A Policy measures announced since March

Overview

A.1 Our *Economic and fiscal outlook* (*EFO*) forecasts incorporate the expected impact of the policy decisions announced in each Budget or other fiscal statement. In the run-up to each one, the Government provides us with draft estimates of the cost or gain from each policy measure it is considering. We discuss these with the relevant experts and then suggest amendments as 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 announce and which costings to include in its main policy decisions scorecard. For these scorecard costings we choose whether to certify them as 'reasonable and central', and whether to include them – or alternative costings of our own – in our forecast. We also include the effects of policy decisions that do not appear on the scorecard. In this *EFO* we have certified all measures as reasonable and central. As well as the particular uncertainties associated with each one, they are of course also clouded by the more fundamental uncertainties associated with the future course of the pandemic.

A.2 Given the unusual and challenging circumstances under which officials across departments have been working – and the variety of novel measures being costed – the process worked remarkably efficiently. We are grateful to all those involved for providing the information we requested in order to complete the scrutiny process that enabled us to certify the costings.

Government policy decisions

A.3 The Government's fiscal policy response to the pandemic is summarised in Table A.1, along with the more modest effects of several Brexit-related policy measures, the lower path for medium-term departmental spending announced in the Spending Review, and other minor measures:

- Split **by time period**, the top panel shows that around two-thirds of the cost of virus-related interventions relates to measures announced by the time of the Chancellor's Summer Economic Update (SEU) in early July. Measures announced over recent months as the virus took hold again, including those in the Spending Review, have cost relatively less, though they are still large sums by historical standards.

- Split **by type of measure**, the middle panel shows that virus-related measures dominate. Support for public services (especially health), for employment (via furlough support and payments to the self-employed), and for businesses (via grants, business rates holidays and guaranteed loans), all run into the tens of billions of pounds. From

2022-23 onwards, the single most important measure is the Spending Review decision to cut £10 to £12 billion from departmental resource spending relative to the totals set in the Budget in March.

- Split **by receipts and spending lines**, the bottom panel shows that departmental resource spending dominates (where the health costs sit), followed by annually managed resource spending (where the employment support measures sit).
- The **indirect fiscal effect of decisions** relates only to measures announced since the SEU. It largely reflects the boost to receipts via a higher path for GDP from further rises in departmental spending and the extension of various virus-related support measures.

Table A.1: Summary of the total effect of Government decisions since March

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Government decisions since March	**-1.8**	**-242.5**	**-20.1**	**10.7**	**14.0**	**14.8**	**13.9**
Direct effect of decisions since March	**-1.8**	**-266.6**	**-43.3**	**11.0**	**15.2**	**16.0**	**15.5**
of which:							
Direct effect of decisions up to SEU	-4.1	-192.3	-0.1	-0.2	-1.4	-0.9	0.0
Recostings of FSR plus SEU	2.4	11.5	-3.7	-0.8	0.3	-0.1	-1.0
Direct effect of decisions since SEU	-0.1	-85.7	-39.5	12.0	16.3	17.1	16.5
of which:							
Winter Economy Plan	-0.1	-37.3	5.2	-0.7	0.0	0.0	0.0
CJRS, SEISS extensions	0.0	-21.1	0.9	0.0	0.0	0.0	0.0
New policy measures	0.0	-27.2	-45.6	12.7	16.3	17.1	16.5
of which:							
Virus-related support measures	-1.8	-280.0	-52.7	-1.9	-0.7	-0.7	-0.5
of which:							
Public services	0.0	-127.1	-58.8	0.1	0.3	0.0	0.0
Employment support	-1.8	-73.3	2.5	0.0	0.0	0.0	0.0
of which:							
CJRS	-1.8	-53.7	0.0	0.0	0.0	0.0	0.0
SEISS	0.0	-19.6	2.5	0.0	0.0	0.0	0.0
Loans and guarantees	0.0	-31.4	-0.4	0.0	0.0	0.0	0.0
Business support	-0.2	-34.1	6.5	-0.6	0.0	-0.1	-0.1
Welfare spending	0.0	-8.3	-1.7	-1.3	-0.8	-0.5	-0.3
Other tax measures	0.1	-5.7	-0.8	-0.1	-0.2	-0.1	-0.1
Spending Review (non-virus)	0.0	0.0	12.3	11.9	13.3	13.8	14.0
Other measures	0.0	13.4	-2.9	1.0	2.6	3.0	2.0
of which:							
Resource DEL	0.0	-121.0	-47.4	10.5	12.7	13.2	12.5
of which:							
Virus-related RDEL	-2.2	-123.1	-56.0	-0.7	-0.8	-0.8	-0.8
Capital DEL	0.0	-5.8	0.3	0.0	0.0	0.0	0.0
Resource AME	-2.1	-94.7	-5.4	-0.3	0.7	0.7	0.7
Capital AME	0.0	-29.5	0.9	0.3	0.3	0.4	0.4
Receipts	0.3	-15.5	8.4	0.5	1.5	1.7	1.8
Indirect effect of decisions since SEU	**0.0**	**24.0**	**23.2**	**-0.3**	**-1.2**	**-1.3**	**-1.6**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).

Virus-related policy measures

A.4 In the following sections we document the £280 billion of virus-related policy interventions announced since March that account for almost three quarters of the record peacetime budget deficit this year. (In Box 3.1 in Chapter 3 we show how this cost built up this year.)

Public services spending

A.5 Virus-related spending on public services is the largest contributor to the overall cost this year at £127.1 billion. At £58.8 billion in 2021-22, it more than explains the total cost in that year. The vast majority of this additional spending relates to health services, including the purchase of PPE and the cost of the Test and Trace programme, as discussed in Chapter 3. The Spending Review reduces business-as-usual (or non-virus-related) RDEL spending in the medium term relative to the totals that were set in the Budget in March.

Employment support measures

A.6 The **coronavirus job retention scheme** (CJRS) was first announced on 20 March, initially to run until the end of May but now to continue until the end of March 2021 (see Chapter 3). The gross cost of the subsidy has risen to £64.6 billion, with £62.5 billion of that in 2020-21. The cost relating to the period to the end of October is £42.5 billion (£12.1 billion less than we estimated in the *FSR* largely due to claims falling faster than expected).

