



The Budget Briefing

24 March 2010

What's the politics?

Even in the current economic climate, a Budget so close to a General Election was never going to be anything but political. Arguably, the only reasons for having this Budget are political ones, given the spending review is later in the year and the pre-budget report covered all the substantial tax decisions. The Chancellor used the fact that the Government has borrowed less than expected to introduce a note of optimism as he tried to tread the line between deficit reduction plans to reassure the markets and measures to lure the voters.

Spending schemes to appeal to key electoral demographics were thin on the ground but eye-catching. Raising the stamp duty threshold to £250,000 for first time buyers is the politics of aspiration rather than austerity, but is paid for by a 5% increase on the top rate which the Conservatives could find hard to support.

An extension of measures to tackle youth unemployment will be talked up throughout the campaign, as will an increase in winter fuel allowance for the elderly. The latter will provide a hook for Labour to repeat their allegations that the Conservatives will scrap the allowance – an allegation hotly refuted by David Cameron.

The political message was clear; the recovery is too fragile to hand over to an inexperienced Conservative party, with no vision for growth and too much appetite for hasty and overzealous cuts. This is a nuanced distancing from the 'Labour investment versus Conservative cuts' which dominated last year's statement. The Chancellor shied away from detailing where the axe would fall on public spending and instead reiterated intentions to make efficiency savings across Whitehall.

What does this mean for the General Election?

The 2010 campaign messages for the Labour party will be a commitment to fairness, a Robin Hood style party for the many rather than a privileged few, a lamentable hark back to the battle lines of old with some high speed broadband thrown in for a modern feel. It is a comfortable and familiar position to fight the Conservatives. The good news for an opposition seeking to frame the choice at the election as time for a change or five more years of the same, is that Labour has ceded that ground.

Drawing the Election Battle-lines

The Chancellor's report on the state of the public finances was somewhat pre-empted by optimistic Treasury predictions last week that forecasted public sector

key facts and figures...

- A £2.5bn one-off growth package paid for by switching spending in some areas and the extra proceeds from the tax on bank bonuses announced last year
- Tax on bank bonuses raised £2bn, twice as much as forecast
- UK economy has shrunk by around 6% over the course of the recession
- Growth forecast in 2011 revised down to between 3% and 3.5%
- Borrowing will be £11bn lower this year at £167bn. Next year it should be £163bn, £131bn in 2011-12 and £110bn in 2013-14. It will reach £74bn in 2014-15, £8bn lower than forecast in December
- The reduction in the deficit will go from 11.8% of GDP to 5.2%, more than halved over a four-year period



net borrowing of £167 billion for 2009-2010, rather than the £178 billion in the pre-budget report last year. This number is still at a record high at the equivalent of 11.8% of GDP. The government outlined plans to cut borrowing by more than half over the next four years, and Darling lowered his forecasts for public borrowing by more than expected - by 2014, the Chancellor now expects borrowing to be reduced by 5.3% of GDP, lower than the 5.7% previously targeted. In a budget that was relatively neutral for markets, gilt prices also eased; projected gilt sales in long conventional and index-linked gilts will increase to 45% of total gilt sales, with issuance rising £2.4 billion to £83.3 billion.

Darling downgraded his growth forecasts for the UK economy; he now expects GDP to grow by 3% in 2011, rather than the 3.5% forecast in the pre-Budget report. The earlier forecast was regarded as too optimistic by numerous commentators, with the new forecast now in line with that of the Bank of England.

Tax receipts in December, January and February had been higher than expected, with corporation tax and income tax bringing in additional money. Darling told the Commons that the tax on bankers' bonuses had brought £2 billion into Treasury coffers, more than twice the amount expected. So while it was positive news on the state of public finances, Darling was slightly less optimistic about the outlook for economic growth.

Taxing the bankers

The Chancellor recapped the outcomes to date of past measures introduced to stabilise the financial system and curb banking excesses. £8bn has been raised in fees and charges from banks for the support they received from the Government during the crisis, and £2bn has been raised from the 50% tax on banker's bonuses. However the Chancellor stressed that global banking reform must be pursued with continued vigour, and so announced his support for the hotly anticipated systemic tax on banks. The measure is both symbolic "payback", in the words of Lord Myners, to compensate society and the real economy for bailing out the financial system; and pragmatic - raising revenue to help plug the hole in public finances (proceeds of the tax would go straight to the Treasury rather than into an insurance fund for future bank bail-outs).

