity for a lump sum, which will attract an upfront tax charge. The yield over the forecast period – and the resulting costs in the longer term – depends on two forms of take-up: annuity holders wishing to sell their income stream and prospective buyers wishing to purchase that flow of income for an upfront cash sum. These assumptions come together via a highly uncertain assumption about the discount buyers are likely to apply given the likely informational asymmetries in the transaction and the lack of such a market at present. Any estimates on how potential buyers will view the risk associated with this product and set their preferred discounts are particularly uncertain. This measure is also unusual in the sense that it is not impossible that potential buyers will view this as a risk that cannot be priced, in which case no secondary market would develop and the effect of the policy would be nil. There is also uncertainty about how sales of annuities will affect benefit payments, especially in respect of the effect of DWP's 'deprivation of capital' rules and the Government's consultation, which asks if annuities should be sold by those receiving means-tested benefits;

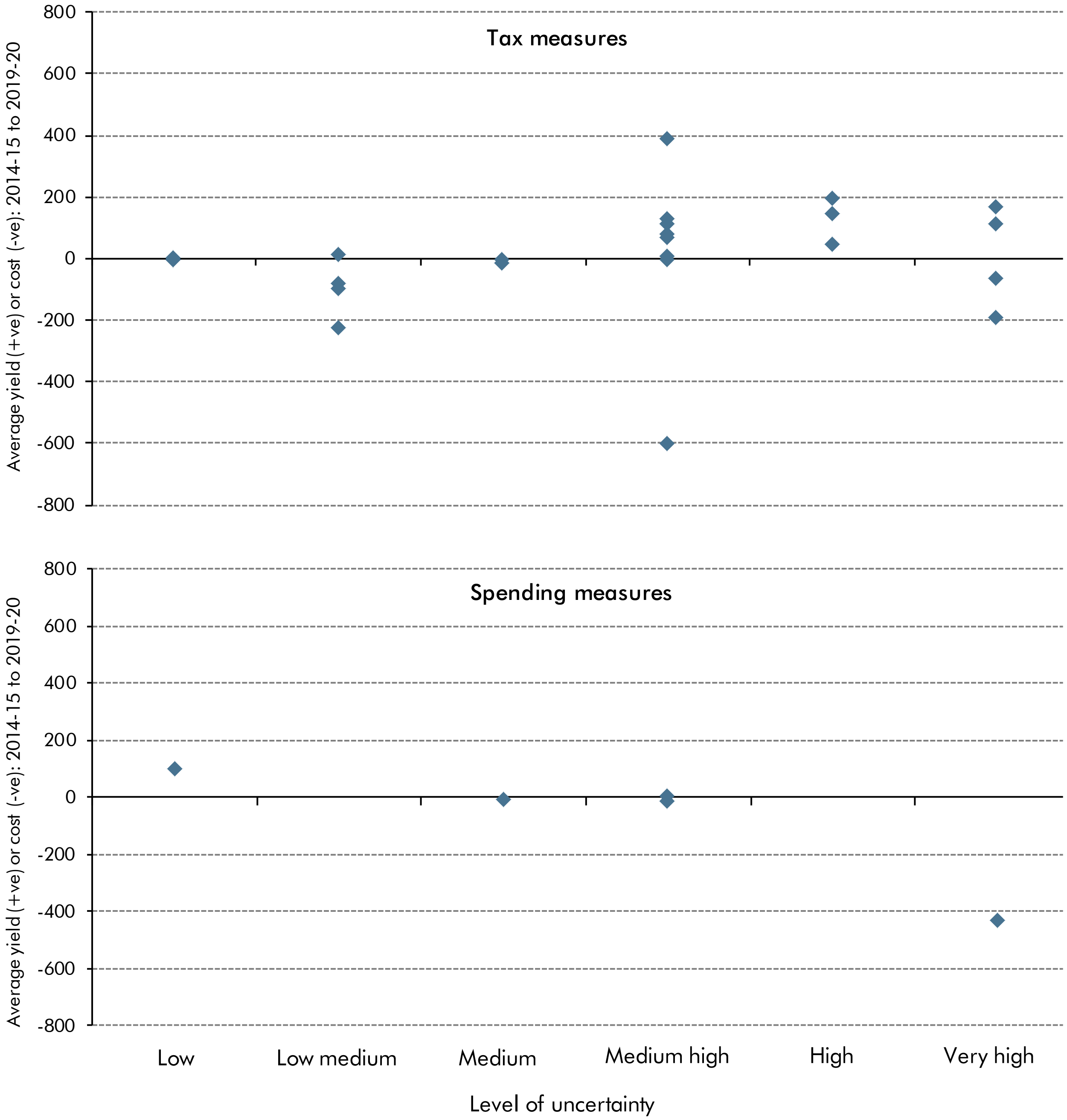
- **oil and gas: investment allowance and 10 per cent cut to supplementary charge** and **15 per cent cut to petroleum revenue tax:** This comprises two measures that we have considered together as they collectively alter the post-tax returns from oil and gas extraction. The measures receive a 'very high' uncertainty rating. They are expected to encourage investment and production in the North Sea, offsetting some of the effect of the fall in oil prices over the past year. The post-behavioural cost is based on uncertain assumptions about the investment and production response of oil and gas companies – a key source of uncertainty in our offshore corporation tax receipts and PRT forecasts more generally. We estimate that these measures will increase production by around 15 per cent compared to the pre-measures baseline. If the production response is stronger or weaker than expected – or the oil price moves substantially again – then the cost of these measures and their wider impact on the economy could significantly different. There are also data uncertainties, since the precise cost of the measures will depend on the specific effects at individual field and company level. The modelling is also complex and important for the costing;