A.7 Close to £9 billion of the gross cost comes directly back to the Exchequer in the form of the tax and NICs paid on the subsidised wages. Around £0.3 billion of payments had been repaid by employers by the end of October, reducing the net cost. But around £0.2 billion net loss of compliance yield across the tax system is due to the fact that HMRC is diverting staff from higher yielding activities to focus on CJRS recoveries. Taking all these factors into account gives a net cost of £55.5 billion over the lifetime of the scheme (see Table A.1).

A.8 The **self-employed income support scheme** (SEISS) is a taxable grant for the self-employed and members of partnerships. It was initially announced on 26 March as a single payment covering three months, and worth 80 per cent of average monthly profits over the preceding three tax years, up to a maximum of £7,500. A second grant worth 70 per cent of average monthly profits and capped at £6,570 in total was announced on 29 May, with a third following on 5 November, this time reverting to the 80 per cent rate. The gross cost of the three grants is £20.9 billion, all falling in 2020-21. £3.6 billion is recouped in income tax and NICs, around two-thirds of which falls in 2021-22 due to the lag in self-assessment payments. This gives a net cost of £17.1 billion (see Table A.1). A fourth grant has been announced, but the terms on which it will be paid have not yet been set.

Business support: loan guarantees

A.9 On 17 March, the Government pledged up to £330 billion in guarantees to support the economy. Following subsequent announcements, this now covers several loan schemes and a reinsurance agreement with trade credit insurance providers. As we explained in our July

FSR, the £330 billion is not a good guide to the likely fiscal costs, which will depend on both the volume of guaranteed lending and the proportion that is eventually called.

A.10 Our *FSR* central scenario estimated lifetime fiscal costs of £19.7 billion for all loan and guarantee schemes, based on the policies at the time. Since then the Government has extended the Bounce Back Loans Scheme (BBLS), the Coronavirus Business Interruption Loan Scheme (CBILS) and the Coronavirus Large Business Interruption Loan Scheme (CLBILS) so that they are now open until 31 January 2021. The Government also announced a *Pay As You Grow* plan that provides more flexible repayment options for BBLS and CBILS borrowers should they need them. This includes options to increase the repayment period to 10 years, take repayment holidays, or make interest-only payments.

A.11 As of 15 November 2020, over £65 billion of lending had been provided through the three schemes with almost 1.5 million facilities approved. We have assumed that this will rise to £87 billion by the time the schemes close. Our *FSR* scenarios for the fiscal costs of the schemes used broad-brush assumptions about loss rates by scheme that drew on some historical precedents. The British Business Bank (BBB) has since published its own estimates of lifetime loss rates on each scheme.[1] As with our initial assumptions, these lie in broad ranges, with central estimates that imply even higher loss rates than we had assumed, though with the same key conclusion that uncertainty over future costs is large. We have used the BBB's estimates in the updated costings in this *EFO*. The combined effect of these higher loss rates and the scheme extensions is to increase the expected calls on the guarantees from £16.9 billion at the *FSR* to £29.5 billion in this forecast.

Table A.2: Costings for loan guarantees

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
BBLS	Spend	-26.6	-0.2	0.0	0.0	0.0	0.0
CBILS	Spend	-3.8	-0.2	0.0	0.0	0.0	0.0
CLBILS	Spend	-0.5	0.0	0.0	0.0	0.0	0.0
Other guarantees	Spend	-0.5	0.0	0.0	0.0	0.0	0.0
Loans and guarantees		**-31.4**	**-0.4**	**0.0**	**0.0**	**0.0**	**0.0**
Memo: Cash impacts							
BBLS	*Cash*	*-1.3*	*-13.6*	*-8.3*	*-2.9*	*-1.1*	*0.0*
CBILS	*Cash*	*-0.6*	*-1.1*	*-0.6*	*-0.6*	*-0.4*	*-0.2*
CLBILS	*Cash*	*-0.1*	*-0.3*	*-0.1*	*0.0*	*0.0*	*0.0*

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Business support: tax and spending measures

A.12 Several tax and spending measures provide businesses with further support, at a total cost of £28.5 billion. Many were described in our July *FSR*, so this list describes the main changes to the *FSR* costings plus new announcements since the SEU:

[1] Department for Business, Energy, and Industrial Strategy, *BEIS annual report and accounts 2019 to 2020*, September 2020.

- **Business rates relief** and **business grants** are the two most costly measures. At £20.8 billion in total, the cost is around £1 billion higher than estimated in the *FSR*, largely due to outturn data.[2] **Freezing the business rates multiplier in 2021-22** rather than raising it by CPI inflation was announced in the Spending Review, saving business rates payers (other than those already benefitting from full relief) £0.1 billion a year.

- The **VAT payment deferral** measure now has two elements. The original measure allowed VAT payments that were due between 20 March and 30 June 2020 to be deferred to no later than 31 March 2021. In the *FSR* we assumed all payments would be made on the initial due date (other than some non-payment by firms that go out of business). In reality it is likely that many will go into staggered payment arrangements, which alters the payment profile. The second element is the **'New Payment Scheme'** that was announced in the Winter Economy Plan (WEP) and that effectively extends the deferral period by allowing taxpayers to pay their deferred VAT payments in up to 11 equal instalments, starting no later than 31 March 2021. Around £34 billion of VAT payments have been deferred (around £4 billion lower than we assumed in the *FSR*). We maintain our original assumption that the non-payment rate for the original measure is 5 per cent, but add a further 1.5 per cent to the extension on the basis that more time to pay will also involve more time for firms to go out of business. The costings now also account for some yield from HMRC's debt recovery activities.

- The **income tax and NICs self-assessment (SA) payment deferral** now also includes two parts. The original measure allowed taxpayers to defer the July payment-on-account to the January 2021 final SA deadline. An estimated £5.8 billion of SA payments have been deferred, much lower than the £11.8 billion assumed in the *FSR*, probably at least partly due to the messaging from HMRC and tax advisers. In the WEP the deferral was effectively extended with the announcement that the **eligibility criteria for Self-Service Time to Pay (TTP) arrangements would be widened** to include taxpayers with outstanding SA tax bills of up to £30,000 (previously £10,000). This allows them to arrange a TTP of up to 12 months online. The costs from these measures relate to the amount of deferred tax that is not then repaid. We retain the 10 per cent non-payment rate we assumed for the original measure in the *FSR* and add a further 1.5 per cent for the second measure, again to allow for additional defaults given the longer deferrals. The costing accounts for payments received through HMRC's debt recovery activities.