Notably the Government is supporting an *internationally agreed* banking tax (a dig at the Conservative plan to go it alone), so it remains unclear how the UK would act should other G20 nations choose to adopt a different approach. Details of the nature of the levy (the rate, and the way it would be applied) will be discussed by G20 finance ministers following the publication of the IMF's recommendations next month.

The Government will also consult on draft regulations to require enhanced disclosure of remuneration in the financial services sector, and the strengthening of shareholder's powers of scrutiny.

Improving financial services

The Chancellor also set out a universal service obligation to guarantee a basic current account to all UK adults. This is forecast to extend access to banking services to 1m financially excluded people in the next 5 years. In a bid to placate savers who have arguably been worst affected by the low interest-rate environment of the last two years, Darling announced ISA thresholds would increase annually in line with inflation. Stamp duty was scrapped for homes below £250,000 for first-time buyers, which should see a rise in mortgage applications, supporting the base of the housing pyramid. Stamp duty on residential property sales over £1m will increase to 5%.

- **Business rates cut for one year from October**
- **RBS and Lloyds will provide £94bn in new business loans, nearly half to SMEs, over the next year.**
- **Tax information agreements with Dominica, Grenada and Belize**
- **Doubling of stamp duty allowance from £125,000 to £250,000. This will be paid for by 5% stamp duty for properties over £1m**
- **From next month the annual ISA limit will rise from £7,200 to £10,200 and ISA limits will increase annually**
- **Inheritance tax frozen for next four years**
- **Duty on cider will increase by 10% above inflation from Sunday. Duty on beer, wine and spirits will increase as planned from midnight on Sunday**
- **Over £4bn next year for operations in Afghanistan**
- **Tobacco duty will increase from today by 1% above inflation**
- **Number of civil servants in London to be reduced by a third, with 15,000 posts relocated outside the capital within the next five years**



The Government will also ask the Retail Financial Services Forum to consider to what extent sales targets and incentives for staff working in financial services lead to poor outcomes for consumers, and how these can be reformed.

Support for SMEs

A substantial part of the Chancellor's growth package was targeted at helping small businesses access credit and included tax incentives and support from the banking sector which has been lent on by the Government to contribute.

The Chancellor announced greater redress mechanisms for small business owners via the creation of an independent Small Business Credit Adjudicator Service with legal powers to review banks' credit decisions.

State-owned banks RBS and Lloyds now also face higher targets for gross lending to businesses - £94bn, of which half will go to SMEs. Competition in the banking sector, which should ultimately lead to increased lending, is being boosted by measures to speed up FSA licensing of new entrants into the banking market.

Non-bank financing for small business is being streamlined under a new national investment corporation, 'UK Finance For Growth.' This will oversee the Government's finance support and will incorporate the new Growth Capital Fund, originally announced during the PBR, which will channel private investment (£500m in total) into small, fast-growing companies.

The Chancellor also announced a cut in business rates for a year from October which will create a tax reduction for 500,000 SMEs in the UK, of which 345,000 will pay no business rates. To encourage SME expansion the annual investment allowance will be doubled to £100,000. Capital Gains Tax Entrepreneurs Relief has been doubled from £1m to the first £2m of gains made over a lifetime but otherwise Capital Gains Tax remain unchanged. Additionally the government will continue to offer Time to Pay arrangements to allow businesses to spread tax payments over an agreed timetable.

Acting on the recommendations of the Glover Review there will be a 15% increase in the number of government contracts awarded to SMEs providing them with £3bn extra potential investment. For those SMEs already with government contracts the Chancellor committed to speeding up payments from government to business.

Energy and infrastructure

The creation of a £2billion fund for energy and infrastructure projects will be substantively well received by industry and green NGOs, who have long clamored for such a body to be created. Green groups were critical of the 2009 budget for merely 'applying a sticking plaster to a low carbon industry on life support' and although this Budget comes with less 'low carbon' spin it is in truth a more substantive commitment.

The fund will be made up of an initial equity outlay for the bank of £1billion private sector investment and £1billion government funds from the sale of various state assets. The bank will focus primarily on green transport (the announcement on the staging of fuel duty may be criticised in this respect) and sustainable energy, particularly offshore wind. The latter will receive an additional £60million to develop ports hosting manufacturers of offshore wind turbines. Although this green bank is double the size of the similar institution proposed by the Conservatives, it still falls far short of the £10bn a year the Stern review predicted would be needed to prepare the economy for cuts in emissions.

