



The PBR Briefing

Wednesday 9 December 2009

Key facts and figures

Economy shrinks in 2009 by 4.75% - worse than the 3.5% predicted in the Budget

New 50% tax on banker bonuses exceeding £25,000

Growth predictions of 1-1.5% for 2010 and 3.5% for 2011/12

Public borrowing for 2009 £178bn, falling to £96bn by 2013/4

Borrowing as a % of GDP 12.6%, falling to 4.4% by 2014/15

Public sector net debt 56% of GDP and rising to 78% by 2014/15

VAT to revert back to 17.5% from 1 January 2010

National Insurance increase by a further 0.5% from April 2011

Overview

The Shadow Chancellor labelled today's package a '*pre-election report*' rather than a pre-budget report. Normally, this would mean giveaways designed to tempt voters to the polling booths but, with no money in the bank, the Chancellor's aim was to present a credible plan for recovery. This was not easy when he also had to come clean that the economy will shrink by 4.75% in 2009 compared with his April estimate of 3.5%. His decision not to hold a comprehensive spending review until after the election allowed him to be vague about areas that will face significant cuts while making promises to protect schools, hospitals and the police.

Delivered in the Chancellor's downbeat style, this was a pre-budget full of small-scale measures to maintain and extend the support for individuals and businesses affected by the recession. Business groups will argue that the rise in National Insurance will negate this help and amounts to a tax on jobs. Although he specifically rejected an assault on wealth creation, the City will see his levy on bonuses as a windfall tax in all but name.

Alastair Darling's rhetoric focussed on promoting Labour as the party of ambition and fairness. In response, the Shadow Chancellor's accused Labour of abandoning aspiration and enterprise. We can expect more such exchanges in the months leading up to a general election.

Economic growth and public spending

As expected, the Chancellor was forced to concede that the gravity of the downturn has been worse than he forecast at the Budget in April. His forecast that growth would reach a bullish 3.5% by 2011-12 also appears optimistic, setting a tough target for an incoming Conservative Government to attain. Also underestimated was public sector net borrowing, which will be £178bn, falling to £96bn by 2013/14, providing more ammunition for George Osborne can use to attack the credibility of Chancellor's forecasts.

The dividing line between the Government and Opposition on public spending again featured heavily, with the Chancellor stressing the need to maintain necessary Government support as the country stutters out of recession. Darling announced that public spending would continue to grow next year with current spending growth to fall to 0.8 per cent of GDP in 2011/12 and 2013/14. Although emphasis on health, education and police spending were prominent, the lack of detail around departmental cuts in the next two years will leave the Government open to criticism that it is hiding the extent of the problem from the electorate ahead of the election next year.

Bankers' bonuses

On the basis of legal simplicity and so as not to endanger balance sheet stability, the Chancellor chose to target bank bonus pools, and not bank profits, for his controversial new tax. The decision to impose a one-off levy of 50% on bonuses of over £25,000 paid to bankers was not as drastic a threshold as had been trailed in the media throughout the day. While the income that the move will earn the Exchequer is nominal at £500m, the political message is clear: Labour understands the need for restraint in financial services to reflect both the support the sector has received and wider public sentiment. To drive home the message of fairness, which featured throughout the speech, the Chancellor announced that the revenue income from the bonus tax would be fed into youth unemployment programmes.

Small business support

The Chancellor's priority here is to assist businesses into the recovery by extending existing support measures or postponing tax rises. He deferred the increase in corporation tax for smaller companies (affecting 850,000 businesses) and extended the temporary increase in the threshold for empty property rate relief. The Business Payment Support Service, that allows companies to spread the payment of tax, will continue.

To assist access to capital, the Enterprise Finance Guarantee will be extended with a further £500 million of loans to small firms. A new Growth Capital Fund will be created to provide funding for SMEs where traditional bank finance is unavailable. Funding for this is unclear as although major banks have been asked for contributions, the Chancellor was unable to confirm any firm support.