- In the SEU the Government announced a **temporary cut to VAT for the 'hospitality, accommodation and attractions' sectors**, from 20 to 5 per cent. It was initially due to last until 12 January but was subsequently extended to 31 March 2021 in the WEP. The cost of the combined measures is £2.5 billion. Further support for the hospitality sector came from the '**Eat Out to Help Out'** scheme that was also announced in the SEU and offered 50 per cent discounts up to £10 per head on Mondays to Wednesdays through August. The final cost of the scheme is £0.8 billion, with 160

[2] The *FSR* total included the Barnett consequentials, while for this *EFO* they are captured within public services spending.

million meals having been subsidised at a total of 70,000 restaurants, pubs and other eateries. This is two-thirds higher than the Treasury's initial estimate of £0.5 billion.

- Other tax and spending business support measures include **extending the temporary increase in the annual investment allowance to £1 million by a further year** (so it now runs until 31 December 2021) that was announced in November 2020.

- One of the largest proportionate downward revisions to a virus-related measure has been to the **statutory sick pay rebate**. In the March Budget, the Treasury estimated that this might cost £2 billion. We initially put a figure of £1 billion on it, before revising it down again to £200 million in the *FSR*, by which point it was clear that furloughing under the CJRS meant that sick leave would be much less prevalent than initially assumed. Outturn data to the end of October are now available and suggest that the cost will amount to just £50 million this year.

Table A.3: Costings for business support: tax and spending

		£ billion						
		Outturn	Forecast					
	Head	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Business rates relief	Tax/Spend	0.2	-9.6	0.3	-0.1	0.0	0.0	0.0
Business rates: freeze multiplier	Tax/Spend	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Business grant schemes	Spend	0.0	-11.7	0.0	0.0	0.0	0.0	0.0
VAT payment deferral	Tax	-0.3	-1.9	0.0	0.0	0.0	0.0	0.0
Self-assessed tax and NICs payment deferral	Tax/Spend	-0.1	-7.2	6.9	-0.3	0.0	0.0	0.0
Temporary VAT cut for hospitality & accomodation	Tax	0.0	-2.5	0.0	0.0	0.0	0.0	0.0
Eat Out to Help Out	Spend	0.0	-0.8	0.0	0.0	0.0	0.0	0.0
Other measures	Spend	0.0	-0.3	-0.5	-0.1	0.1	0.1	0.0
Business support		**-0.2**	**-34.1**	**6.5**	**-0.6**	**0.0**	**-0.1**	**-0.1**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Welfare spending measures

A.13 Welfare spending measures have contributed £8.3 billion to the overall cost of virus-related support measures in 2020-21 and £12.9 billion in total over the forecast period:

- The largest measure is the **temporary £20 a week increase in the standard allowance of universal credit (UC)**. This costs £4.6 billion in 2020-21, which is £0.9 billion lower than we assumed in the *FSR*, reflecting the smaller rise in the UC caseload than we assumed then. The possibility that this measure (and its equivalent in tax credits) is extended rather than being withdrawn next April poses a risk to our spending forecast.

- The **increase in the basic element of working tax credits (WTC) by the equivalent of £20 a week** costs £1.5 billion in 2020-21, similar to our *FSR* estimate. The **£20**

additional earnings disregard in housing benefit measure ensures the majority of WTC claimants do not lose housing benefit as a consequence of their higher WTC awards.

- The **increase in local housing allowance (LHA) rates to equal the 30th percentile of an area's market rents** raises UC or housing benefit awards for eligible private renters. At the time of the *FSR* the Government had not specified LHA rates beyond this year, so we assumed they rose in line with CPI inflation consistent with the default policy assumptions underpinning our March forecast. It has now decided that rates will be frozen in cash terms from 2021-22 onwards. This means the £1 billion cost of the measure in 2020-21 declines to £0.3 billion by 2025-26 (and that LHA rates will fall back below the 30th percentile of local rents over time).

- The **relaxation of the minimum income floor for UC** (the assumed level of income that reduces awards for some self-employed claimants) has been extended to the end of April 2021. The combined cost of the initial relaxation and its extension is £0.8 billion, up £0.3 billion on our *FSR* estimate.

- **Other welfare spending measures** cost £1.8 billion across the forecast period, with the vast majority due to a range of DWP and HMRC 'easements'. The cost falls from £0.9 billion this year to £0.5 billion next year and £0.3 billion in 2022-23.

Table A.4: Costings for welfare spending measures

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Increase weekly UC by £20	Spend	-4.6	0.0	0.0	0.0	0.0	0.0
Increase weekly WTC by £20	Spend	-1.5	0.0	0.0	0.0	0.0	0.0
LHA measures	Spend	-1.0	-1.0	-0.8	-0.7	-0.5	-0.3
UC: minimum income floor	Spend	-0.3	-0.3	-0.2	0.0	0.0	0.0
Other measures	Spend	-0.9	-0.5	-0.3	-0.1	0.0	0.0
Welfare spending		**-8.3**	**-1.7**	**-1.3**	**-0.8**	**-0.5**	**-0.3**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Other virus-related tax measures

A.14 The other virus-related tax measures include:

- **Stamp duty land tax (SDLT): increase the nil-rate threshold to £500,000**. From 8 July 2020 to 31 March 2021, the nil-rate threshold for residential SDLT has been raised from £125,000 to £500,000. This means that, temporarily, around 90 per cent of transactions will be exempt from SDLT. We have revised up the expected cost of this SEU measure from an initial £2.5 billion to £3.3 billion as the housing market recovery of recent months has led to a substantial rise in the number of transactions benefitting from the tax cut. It is not known how strong this recovery would have been in the absence of the measure. Some of the cost is due to transactions that will be brought forward to forestall the 31 March closing date.

- **VAT: zero rate on PPE** and **import VAT and customs duty exemption for medical products**. The combined cost of the two measures has risen ten-fold from our *FSR* estimate to £2 billion. This is largely driven by outturn data, but also a two-month extension to the second measure. As most of the VAT saving accrues to the NHS, the cost in foregone tax receipts largely reduces the amount that would otherwise have had to be allocated to the NHS to fund these purchases to help fight the virus.

- **A package of measures relaxing the immigration health surcharge and visa fees for health care providers**. Together, these cost £0.8 billion across the forecast period.

