

The impact of the increase in the standard rate of VAT on GDP

The interim OBR's June 2010 Budget forecast incorporated the estimated impact of policy measures announced at or before the Budget, including the increase in the standard rate of VAT from 17.5 per cent to 20 per cent that will take effect from 4 January 2011.

The interim OBR applied a range of fiscal multipliers to help inform its judgement on the overall impact of the June Budget measures on aggregate demand in the economy. These multipliers are set out in Table C8 of the June Budget document. A figure of 0.6, for example, means that a measure which has a direct effect of raising revenue by 1 per cent of GDP is estimated to reduce aggregate demand in the economy by 0.6 per cent in the short run.

The interim OBR's June 2010 Budget forecast assumed that the increase in the standard rate of VAT from 17.5 per cent to 20 per cent would reduce the level of real GDP in 2011/12 by around 0.3 per cent.