- **evasion: common reporting standard:** This costing receives a 'very high' uncertainty rating. The common reporting standard is designed to facilitate information sharing on non-residents' financial interests in a given jurisdiction with other signatory jurisdictions where they are resident. The measure aims to capture the effect of the UK's adoption of this standard and the HMRC operational response. There is considerable uncertainty around both the data and behavioural response in this costing. There is little information available to HMRC on the level of assets held abroad that will be captured by the new standard. There is also considerable uncertainty about how individuals will respond to HMRC compliance interventions, be they targeted or more general. As ever, predicting the behaviour of individuals who are already actively changing behaviour in response to the tax system is particularly challenging;

- **Help to Buy: ISA:** This costing receives a 'very high' uncertainty rating. The Help to Buy: ISA will involve the Government offering financial support to first-time buyers who contribute to a special account. There is considerable uncertainty around the behavioural impact – in particular the take-up within the target population;
- **corporation tax: bank compensation payments:** This costing receives a 'high' uncertainty rating. The measure prevents banks from obtaining tax deductions for costs in respect of compensation to customers in relation to the provision of financial services – for example, the large payouts in recent years related to payment protection insurance mis-selling. The costing relies on projecting a particularly uncertain tax base: the future misconduct provisions and compensation payments made by banks. The overall yield is very sensitive to the assumed path of such payments over the forecast period. It is also sensitive to an element of our corporation tax forecast that is itself highly uncertain: the point at which major banks have exhausted stocks of accumulated losses and return to taxpaying status;
- **corporation tax: contrived loss arrangements:** This costing receives a 'high' uncertainty rating. This measure will prevent the use of contrived arrangements to access 'trapped' losses and create versatile in-year relief. The main uncertainty in this costing is with the tax base. It was constructed based on HMRC operational intelligence on the level of non-trading losses, but no data were available to estimate the level of trading losses using these arrangements, so uncertain assumptions had to be made; and
- **capital gains tax: contrived ownership arrangements:** This costing receives a 'high' uncertainty rating. These measures aim to limit use of entrepreneur's relief to reduce CGT liabilities. HMRC does not hold detailed administrative data on the use of the specific arrangements that are to be limited. Again, this required the tax base to be generated using uncertain assumptions on the level of use of such schemes. The behavioural response of affected taxpayers to these measures is also very uncertain.

A.8 We have judged 20 measures to have 'low-medium' or 'high-medium' uncertainty around the central costing, with a further four costings having 'low' uncertainty. That means that 63 per cent of the Budget measures have been placed in the medium range (71 per cent by absolute value) and 13 per cent have been rated as low uncertainty (just 2 per cent by absolute value). Chart A.1 plots these uncertainty ratings relative to the amount each policy measure is expected to raise or cost.

Chart A.1: OBR assessment of the uncertainty of costings



Longer-term uncertainties

A.9 For most policy costings, the five-year period covered by the Treasury's policy decisions table is sufficient to give a representative view of the long-term cost or yield of a policy change. Typically, that effect is either zero – because the policy has only a short-term impact that has passed by the end of the forecast period – or it would be reasonable to expect it to rise broadly in line with nominal growth of the economy.

A.10 There are some measures in this Budget that might be expected to have different costs in the longer term than over the five-year period of our medium-term forecast:

- sales of annuities in a secondary market would raise income tax receipts in the short term, but at the expense of future receipts. The profile would be similar to that expected for the Budget 2014 pensions flexibility measure (see Chart 4.1 of our March 2014 *EFO*);

- the tax foregone on savings income through introducing a tax-free allowance on savings income would be greater if – as we assume in our long-term projections – interest rates eventually normalise at higher rates than is implied by market expectations over the next five years; and

- the cost of the oil and gas tax measures would be greater in the long term if a higher proportion of North Sea companies were tax-paying, as might be expected. (Currently, a large proportion of companies have either past trading losses or tax deductible expenditure sufficient to offset the tax liability from current profits).