Table A.5: Costings for other virus-related support tax measures

		£ billion						
		Outturn	Forecast					
	Head	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
SDLT: increase nil-rate threshold to £500,000	Tax/Spend	0.0	-2.3	-1.0	0.0	0.0	0.0	0.0
Import duty: exemption for medical products	Tax	0.0	-1.1	0.0	0.0	0.0	0.0	0.0
VAT: zero rate on PPE	Tax	0.0	-1.0	0.0	0.0	0.0	0.0	0.0
Immigration health surcharge and visa fees	Tax	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other measures	Tax/Spend	0.1	-1.2	0.4	0.0	0.0	0.0	0.0
Other virus-related tax measures		**0.1**	**-5.7**	**-0.8**	**-0.1**	**-0.2**	**-0.1**	**-0.1**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Devolved administration virus-related support measures

A.15 The devolved administrations have made their own spending decisions, partly funded by the Barnett consequentials of the measures announced by the UK Government that are described above.[3] These are set out below.

[3] These figures are adapted from: *Autumn Budget Revision 2020 to 2021*, Scottish Government, September 2020; *Supplementary Budget 2020-2021*, Welsh Government, October 2020; and *COVID-19 Funding Allocations*, Department of Finance Northern Ireland, 29 October 2020. The latest published figures for the Barnett consequentials are £6.4 billion for Scotland, £4.1 billion for Wales and £2.5 billion for Northern Ireland. The UK Government's guarantee of Barnett consequentials has since increased to a total of £16 billion, of which £8.2 billion is for Scotland, £5 billion is for Wales and £2.8 billion is for Northern Ireland.

Table A.6: Devolved administration virus-related support measures

	£ billion
Scottish Government spending	**6.5**
of which:	
Business support grants	1.2
Non-domestic rates reliefs	1.0
Health and social care	2.5
Community support fund	0.4
Additional support for small businesses and the self-employed	0.2
Other measures	1.2
Welsh Government spending	**4.1**
of which:	
Grants for businesses and charities	0.9
Health, social care and public services	2.1
Economic resilience fund	0.4
Non-domestic rates relief	0.3
Other measures	0.4
Northern Ireland Executive spending	**2.6**
of which:	
Allocated to departments	2.1
Rates support	0.4
Centrally held purposes	0.1

Non-virus-related policy decisions

A.16 Table A.7 sets out the measures announced since March that are unrelated to the virus.

Table A.7: Costings for non-virus-related policy decisions

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Spending Review (non-virus)	Spend	0.0	12.3	11.9	13.3	13.8	14.0
Customs duties: UK Global Tariff	Tax	0.2	0.8	0.9	0.9	0.9	0.9
EU Exit: VAT and excise duty non-compliance	Tax	-0.2	-0.7	-0.3	0.0	0.0	0.0
Abolition of VAT Retail Export Scheme	Tax	0.0	0.2	0.3	0.4	0.4	0.5
Abolition of Tax-Free airside shopping	Tax	0.0	0.1	0.1	0.2	0.2	0.2
VAT: zero rate for EU financial services exports	Tax	-0.2	-0.9	-0.9	-0.9	-1.0	-1.0
Other EU Exit measures	Tax/Spend	0.1	0.3	0.2	0.1	0.1	0.0
Other tax measures	Tax	1.7	0.8	0.9	1.1	1.3	1.5
Other spending measures	Spend	-11.9	3.5	0.2	-0.9	-1.1	0.0
Non-virus-related measures		**-10.3**	**16.4**	**13.4**	**14.1**	**14.6**	**16.1**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

A.17 As we set out in Chapter 3, the **Spending Review** reduces business-as-usual (or non-virus-related) RDEL spending totals by amounts rising to £14 billion in 2025-26 relative to the totals that were set in March. For CDEL plans to 2024-25 the Government has chosen to retain the same cash levels as in March.

EU exit measures

A.18 Since our March *EFO* the Government has announced a range of new policy measures for which estimates have been included in this forecast. For several others, such as the 'border operating model' and the 'Northern Ireland protocol', full costings have not been possible as some details are still pending. Some of these are discussed below.

A.19 **Customs duties: UK Global Tariff (UKGT)**. Our forecast assumes that the UK successfully concludes and ratifies a 'typical' free-trade agreement (FTA) with the EU over the next five weeks and makes a smooth transition to these new trading arrangements (Annex B presents a no-deal scenario where trading arrangements default to WTO terms instead).

A.20 The UKGT was first announced on 19 May and is due to replace the EU's Common External Tariff (CET) on 1 January 2021. The average tariff rate is lower than the CET with a greater number of tariff-free lines.[4] However, following the end of the transition period, existing EU trade agreements will not apply automatically to the UK, and the costing only includes replacement agreements that had been signed at the time we closed this forecast. That means that the rollover agreement with Canada that was announced on 21 November is not included. In 2019, imports from Canada accounted for around 5 per cent of the non-EU total, so the agreement will reduce receipts only modestly (the original EU-Canada trade deal took less than £0.1 billion a year off our November 2017 forecast). Its effect will be included in our next forecast along with any other agreements reached by then.

A.21 Switching to the UKGT under an EU-UK FTA generates around £1 billion a year in additional customs duties. The costing has four main elements:

- Before considering any behavioural responses to the new regime, around £1 billion less a year is raised because **tariff rates applied to non-EU imports are lower than under the previous regime**.
- This is more than offset by **customs duties levied on EU imports that cannot meet the terms of the FTA**. This may occur because of, among other things, the administrative costs or other difficulties in meeting rules of origin requirements. Drawing on evidence from 'preferential utilisation rates' (PURs) under existing FTAs, the costing assumes that between 80 and 90 per cent of EU imports will arrive tariff-free with the remainder paying customs duties that yield around £1.4 billion a year.

[4] *Public Consultation: MFN Tariff Policy – The UK Global Tariff. Government Response & Policy*, Department for International Trade, May 2020.

- A further £0.8 billion a year is generated from **imports from countries with which the UK has yet to rollover existing EU trade agreements**. This yield can be expected to decline over time as deals are signed, as with the Canadian agreement. But the timing of these agreements is uncertain, so the costs associated with them will be captured via new policy costings at relevant forecasts.

- The costing is then reduced by around £0.2 billion to allow for additional **non-compliance**, including around the operation of the Northern Ireland protocol.

