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# **BUDGET 2009 POLITICAL BRIEFING**

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With the UK facing its most difficult economic circumstances since World War II, the Chancellor of the Exchequer, Alistair Darling MP, presented his well-leaked budget statement to the House of Commons against a backdrop of unemployment reaching 2.1 million.

In a serious and sober speech, Mr Darling set out the scale of the challenge facing the government and the UK economy by referring repeatedly to the global nature of the banking crisis, the recession and government action.

His objective in doing so was twofold: to avoid the Conservative charge that the government was responsible for the depth of recession the UK is facing by “failing to fix the roof while the sun was shining,” and to try to demonstrate that in opposing a stimulus, the Conservatives are going against prevailing government action around the world.

The headlines tomorrow will focus on the new top tax rate of 50 percent for those earning more than £150,000, effective from April next year. As the leader of the opposition, David Cameron MP stated in his reply to the budget statement, “This is a breach of a manifesto commitment made by the Labour Party at the last general election in which they stood on the pledge, ‘We will not raise the basic or top rates of income tax in the next Parliament.’”

Higher earners are to be hit further with Darling announcing today that personal allowances for those earning more than £100,000 are to be withdrawn in their entirety from April 2010 and pension tax relief reduced for those with incomes more than £150,000 from the year after.

Some of the media will portray today’s announcements as a “Soak the Rich Budget.” The Prime Minister and his Chancellor are clearly gambling that in the current climate a higher top tax rate in the UK will be more acceptable to an electorate facing financial hardship. A key political question for the Conservatives is whether they will go into the next election pledging to reverse these proposals or whether they accept them in the short term.

Yet although tax changes will steal the headlines, the key announcements today related to growth and public finances. Darling made a series of announcements that in the coming years may well be come to be seen as far too optimistic.

The Chancellor’s forecast for GDP growth for this year is –3.5 percent, which, whilst downgraded from November’s pre-budget report, is roughly in line with forecasts made by independent analysts. Darling claims, “because of our underlying strength, the measures we are taking, domestically and internationally, I expect to see growth resume toward the end of the year,” and that growth next year will be 1.25 percent. This will surprise many commentators who have, by and large, predicted GDP growth in 2010 to be less than 0.5 percent. The IMF is actually predicting that the UK economy will contract by 0.4 percent in 2010. Even more surprising perhaps was his confident prediction that the economy would strengthen to such an extent that growth would be 3.5 percent in 2011.

On public finances, Darling made the expected announcement that public borrowing this year would hit £175bn – over 12 percent of expected national income. As with the Treasury growth forecasts, Darling presented an optimistic pathway for improvement in the state of the finances, claiming that the budget deficit will be halved in the next four years. Whilst there would be fiscal easing of 0.5 percent this year, he claimed deficit reduction would take place through a fiscal tightening of 0.8 percent.

Even if the government's predictions on growth and the public finances turn out to be right, this will mean further, if relatively modest, tax rises and/or spending cuts from 2010. However, if these forecasts are wrong, the tax rises and spending cuts required will need to be far more dramatic.

Critics will argue that the somewhat rosy forecasts presented today are all to do with the fact that the government will be facing re-election in a year's time - and that the true scale of cuts required will only be revealed once that election has taken place. This is something that David Cameron argued in a confident Commons performance, claiming that Government had made an utter mess of the economy and that the country "cannot simply afford another five years of Labour." He derided the Chancellor's figures claiming that he was predicting a "trampoline recovery."

The Liberal Democrat leader Nick Clegg MP's response was to argue that the Chancellor was simply tinkering at the edges of the very rich.

The Chancellor made further announcements today on housing, the automotive industry (the well-trailed £2,000 scrappage scheme), the environment, research & development and help for the unemployed in what will be regarded as a modest stimulus package. In doing so, he appeared to be in agreement with the governor of the Bank of England that, following a decade of massive government investment, a large fiscal stimulus would not be appropriate. In this sense, the usually quiet and modest Chancellor appears to have won an important battle with his Prime Minister.

Unusual for a Labour Budget speech, there was little reference to education and the health service, although, as ever, the devil is in the detail, with the share of the NHS's budget overall resource expenditure limit for 2010-11 being reduced by £2.3bn from £104.6bn to £102.3bn from the 2008 budget.