Key facts and figures

Consumer inflation to reach 3% by early next year before falling back

Surprising 2.5% rise in basic state pension, as of next year

Household boiler scrap-age scheme announced

Inheritance tax threshold frozen at £325,000

£500m Capital Growth Fund to boost lending to SMEs

Enterprise Finance Guarantee extended for another year

More help for young unemployed

1p rise in corporation tax for small firms to be postponed

Income tax

There was some speculation before the Chancellor's speech that he would announce changes at the upper end of the income tax structure, perhaps a new 45% band, or a lower starting point for the new 50% rate. As it turned out, the changes were limited, with no alterations to either the rates or the thresholds. However, Darling did announce that a one year freeze from April 2012 in the point at which individuals start to pay the higher rate of income tax (40%).

VAT

As expected, the Chancellor announced that the temporary VAT cut to 15%, put in place immediately after 2008's PBR, would finish on 31 December this year. The rate will revert to 17.5%. This surprised some commentators, who had expected a further rise, perhaps as far as 20%. BIS would amend the regulations on pricing to allow retailers further time to make changes to prices. A rise in VAT could feature in a Conservative Government Budget following the election.

National Insurance

Immediately picked up by the media and opposition parties, the increase in National Insurance contributions to support certain areas of public sector spending was clearly one of the most significant elements of this PBR.

The sombre Chancellor revealed plans for an increase of 0.5% in NI contributions for employees, employers and the self-employed, beginning at the start of the 2011 financial year. To ease the burden on the lower paid, however, he said that this tax rise would be delivered in such a way that would ensure that no one earning less than £20,000 would pay an increased contribution. Darling projected that this would raise an extra £3bn a year in tax revenues, allowing "guaranteed minimum real terms increases in spending on front-line NHS and schools for two years from 2011". Planned funding increases for the police budget would also be delivered out of these additional proceeds.

Corporation tax

As part of the Government's drive to deliver real support to small businesses during the recession, Alistair Darling announced that corporation tax would remain at 21% for the tax year beginning in

Key facts and figures

1% cap on public sector pay settlements in 2011-/12 and 2012/13

Tax breaks for people with electric cars or their own wind turbines

Bingo duty to fall from 22% to 20% in April

April 2010. The 1p rise would not come in until April 2012. The Government also reported on its tax simplification review covering corporation tax law for related companies. A consultation document on simplifying capital gains legislation for groups of companies should be published in early 2010.

Tax credits and pensions

The Government announced today that it would increase child benefit, the disability elements of the child tax credit and all elements of the working tax credit (benefits determined by the RPI) by 1.5% in April 2010 – bringing a proportion of increases expected in 2011 forward by a year.

The Chancellor announced that the basic state pension will rise by 2.5% in April 2010, which is a real terms increase of nearly 4%, but said that he would scale back tax relief on pensions for people with incomes over £150,000. He included employer pension contributions in the definition of income, in order to ensure that the tax will apply regardless of whether individuals receive their pay as current salary as a future pension benefit. However he assured the House that no one with an income below £130,000 will be affected.

He also told the Commons that pension contributions for public service pensions would be capped by 2012 saving £1bn a year. Public sector workers will have to make a greater contribution to the increasing value of pensions, with those earning over £100,000 paying more.

Tackling unemployment

From January 2010 all 18-24 year olds who have been claiming Jobseeker's Allowance for six months will be guaranteed a job, work placement or work-related skills training. This guarantee will be in place for one year and is to be funded using part of the existing £3bn budget for the Jobcentre Plus network and other employment programmes.

Green economy

A further £400m over 2 years was announced in measures covering new generation, feed in tariffs, energy efficiency and fuel poverty. The importance of stimulating green investment, particularly in infrastructure, was clear, with Infrastructure UK positioned to play a key role in this.

The Carbon Capture and Storage commitment was doubled, with four demonstration plants now pledged, and offshore wind benefitting from hard fought for increased support under the Renewables Obligation. An average yearly payment of £900 for feeding-in domestic solar and wind was announced and, in an end to speculation, it was confirmed this will be tax exempt. An extra £200bn funding for energy efficiency will be made available from April, as well as more funding for the Warm Front Scheme and a new boiler scrappage scheme. Changes, mostly reductions of relief, are also being made to the Climate Change Levy, company car tax and fuel benefit charge.

Taxation of innovation – The Patent Box

Following discussions between Government and business on the taxation on innovative activity, including intellectual property (IP) and the case for a reduced rate of corporation tax applied to income from patents (a so-called “Patent Box”), Darling announced that such a Patent Box, applying to income from April 2013, would be introduced “to strengthen the incentives to invest in innovative industries and ensure the UK remains an attractive location for innovation”. The Government will now consult with business, in time for Finance Bill 2011, on the detailed design of the Patent Box, which will apply to patents granted after the legislation is passed. In addition to this move the Government confirmed that it remains committed to promoting innovation through the R&D tax credit schemes.