A.22 **Abolition of the VAT Retail Export Scheme (RES):** this scheme allows individuals from parts of the world other than the EU to claim back VAT on goods purchased in Great Britain. Abolishing it brings the treatment of tourists from outside the EU into line with those from the EU from the end of the transition period (as opposed to extending the scheme to EU tourists). Alignment is a requirement of WTO rules. Most VAT RES beneficiaries do their shopping in luxury stores, particularly those in London and the South East, with 90 per cent of refunds from London and Oxford (Bicester Village). Ending the scheme results in a direct Exchequer saving – around £0.5 billion was refunded through the scheme in 2019 – but there will also be costs as the UK becomes less attractive for affected tourists relative to alternative EU destinations such as Paris or Milan. Estimates of the sensitivity of tourism to price changes generally refer to tourism in general rather than those focused on luxury shopping. The costing takes one UK-specific estimate relating to tourism in general[5] and scales it up by 50 per cent (to an elasticity of 1.9) in recognition of the likely greater responsiveness of those affected by the measure. This reduces the yield slightly, but the estimate is highly uncertain. Several studies have considered the negative consequences of this measure for affected industries. Our forecasts consider such indirect effects at an aggregate level, looking at overall changes in tax and spending (worth tens of billions of pounds at this forecast) rather than measure-by-measure.

A.23 **Abolition of Tax-Free airside shopping:** this measure also aligns the UK with WTO rules. Tax-free airside shopping is currently available for those travelling to destinations outside the EU, but this will be abolished at the end of the transition period. The main impact will be on the sales of beauty products (perfumes and cosmetics) that generate around half of total sales in duty free shops. The yield from this is again subject to uncertainty around the behavioural response. It is not clear how much of the tax rise will be passed through to the prices faced by consumers or the degree that any price rises will reduce sales.

A.24 From 1 January 2021, **exports of financial services to the EU will become zero-rated**, aligning the treatment with exports to non-EU countries. Exports to the EU are generally exempt from VAT at the moment, which means input VAT cannot currently be recovered. The cost of this measure rises to £1 billion a year by 2025-26.

[5] A price elasticity of 1.28, cited in *The Impact of Taxes on the Competitiveness of European Tourism – Final Report*, PWC, October 2017.

Policy costings and uncertainty

A.25 In order to be transparent about the potential risks to our forecasts, we assign each certified costing a subjective uncertainty rating, shown in our online *Policy costings uncertainty database*. These range from 'low' to 'very high'.

A.26 In order to determine the ratings, we assess 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 account of the relative importance of each source of uncertainty for each costing. The full breakdown that underpins each rating is also available in the database. It is important to emphasise that where we see a costing as particularly uncertain, we see risks lying to both sides of what we nonetheless judge to be a reasonable and central estimate. It is also worthwhile emphasising that this relates to uncertainty about the costings themselves, abstracting from the wider virus-related uncertainty that affects the underlying forecast.

A.27 In addition to those discussed in this annex, a measure-by-measure discussion of the 'high' and 'very high' uncertainty measures is available in the database.

The post-Brexit border for VAT and excise duties

A.28 Since our March forecast, the Government has announced more information on how the new border between Great Britain and the European Union will operate from the end of the transition period.[6] The direct impact of quantifiable policy costings has been captured in the usual way, as described above. Here we set out some of the indirect risks these changes pose to VAT and excise duty revenues.

A.29 The Government's chosen approach to EU exit means that many aspects of the VAT and excise duty regimes will change. For example, Great Britain is leaving parts of the tax system that are shared across the EU, such as information sharing and tax simplification schemes. The Government is also introducing new rules and systems, such as requiring overseas retailers to collect UK VAT liabilities on the behalf of HMRC.

A.30 The National Audit Office (NAO) published a report this November that reviews the preparedness of UK border procedures for the end of the transition period.[7] The report highlighted two key areas for potential non-compliance risk:

- First, the **risks arising from the measures brought in to ease the burdens on businesses**. From 1 January 2021, the Government will phase in border controls for many goods, potentially increasing opportunities for smuggling and fraud (though 'controlled' goods such as alcohol and tobacco will still be subject to normal declarations). The NAO noted that "*the government accepts its decision to phase in import controls increases fiscal risk in the six-month period when full import controls will not be in*

[6] *The Border Operating Model,* Cabinet Office, July and October 2020.
[7] *The UK border: Preparedness for the end of the transition period,* National Audit Office, 6 November 2020.

place". At the same time, Great Britain will lose access to EU information systems and will introduce 'postponed VAT accounting' rules that allow traders to submit returns for import VAT at a later date than when goods cross the border. Each change carries its own risk but their simultaneous introduction multiplies those risks.[8]

- Second, the NAO says that **neither the Government nor businesses are fully prepared for the imminent changes**. The Government's 'Border and Protocol Delivery Group' (BPDG) highlights two 'red' delivery risks: traders are not ready; and there are not enough customs intermediaries to support them. HMRC estimates that around 235,000 EU-only traders may face difficulties in securing a customs intermediary if the customs intermediary market does not expand.[9] This may impact revenues through increases in errors and 'failure to take reasonable care', which HMRC estimates to have cost a combined £8.6 billion in revenue across all taxes in 2018-19.[10]

- The NAO also highlights significant **risks around the readiness of border infrastructure, IT and staffing** levels from 1 January 2021.

A.31 Quantifying these risks remains a challenge, but the risks to tax receipts from increased non-compliance in VAT and excise duties is clearly on the downside. One way to frame this is to consider past episodes of non-compliance. Chart A.2 shows VAT and excise duty tax gap estimates since 2005-06. It shows that:

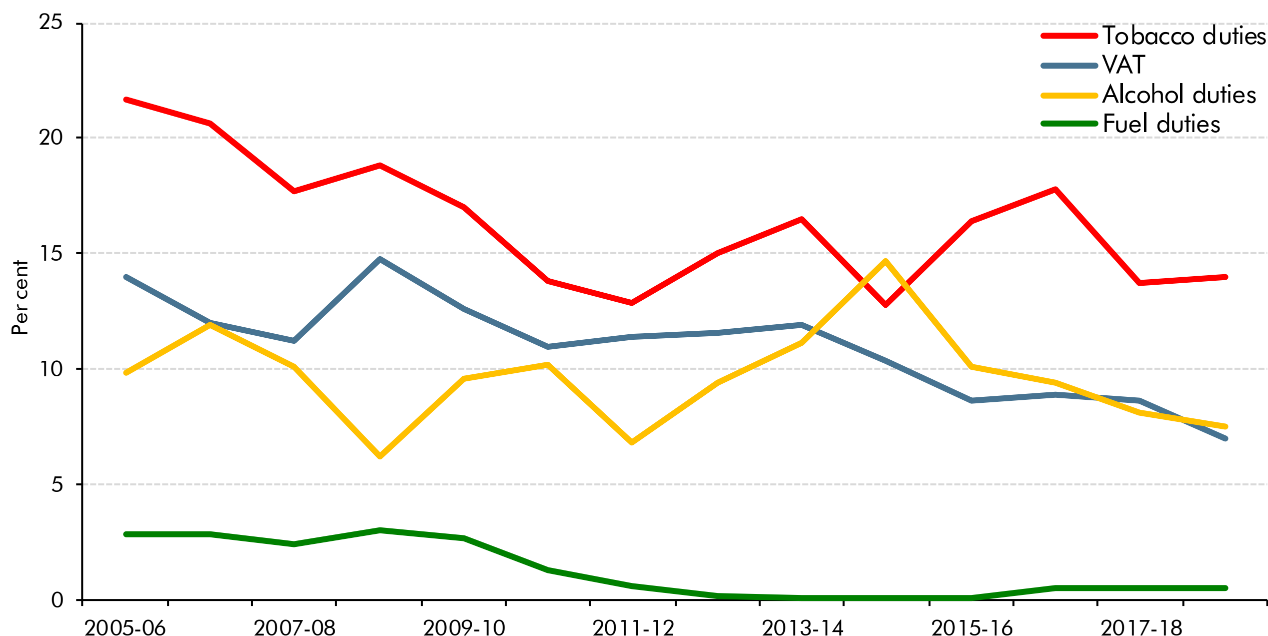
- The VAT gap spiked in 2005-06, reflecting a sharp increase in **'missing-trader' fraud** as criminals exploited VAT rules across EU borders. Previous estimates suggest this fraud cost the exchequer several billions of pounds during the mid-2000s.[11]

- The **tobacco and alcohol** tax gaps have averaged 15.3 and 9.3 per cent respectively over the past decade. The most prevalent form of alcohol and tobacco fraud involves the smuggling or diversion of products into the UK in large commercial quantities.[12]

- The **fuel duty** tax gap is much lower, averaging just 0.9 per cent over the past decade, although the Northern Ireland diesel tax gap has averaged 8.4 per cent.

[8] *Postponed Accounting in the European Union*, International VAT Monitor, 2014 (Volume 25), No 1.
[9] According to the NAO, this estimate incorporates two sets of figures with different populations. In 2019, there were 149,000 VAT-registered businesses who traded only with the EU, of which 135,000 relate to Great Britain. HMRC does not know precisely how many non-VAT registered businesses trade only with the EU but estimates this to be around 100,000 (this figure applies to the UK as a whole).
[10] *Measuring tax gaps 2020 edition,* HM Revenue and Customs, 9 July 2020.
[11] *Stopping the Carousel: Missing Trader Fraud in the EU*, House of Lords European Union Committee, 25 May 2007.
[12] *Alcohol Fraud: Next Steps*, HMRC, 16 January 2014.

Chart A.1: VAT and excise duty tax gaps since 2005-06



Source: HMRC

A.32 Historical variability of tax gaps provides a benchmark against which to consider possible short-term non-compliance costs as tax systems and border processes change in 2021. We have not attempted to estimate these costs bottom-up – i.e. considering how the implementation of each of the several changes being made would interact with all the other changes. Instead we have drawn on the historical evidence and the reviews undertaken by the NAO and others to come to a top-down assumption about overall tax losses. Specifically, we have reduced our forecast for VAT in 2021-22 by £0.6 billion (equivalent to around a half percentage point increase in the VAT gap), with the effect halving in 2022-23. We have also reduced our forecasts for alcohol and tobacco duties by £0.1 billion in 2021-22, roughly equivalent to a quarter of a percentage point increase in the tax gap. It is clearly possible that these figures could be higher if fraudsters or smugglers spot opportunities to exploit the changes in ways that have not been identified.

Uncertainties around the Northern Ireland Protocol

A.33 The '*UK's approach to the Northern Ireland protocol*' was published in May, setting out the Government's principles for operationalising the protocol, though much of the practical detail has yet to be finalised. The Government has told us that "*further guidance will be published before the end of the Transition Period*". Absent that detail, we treat these changes as a fiscal risk to our central forecast that will be quantified as soon as that becomes possible.

A.34 One important aspect that has yet to be clarified is the definition of goods deemed to be 'at risk' of moving through Northern Ireland and into the EU, either from Great Britain or third countries. Details on how Northern Ireland businesses prove their goods qualify for unfettered access to Great Britain are also pending. The NAO concluded that implementation of the protocol in time for 1 January 2021 is "*very high risk*" and that "*any*

tariff differentials between different customs regimes could present new opportunities for fraud, evasion or avoidance and smuggling".[13]

Update on previous measures

A.35 We cannot review and re-cost all previous measures at each fiscal event (the volume being too great), but we do look at any where the original (or revised) costings are under- or over-performing, and at costings that were identified as particularly uncertain.

Policy reversals

A.36 The Government has announced and then scrapped two policies since March:

- **Job retention bonus**: this measure was announced as part of the Chancellor's *Plan for Jobs* on 8 July as a payment to employers of £1,000 for each employee that they had furloughed and who remained continuously employed as at 31 January 2021. On 5 November, when announcing the extension of the CJRS to the end of March, the Chancellor stated that "*the government will redeploy a retention incentive at the appropriate time*". With the terms of that incentive yet to be set, it represents a future policy risk that could increase spending relative to this forecast.

- **Job support scheme**: this was first announced in the Chancellor's Winter Economy Plan on 24 September as a successor to the CJRS that would take effect on 1 November. The terms of the scheme were changed at a second announcement on 9 October, and it was made significantly more generous at a third announcement on 22 October. It was scrapped alongside the 5 November CJRS extension before receiving any claims.

Policy delays

A.37 To certify costings as central, we need to estimate when – as well as by how much – measures will affect the public finances. As we have set out in previous *EFO*s, many policy measures do not meet the timetable factored into the original costings – even where we have required greater contingency margins before certifying the measure. This continues to pose a risk to our forecast. Policy delays we have been notified about since March include:

- **Full PIP rollout delay:** the rollout of personal independence payment (PIP) has been delayed by a further two years as a consequence of the pandemic. This follows several previous delays and means migration is now expected to be complete by 2025, nine years behind the original schedule.