- **A £2bn green infrastructure fund - using £1bn of public cash matched with private funds**

- **£60m to develop ports hosting manufacturers of offshore wind turbines**

- **The pensioners' higher winter fuel payment of £250 and £400 for the over-80s, guaranteed for another year**

- **£100m set aside for repairs to local roads, £285m for improvements to motorways**

- **A £270m fund to create 20,000 university places in subjects such as science, maths, and engineering**

- **A £35m University Enterprise Capital Fund to support university innovation and spin-off companies.**

- **Parents of one and two-year-old children will get an increase of £4 a week in child tax credit from 2012**



Timing for availability of funds may well also prove an issue if the Government's asset sales meet with any delay or problems.

The Government's commitment to various infrastructure projects including Crossrail, Heathrow Third Runway and a North South high speed rail link was restated, plus an additional £100million and £280million will be provided to rebuild local roads and motorways respectively.

Pensions and savings

Darling included measures to reform public sector pensions and control public sector pay, including confirmation of a 1% cap on basic pay uplifts for 2011-12 and 2012-13.

The government has said it is committed to continuing to provide sustainable defined benefit pensions. As part of this, cap and share provisions will be implemented for teachers, civil service, NHS and local government pension schemes. These provisions will cap the contribution to pensions made by employers, thereby limiting the liability of the taxpayer as pensions become more valuable. Additionally, the Budget has introduced a new Code of Practice on setting pay for senior public sector workers, following the pay freeze for these workers in 2010-11.

The government is accepting the results of the Senior Salaries Review Body review of senior pay in the public sector. This recommends greater use of independent Remuneration Committees, which will include 'taxpayer champions' and escalation of decisions to ministers, or audit and regulatory bodies, where there is a proposal to pay above agreed norms. The government is asking all public sector organisations to explain, publicly, how they will comply with the code by the end of the year, and working with the SSRB, will consult on detailed implementation of the code's provisions.

The 'Sin taxes'

Last minute wrangling is reported to have continued late last night over whether Mr Darling could afford to postpone increases in fuel duty and today he announced that next month's planned 3p increase will be staged to soften the blow. It will go up by 1p in April, another 1p in October and a final 1p in January 2011. The move will be seen as a bid to quell a pre-election revolt by motorists over soaring pump prices.

The so-called sin taxes have risen across the board, with tobacco duty increasing by 1% immediately, then 2% in subsequent years. This will not go far enough for centre-right think tank Policy Exchange who recently called for a 5% rise in tobacco duty in the next five Budgets, pushing the price of a packet of cigarettes to £7.42 to make smoking 'revenue neutral'.

The Chancellor has increased duty on beer, wine and spirits by 2% above inflation - around 5% - from midnight on Sunday, under the existing four year duty escalator system introduced in the March 2008 Budget. This follows three duty increases and one VAT hike in the last two years, pushing duty on spirits up by more than 15% and duty on wine by 20%.

As outlined in the Pre-Budget Report cider duty will go up by 10% to address a long-standing anomaly, and the definition of cider will also be changed, so that higher strength brands are taxed more. Giving his response to the Budget Mr. Cameron said Labour's "big idea" were all existing Tory policy, including the increase in cider duty which the Chancellor had previously claimed was illegal.

While it might appear inevitable that the Chancellor has looked to squeeze



additional revenue from alcohol duty, industry figures have warned that there is no logic to today's increase which will be unpopular with voters and, according to the Treasury's own figures, will not generate the anticipated additional revenue. Recent pressures on the sector have resulted in over 30,000 redundancies and industry will argue the extension of the tax escalator could further threaten investment and jobs.

Digital Britain

Alistair Darling reiterated the government's commitment to making Britain a digital world leader, by promising more tax breaks for the UK's computer games industry and confirming the government's intention to roll-out super-fast broadband for the majority of homes by 2017, funded by a £6 annual tax on landline phones. "The UK has the potential to be a digital world leader. It needs high-speed broadband for rural areas as well as urban, it must not be limited to the well-off," the Chancellor said in his speech. He also emphasised a superfast broadband network to create thousands of new businesses and jobs and open the way for public services to be delivered "more effectively and at lower cost."

The broadband tax has proved controversial and is increasingly becoming a hot election issue. The funding mechanism has been strongly criticized as unnecessary and regressive by both the Business Select Committee and the Opposition. The Conservatives favours leaving the roll out of such services to the industry, although it would consider government assistance in 2012, when funds are freed up by the digital switchover.

Gordon Brown also signalled how seriously the government is talking all of its digital commitments with a speech earlier this week in which he described high-speed web access as "the electricity of the digital age". Alongside Broadband proposals the budget also made it clear that the government will establish a new Digital Public Services Unit, to drive "rapid progress in transferring services to online channels," to get one million more people online in the next three years and reduce the gap in digital inclusion.