In an increasingly tight economic environment, questions of whether Labour has done enough to encourage efficiency, value for money and reform in the public services will dominate the next election. Public services have arguably improved since 1997, but has there been real, sustained transformational change?

Many believe the reform process has stalled since Gordon Brown became Prime Minister. Will the pressure of the public finances finally force his hand? Certainly it seems that unless Gordon Brown embraces public sector reform at least as

enthusiastically as his predecessor, he will face an electorate who are likely to decide it is wrong for the public sector to be shielded from the changes that private sector businesses are being forced to adopt to survive.

The Chancellor had limited room for manoeuvre with this budget. This was a constrained budget for constrained economic times which may well prove to be the Brown government's legacy.

## BUDGET 2009 SUMMARY

### **Key Points**

- A predicted 3.5 percent decline in GDP for 2009, followed by optimistic growth predictions of 1.25 percent in 2010 and 3.5 percent in 2011; budget deficit predicted to halve in four years.
- Tax on income above £150,000 to be increased to 50 percent from April 2010 and personal allowance to be withdrawn for incomes more than £100,000 from April 2010.
- Funding for off-shore wind, renewable projects, low carbon energy and energy efficiency measures announced as part of the “green stimulus.”
- £1bn announced for future housing support along with extensions for stamp duty exemptions, Support for Mortgage Interest scheme and HomeBuy Direct.

### **Economy and public finances**

#### **Economy**

- The British economy contracted by 1.6 percent in the last quarter of 2008. For the 1st quarter of 2009, the economy is expected to contract by a similar amount.
- The forecast for GDP growth for 2009 will be -3.5 percent, in line with other independent forecasts but revised down substantially since the 2008 pre-budget report.
- GDP is forecast to contract sharply in the first half of 2009, to stabilise in the second half of the year and begin growing toward the end of the year.
- In 2010, the government predicts growth will reach 1.25 percent.
- From 2011, the Chancellor forecasts that the economy will continue to recover, with growth of 3.5 percent, with growth of 2.75 percent forecast for future years.

#### **Inflation**

- CPI inflation targets will remain the same at 2 percent in 2009.
- CPI inflation was 2.9 percent in March 2009, while RPI inflation was -0.4 percent.
- CPI inflation is expected to continue to ease through 2009, falling to 1 percent by the end of the year. RPI is expected to stay negative, falling to -3 percent by September before reaching zero percent again next year.

**Exports**

- UK exports are forecast to be down 14 percent from 2008, but less severely affected than other major export economies, including Germany and Japan.

**Budget Deficit**

- Through government initiatives, the budget deficit is predicted to halve in four years.

**Unemployment**

- An additional 74,000 became unemployed in Britain in March 2009.
- The claimant unemployment rate now stands at 4.5 percent.

**Public Borrowing**

- The projection for net borrowing will be £175 billion this year, or some 12.4 percent of GDP.
- From 2010, borrowing will fall to £173 billion, then £140 billion in 2011, £118 billion in 2012 and £97 billion in 2013.

**Debt**

- UK net debt will, as a share of GDP, increase from 59 percent this year, to 68 percent next year, 74 percent in 2011-12, peaking at 78 percent and 79 percent in 2013-14.

**Public Expenditure**

- Public sector net investment will be at 1.25 percent of GDP by 2013-14.
- Spending will continue to rise by 0.7 percent a year after 2011.

**Tax Revenues**

- Tax as a share of GDP has fallen 1.2 percent since last year.
- The fiscal forecast includes losses of 3.5 percent of GDP.

**Financial Sector Regulation**

- The Treasury is preparing a paper on financial sector reform geared toward retaining the UK's position as a global leader in the sector.
- The paper will propose reforms across a number of areas including: corporate governance, capital liquidity and transparency.
- The proposals, designed to complement the agreement reached at the G20 summit, will regulate all financial institutions, including hedge funds.

**Personal Taxes**

- Tax on income above £150,000 to be increased to 50 percent as of April 2010.

- Personal Allowance to be withdrawn for incomes of more than £100,000 from April 2010.
- Pension tax relief to be reduced for those earning over £150,000.
- Duty on tobacco to rise 2 percent by 6 p.m. today and alcohol to rise 2 percent from midnight.
- Fuel duty to rise by two pence from September and one penny per litre above indexation every April for the next four years.
- Limit for tax free ISAs to rise to £10,000 for over 50s this year, and for everyone else next year.