- **18-month PIP award reviews**: this Budget 2020 measure has been delayed to April 2021 from June 2020. The delay is due to the pandemic limiting DWP's ability to conduct PIP assessments.

[13] *The UK border: Preparedness for the end of the transition period,* National Audit Office, 6 November 2020.

- **Off-payroll reform (or 'IR35')**: this measure targets private sector off-payroll workers who work through an intermediary, which enables them to pay less tax and NICs. It moves the burden of responsibility for determining whether existing rules apply to the engager rather than the intermediary. The Government postponed its start date by a year to April 2021 to avoid burdening contractors as the pandemic hit.

- **Construction industry reverse charge delay**: the construction industry reverse charge was first announced in Autumn Budget 2017 and was originally due to come into effect from October 2019. This was delayed to October 2020 in the March Budget and has now been pushed back to March 2021.

- **Notification of uncertain tax treatment**: this Budget 2020 measure requires large business taxpayers to notify HMRC of potential tax disputes if the value of the uncertain tax liability exceeds £1 million. The original April 2021 start date has been delayed by a year in response to feedback from taxpayers at the consultation stage.

Updates on other measures

A.38 The cost or yield associated with several recently announced measures has fallen due to pandemic-related falls in the underlying tax forecasts. Three examples from the March Budget (all of which we had deemed highly uncertain costings pre-pandemic) are:

- **CGT: reducing the lifetime limit in entrepreneurs' relief to £1,000,000**: under this relief (since renamed business asset disposal relief) company owners pay a lower 10 per cent tax rate on disposals of shares up to a lifetime limit for each taxpayer. The measure reduces that limit from £10 million to £1 million. The yield has been revised down by around £0.7 billion a year (41 per cent) from 2022-23 onwards, entirely due to the weakness in the underlying CGT, stamp duty and income tax forecasts.

- **Red diesel: limiting eligibility**: this measure removed red diesel relief from around three-quarters of existing consumption. The costing has been reduced by an average of £0.2 billion a year (13 per cent) from 2022-23 onwards. Around half of this is due to updates to the underlying data, including the data used to estimate the proportion of red diesel eligible for the relief. The remainder is due to a lowering in the amount of consumption affected by the policy. The 'marine voyages relief' provides 100 per cent red diesel relief for eligible journeys other than those in a private pleasure craft. Its continued availability and use was not reflected in the original costing.

- **Changes to the pensions annual allowance and annual allowance taper**: this measure reduced the restrictiveness of the annual allowance taper that was introduced in 2015. The latest estimate reduces the yield by an average of £0.1 billion a year (14 per cent) from 2022-23 onwards to reflect our lower CPI inflation and earnings forecasts.

A.39 Our forecast reflects material updates to three other measures, the first two where the changes are also largely related to the pandemic, plus a third which bucks the trend, as the cost of R&D tax credits continue to surprise on the upside. These measures are:

- **Protecting your taxes in insolvency**: this Budget 2018 measure moves HMRC up the priority list of creditors when businesses go into insolvency.[14] Relative to March, the costing for this year remains unchanged but it has been revised up materially between 2021-22 and 2023-24, raising an additional £135 million across the three-year period despite lower underlying tax forecasts. This reflects the expected rise in business insolvencies next year as the large virus-related fiscal support measures are withdrawn.

- **Working from home allowance**: this was a Budget 2020 measure increasing a little-known and little-used tax relief. It was originally expected to have a negligible cost, but the changes in working practices prompted by the pandemic means the cost has been revised up twelve-fold (to a still modest £25 million this year). The eventual cost remains uncertain and it is possible that awareness and take-up might rise further.

- **R&D PAYE cap**: this Budget 2018 measure introduced a limit on the amount of R&D tax credit a company can claim under the SME scheme to prevent abuse. The policy was modified at Budget 2020 and the implementation date shifted one year back. Its yield has risen in line with the further upward revision to the underlying R&D tax credits forecast, driven by higher than expected take-up across several sectors. The yield from 2023-24 onwards is an average of £115 million a year higher now than in March.

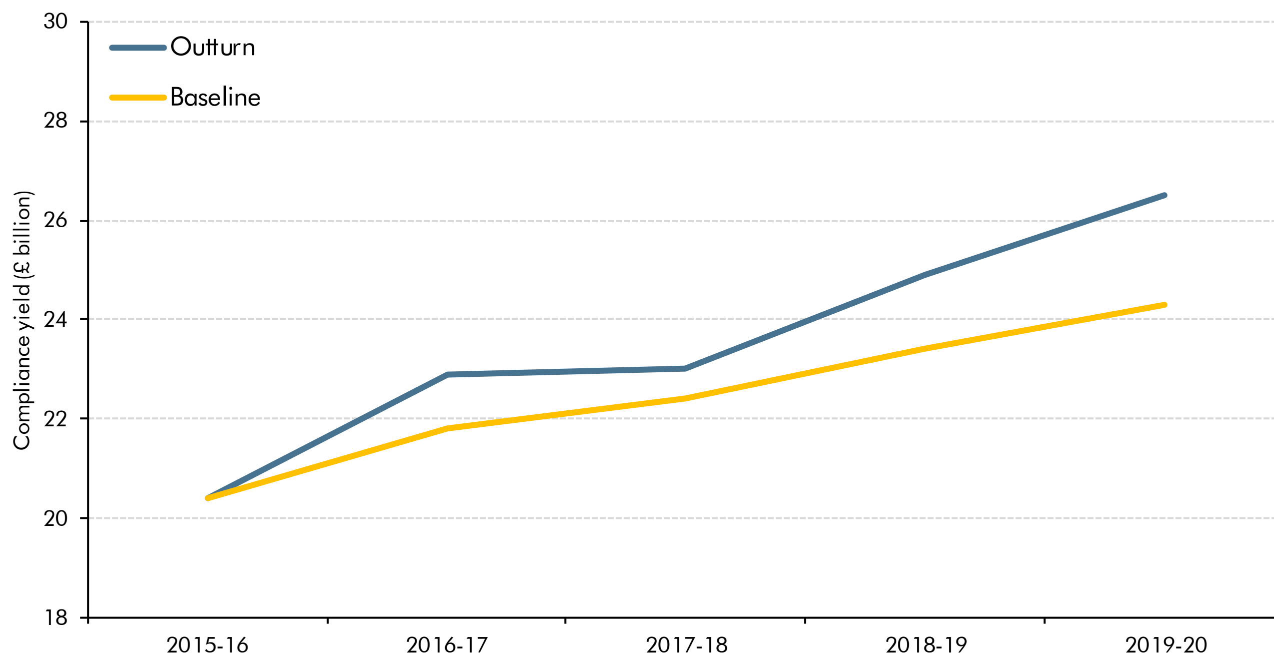
HMRC compliance performance

A.40 In our July 2015 *EFO* we scrutinised evidence on the performance of HMRC compliance activity between 2010 and 2015 and its implications for the required increase in the effectiveness of compliance efforts needed to offset expected resource cuts. This was to satisfy ourselves that the significant package of operational measures announced at the July 2015 Budget would be additional to that baseline performance.