Telephone tax

The Chancellor has confirmed plans to introduce a ‘telephone tax’ of 50p a month to help fund the rollout of next generation broadband to 90 per cent of the country by 2017. A consultation on the new levy will be published next week with the measure to be included in a Finance Bill before the election. Conservatives are opposed to the measure and have committed to reversing it in office.

Capital Gains Tax

There were no significant changes announced to the Capital Gains Tax regime, in spite of it being one of the areas that came up repeatedly in the pre-PBR rumour mill. In the full PBR document, it was noted that the revenues from this tax would show a significant fall for 2009-10, to £2.5bn, from £7.8bn the year before.

Fuel, alcohol and tobacco duties

Fuel, alcohol and tobacco duties together bring in more than corporation tax for the Treasury but changes are traditionally announced in the main budget rather than the PBR. As expected, while the planned 3.5pc rise in fuel duty will go ahead from April, there will be no further increases in alcohol and tobacco duties, although duty on cider will be reviewed and proposals brought forward in time for next year's Budget.

While this will be a relief for the struggling pub trade, unusually the PBR last year announced increases in excise duties on cigarettes and alcohol to offset the VAT rate decrease. With those excise rates not going back down as the VAT rate goes back up, businesses in the sector will effectively see a tax increase come 1 January. This is on top of already announced 'duty escalator' increases of 2% above inflation on alcohol duty until 2013/14. The 2%, equivalent to a 1p on a pint, follows the 2008 Budget in which the Treasury hiked alcohol duty by 6% above inflation, one of the biggest rises on record.

The UK economic outlook has changed dramatically since 2008/9, when the alcohol industry witnessed these exceptional duty rises, and the sector will be pushing for the Chancellor to withdraw the 'duty escalator' and to freeze excise duty on alcohol in his next Budget.

Government assets

The Chancellor also announced that the government will look to sell off assets that it believes would be better managed by the private sector. First up for sale is The Tote, the state owned betting operation, for which the sale process will be launched next summer. The government will publish a study of how to monetise the Student Loans Portfolio, given that it may no longer be possible to securitise the loans. The Dartford Crossing, High Speed 1 and the Government's stake in URENCO are other priorities for sell-off.

The Pre-Budget Report 2009: What happens next...

1. Pre Budget Report Week

Wednesday 9 December

- 00.00am: Public Accounts Committee published 2nd report on HM Revenue & Customs: improving processing & collection of tax: income tax, corporation tax, stamp duty land tax & tax credits
- 00.00am: National Audit Office published report on Department for Business, Innovation & Skills: venture capital support to small businesses
- 12.30pm: Chancellor delivered the pre-budget report to the Commons

Thursday 10 December

- 9.00am: Financial Services Bill Committee – Grimond Room
Witnesses: The British Bankers Association, the Building Societies Association, and the Confederation of British Industry
- 12.00pm: Bank of England Monetary Policy Committee decision on Interest Rates
- 12.30pm: Institute of Fiscal Studies briefing on PBR at UCL
- 1.00pm: Financial Services Bill Committee – Grimond Room.
Witnesses: The City of London Law Society, Simon Gleeson (Clifford Chance), and the Investment Management Association
Former Deputy Governor of Bank of England Sir John Gieve
speech Return to Complexity: Economic Policy Making After the Crisis at Policy Exchange

2. Pre-Budget Debate

This has yet to be announced, although the debate is due to take place before the Christmas recess, which begins on 16th December.

3. Treasury Select Committee

The Treasury Committee has announced an inquiry into the 2009 Pre-Budget Report and the following evidence sessions have been arranged. The committee is welcoming written evidence before Monday 14 December 2009.

- Monday 14 December, 3.15pm: Experts on Macro Economic Issues, 4.00pm: Experts on Micro Economic Issues
- Tuesday 15 December, 9.45am: HM Treasury officials
- Wednesday 16 December, 2.30pm: Rt Hon Alistair Darling, Chancellor of the Exchequer and HM Treasury Officials