Efficiency across Whitehall

The Chancellor announced that a number of Government departments will be forced to bear the initial burden of spending cuts in a move designed to add clarity and credibility to the government's deficit reduction plan. He claimed they are on track to achieve £11 billion in efficiency savings. Over 15,000 civil servants will be re-located to offices outside London within the next five years and across the board the number of civil servants workers that work in London will be reduced by a third. The Ministry of Justice will be one of the departments undergoing such moves – saving £41 million.

Millions of pounds will be taken off Whitehall departments' spending on back office functions in an attempt to force them to share services such as in human resources and finance. All departments will be publishing reports this week on how they intend to make such savings this week.

Jobs and youth unemployment

Alistair Darling was able to announce that unemployment in general had not reached the levels feared this time a year ago. Unemployment has stabilised in recent months to 1.6 million people, which is a lower average than the Euro Area. However youth unemployment remains a concern and will be a campaign issue. Darling announced today a £450 million pot to extend to March 2012 the guarantee of a job, training or work placement for every 18 to 24 year old who has been claiming Job Seeker's Allowance for six months.



Supporting this focus on youth unemployment, the Government has announced a £270million University Modernisation Fund to finance 20,000 additional student places.

Healthcare

By no measure the centre piece of the budget, the Chancellor reinforced his plans to ring-fence NHS funding. He confirmed today that the Government will be sticking to their spending plans for the next year, ensuring that recent improvements in frontline services are maintained. The budget reiterates calls for the NHS to deliver annual efficiency savings of £15 to 20 billion by 2013-14. Promises were made to uphold the pledges for two-week maximum waiting times for cancer referrals, as well as NHS health checks every 5 years for over 40s. He also announced that a four year freeze on the inheritance tax threshold would help pay for care of the elderly.

Tax reform

Industry and inventors will set to benefit from the government's 'patent box' scheme, whereby corporation tax will be cut to 10% for patents that originate in the UK from 2013. The Chancellor announced another tax giveaway to reduce the age at which people working 16 hours a week are eligible for Working Tax Credit from 65 to 60.

These commitments aside, the Chancellor's handling of tax was predominantly directed to raising government revenues. Income tax bands and the inheritance tax threshold were maintained at current rates, despite modest inflation returning to the economy. High-earners were singled out for increased taxation, with people earning over £150,000 subjected to a 50% rate of taxation from April this year, those with incomes over £130,000 having their pension tax relief restricted from 2011 and those with incomes over £100,000 seeing the value of their personal allowances decrease from April this year.

Finally the Chancellor stated his intent to extend the measures against tax-evasion and avoidance announced in December's pre-Budget report. Among wider reforms, the government will sign three new tax information exchange agreements, subject those who fail to declare offshore tax liabilities to the same penalties attracted by deliberate tax evasion and impose a new requirement to notify HMRC when opening offshore bank accounts in certain jurisdictions. As a result, evading tax offshore could result in penalties totaling up to 200% of the unpaid tax.



The Budget 2010 – what happens next ...

1. Budget Day: Wednesday 24 April

12:30pm: Chancellor delivers the Budget Statement
1:30pm: HM Treasury issues full Budget Report with all accompanying materials
1:30pm: Response by the Leader of the Opposition

2. Budget Debate

Provisions within the Budget will be given time for debate in the House of Commons main chamber between 24-30 April 2010

3. Treasury Select Committee – Budget 2010 Evidence Sessions: Monday 29 March – Tuesday 30 March

Monday 29 March, 4.00pm
Oral Evidence Session
Industry Specialists

Wednesday 30 March, 9.45am
Oral Evidence Session
Rt Hon Alistair Darling MP, Chancellor of the Exchequer, and HM Treasury officials

4. Legislation

First Reading: HM Treasury publishes updated Finance Bill imminently (containing budget resolutions)

Second Reading: Within 30 days of Budget Statement

Committee of the House: Key clauses of Finance Bill debated in Commons chamber

Standing Committee: Finance Bill scrutinised line by line

Report Stage and Third Reading: Amended Bill returns to the Commons chamber for further debate and approval

Lords consideration: Scrutiny of the Bill by the House of Lords is purely formal and usually the Bill passes through all its stages in the Lords on a single day

Finance Act 2010 must achieve Royal Assent before the General Election, expected to take place on 6 May.

NB: In order to ease pre-election passage of the Finance Bill, the Government can choose to only include measures essential to maintaining the Government's revenue-raising capacity while leaving other measures to a post-election Finance Bill.