A.41 At the time, as well as guaranteeing the measure-specific resource, the Treasury told us that "*HMRC's compliance yield targets will increase to reflect the impact of the Budget measures*". In our March *EFO* we showed that the yield from that package is relatively close to original expectations. Chart A.2 shows that compliance productivity growth in the five years since has slightly exceeded those 2015 targets, with compliance yield in 2019-20 £2.2 billion higher than the baseline. To put this in context, if HMRC's estimated tax gap had remained at its 2015-16 level (rather than falling) then around £7 billion less tax would have been collected in 2018-19 (the most recent year that tax gap estimates are available).

[14] The announced measure included a second element seeking to prevent taxpayers from avoiding tax through the misuse of insolvency (known as "phoenixism"). The revised costing does not relate to that.

Chart A.2: HMRC baseline compliance yield: outturn versus baseline target



Source: HMRC

Policy risks

A.42 Parliament requires that our forecasts only reflect current Government policy. As such, when the Government sets out 'ambitions' or 'intentions' we ask the Treasury to confirm whether they represent firm policy. We use that information to determine what should be reflected in our forecast. Where they are not yet firm policy, we note them as a source of risk to our central forecast. The full list of risks to this forecast and changes from previous updates is available on our website. Brexit-related policy risks were discussed above. Other risks that are particularly large, have changed materially since our last forecast, or are new include:

- A **ban on the sale of new petrol and diesel vehicles** has been brought forward from 2035 to 2030, as announced by the Prime Minister on 18 November. Hybrid cars will remain on sale until 2035, after which all new cars must be zero emission. There is insufficient detail on implementation and enforcement to score the fiscal impacts at this time, but it is highly likely to reduce VED and fuel duty receipts.

- As set out above, the Government has decided against introducing the **job retention bonus** but has said that it will "*redeploy a retention incentive*" in the future. This intention is not sufficiently clearly specified to incorporate in this forecast. In July, we estimated that the bonus would cost £6 billion.

- The Chancellor announced third and fourth instalments of the **Self-Employed Income Support Scheme** as part of his Winter Economy Plan. The third instalment is included in our central forecast (though on different terms to those originally announced). But the terms of the fourth grant have yet to be set, so its cost cannot be estimated. If the policy design were to remain as per the previous grants, the cost would range from

around £6 billion (if the generosity matched the third grant at 80 per cent of average monthly trading profits) down to £1.5 billion (if instead of paying 80 per cent it paid 20 per cent, the generosity that was originally announced for the third grant).

- **Passenger rail services.** In March 2020 the Government suspended all existing rail franchise agreements through Emergency Measures Agreements and later with Emergency Recovery Measures Agreements. These agreements mean that the Government has taken on all revenue and cost risk, with train operating companies classified to the public sector as a result. Absent detailed spending plans beyond 2021-22, it is unclear what mechanism will be used for delivering passenger rail services in the future and what fiscal risks this might pose.

- The Bidding Prospectus for bidders across England to apply for **'Freeport'** status opened in November 2020. Freeports are secure customs zones enabling business to be carried out inside a country's land border, but where different tax and customs rules apply. Areas granted freeport status will benefit from duty suspension, duty inversion, duty exemption for re-export, and simplified customs procedures.[15] At least seven of ten proposed freeports are expected to be in England. Successful locations should be announced by Spring 2021. The fiscal impact will depend on the precise policy detail and will be reflected at the appropriate time.

- The **2018 McCloud ruling** concluded that transitional protections offered as part of the 2015 public sector pension reforms were discriminatory. The Government published a consultation in July 2020 setting out two options to remedy the discrimination and announced the plan to move all members to the reformed schemes from 2022. The Treasury's latest estimate suggests that this will increase public service pension schemes liability by around £17 billion. The Treasury has told us that a consultation response and policy decision will be published in the new year.

- **Prospective reforms to adult social care**. Having postponed implementation of reforms underpinned by the 2011 'Dilnot Commission', the Government announced in December 2017 that it would publish a green paper on the future of adult social care in the summer of 2018. This did not materialise. The 2019 Conservative manifesto commits to "*urgently seek a cross-party consensus in order to bring forward the necessary proposal and legislation for long-term reform*". The Prime Minister told the BBC in January 2020 that he would be "*bringing forward a proposal*" later this year, and in relation to implementation that "*we will certainly do it in this Parliament*".[16] The Spending Review allows local authorities to raise council tax faster to increase funding for adult social care, but news of long-term reform of the system is still pending.

A.43 The risks listed here and monitored in our database relate to policy-like statements that have not yet been fleshed out sufficiently to be costed and reflected in our forecasts. There are of course broader policy risks that overlay these specific items that we have discussed in

[15] Other tax reliefs are available on purchasing land, constructing and renovating buildings, investing in new plant and machinery assets and on National Insurance contributions.
[16] Prime Minister interviewed by Dan Walker, BBC Breakfast, 14 January 2020.

previous chapters and in our *Fiscal risks reports*. A perennial risk is that posed by the Government's stated policy assumption to raise fuel duty with RPI inflation not matching its annual decisions to freeze the rate in cash terms. A notable near-term risk relates to the temporary nature of the £20 a week increase in amounts paid to millions of families in receipt of universal credit and working tax credits, that is due to expire in April. Its removal will mean year-on-year falls in their incomes. A previous policy that would have generated cash losses to large numbers of families – the cuts to tax credits announced after the 2015 election – was reversed before being implemented in the face of widespread opposition.