### Corporate Taxes

- Scheme allowing loss-making businesses to claim back taxes on profits made in the last three years to be extended until November 2010.
- The government will continue allowing some business to defer their tax bills.
- Main Capital Allowance rate to be doubled to 40 percent in order to encourage investment.

### Public Services

- Public sector net investment will be at 1.25 percent of GDP by 2013-14.
- The Government recommitted to increasing investment on schools (4 percent) and hospitals (5 percent).
- The Department of Health revenue budget for 2010-11 has been adjusted from £104.6bn to £102.3bn.
- They have identified extra efficiencies from 2011 which rise to a further £9bn of additional savings a year by 2013-14.
- They include efficiencies in public sector back-office functions and IT, improved procurement, and better collaboration and innovation at the local level.

### Energy and the Environment

- Fuel duty is predicted to increase by two pence per litre in September, and then by one penny a litre above indexation each April for the next four years.
- £1bn will be allocated to combating climate change, by supporting low carbon industries and green collar jobs.
- A carbon budget is being introduced which aims to cut Britain's carbon emission by 34 percent by 2020.
- £435m of extra support will be provided to deliver energy efficiency measures for homes, businesses and public buildings.

- The government will provide £524m of financial support over the next two years to lift the barriers for off-shore wind, funded through the renewables obligation.
- Up to £4bn of new capital from the European Investment Bank will be allocated to renewable and other energy projects in the UK.
- The government will exempt combined heat and power technology projects from the Climate Change Levy from 2013.
- £405m of new funding will be invested in small scale projects to drive low carbon energy and advance green manufacturing in Britain.
- A new funding mechanism will be introduced to finance up to four Carbon Capture and Storage demonstration projects.
- Coal, oil, nuclear and gas will continue to be major sources of energy for the foreseeable future.

### Housing

- The higher level of the Support for Mortgage Interest scheme will be continued for a further six months to help homeowners looking for jobs.
- Following government support to encourage mortgage lending, the Chancellor hopes UK banks will increase the availability of mortgages by around £20bn.
- The Stamp Duty holiday on properties sold for less than £175,000 has been extended until the end of the year.
- The shared equity mortgage scheme, HomeBuy Direct, will receive an additional £80m of funding.
- Around £1bn will be allocated to meet future housing supply: £500m of extra financial support will be allocated to kick-start building on housing projects, £100m of which will be allocated to local authorities to build new energy-efficient housing.
- £50m of funding will be brought forward to accelerate the modernisation programme for housing for the armed forces.

### Pensions

- The basic state pension will be increased by at least 2.5 percent.
- From April 2011, the government will restrict pension tax relief for those with incomes over £150,000.
- The government will maintain the Winter Fuel Allowance at the higher level of £250 for the over 60s and £400 for over 80s for one more year.
- The Pension Credit limit will be raised to £10,000 from November 2009 resulting in over half a million pensioners gaining an average of £4 per week.

### **Transport**

- A scrappage scheme will be implemented in April 2009 and will run until March 2010 which will provide motorists with a £2,000 discount on new vehicles bought when they trade in cars over ten years old.

### **Education and Young People**

- £250m this year and £400m in 2010-11 to be used to allow 16-17 year olds to stay in education if they wish and create an additional 54,000 places at sixth forms and colleges.
- Investment in schools will increase by 4 percent.

### **Families**

- Child tax credit to rise £20 per child from April 2010.
- Child Trust Funds for disabled children to rise by £100, £200 for the seriously disabled.
- Grandparents of working age who care for their grandchildren will see that work count towards their entitlement for the basic state pension.

### **Workforce and Skills**

- Government support for economy is forecast to protect 500,000 jobs.
- Job Centre Plus to receive £1.7bn of additional funding.
- All under-25s unemployed for 12 months to be offered a job or training.
- £260m to be spent helping young people get experience and training.
- Statutory redundancy pay to be increase to £380 per week.

### **Research & Development**

- £2.5bn for businesses to invest in industries and high-paid, high-skilled jobs of the future such as advanced manufacturing, the creative industries and low-carbon technologies.
- Extra funding to be allocated for digital investment.
- £750m Strategic Investment Fund to help develop emerging technologies and regionally important sectors.