Small measures

A.11 The BRC has agreed a set of conditions that, if met, allow OBR staff to put an individual policy measure through a streamlined scrutiny process. These conditions are:

- the expected cost or yield does not exceed £40 million in any year (this has been increased from £25 million following review of the process);

- there is a good degree of certainty over the tax base;

- it is analytically straightforward;

- there is a limited, well-defined behavioural response; and

- it is not a contentious measure.

A.12 A good example of a small measure announced at Budget 2015 is the 'capital allowances: energy and water efficient technologies', updates the list of technologies and products covered by the first-year allowance scheme for energy-saving and environmentally beneficial technologies. This costing was based on DECC and DEFRA estimates on the change to qualifying sales due to the policy. The modelling involves simple assumptions about the proportion of the enhanced capital allowances that will be claimed. No behavioural adjustment was made.

A.13 By definition, any costings that meet all of these conditions will have a maximum uncertainty rating of 'medium'.

Indirect effects on the economy

A.14 The Government has announced a number of measures taking effect between 2015-16 and 2019-20 that are expected to have a broadly neutral fiscal impact overall, with 'giveaways' offsetting 'takeaways' over this period. Further details of the judgements we have taken about indirect effects of policy changes on the economy are provided in Box 3.2.

A.15 The Government has announced a package of policies affecting the North Sea oil and gas sector, including the introduction of a new investment allowance, a 10 per cent reduction in the supplementary charge on profits and a 15 per cent reduction in petroleum revenue tax. All else equal, these measures would be expected to reduce the cost of capital associated with investment in the sector and therefore have a positive effect on capital expenditure and production, partially offsetting the negative effect of lower oil prices on the profitability of oil and gas extraction. We have assumed that these measures increase the level of oil production by 2019 by around 15 per cent, equivalent to around 0.1 per cent of GDP. This partly offsets the effect of the significant decline in the oil price since December, which in the absence of these policy changes we assume would have reduced the level of North Sea production by around 30 per cent. In Chapter 4 we provide greater detail on these pre- and post-measures assumptions that underpin our North Sea revenues forecast.

A.16 The Government has announced a number of measures that will directly affect inflation. This includes a 2 per cent reduction in duty on most beer, cider and spirits and freezing duty on wine, relative to previously assumed increases in line with RPI in April, and the cancellation of the planned increase in fuel duty in September 2015 (in line with RPI inflation). These changes are expected to reduce CPI inflation by less than 0.1 percentage points in 2015 and 2016.

A.17 We have not adjusted our economy forecast in light of the support for first-time buyers, savings tax reform and annuities flexibility announced in the Budget or our updated assessment of the effect of the changes announced in Budget 2014. The effect on the economy of the pensions and annuities flexibility measures is considered to be subject to particularly significant uncertainty.

Departmental spending

A.18 We do not scrutinise the costings of policies that reallocate spending within departmental expenditure limits (DELs), since the total cost or yield is wholly determined by a Government policy decision. Neither do we scrutinise the DEL implications of measures that affect current receipts or AME spending, where those are also wholly determined by Government policy decisions. Instead we include the overall DEL envelopes for current and capital spending in our forecast, plus judgements on the extent to which we expect those be over- or underspent in aggregate. In this forecast, we judge – in line with historical experience and our recent forecasts – that they will be modestly underspent in 2014-15 and 2015-16.

A.19 There are measures announced at this Budget that rely on extra HMRC operational capacity in order to be implemented as intended. These include 'accelerated payments: extension' and 'evasion: common reporting standard'. We sought and received assurances from the Treasury that such activities will be funded. We will be monitoring this commitment ahead of future fiscal events.

A.20 The Treasury's policy decisions table also contains a 'financial transactions adjustment', which reclassifies £0.5 billion of DEL from 'fiscal' spending (which affects borrowing and debt) to 'non-fiscal' financial transactions spending (which only affects debt). This measure therefore reduces borrowing by £0.5 billion, but has no effect on debt. Excluding its effect on borrowing would not have changed any of the conclusions we have reached in this forecast.

Total managed expenditure beyond the Spending Review

A.21 Beyond the years for which the Government has set detailed spending plans, our forecasts are based on the Government's chosen assumption for the growth in total managed expenditure (TME). While the effect of changes in this assumption do not typically appear in the Treasury's table of policy decisions, they can lead to substantial changes in the implied envelopes for current and capital spending in our forecast. In this forecast, that has particularly been true in 2019-20, where spending is significantly higher than would have been the case if this policy assumption had not been changed. Further details of the effect of these changes are described in Chapter 4 of the *EFO*.