

EMERGENCY BUDGET 2010 POLITICAL BRIEFING

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Commentary

Six weeks after the formation of the Liberal-Conservative coalition government, the new Chancellor of the Exchequer, George Osborne MP, presented his first budget to the House of Commons. With the government stating that its first priority is to reduce the budget deficit and restore economic growth, today's announcement made clear the scale of the action it believes is required. Announcements made today are likely to affect the UK's economy, the structure of its public sector and the conduct of its politics for years to come.

In many ways, despite this being an early "emergency" budget, it is likely to provide the parameters for the political divide in Britain from now to the next election in five years. If everything goes according to the government's plan, there will be a chance of a tax-cutting budget just before General Election 2015; if not, then the coalition may have very little chance of surviving the verdict of the people.

In a confident speech, the chancellor characterised his budget as "tough but fair" and said that its objective was to balance Britain's books within five years. He claimed that the emergency budget "deals decisively with our country's record debts. It pays for the past. And it plans for the future." In announcing the government's approach to tackling the deficit, the chancellor said that 77 percent of it would be achieved by lower spending and 23 percent through higher taxes.

In setting the scene for the detail of the budget, the chancellor said that the new Office for Budget Responsibility (OBR) had been asked to determine whether the government was on track to meet two goals: that the structural current deficit should be in balance in the final year of the 5-year forecast period, which is 2015-2016; and that debt is falling as a share of GDP by 2015-2016. Mr. Osborne said that the judgment of the OBR was that as a result of measures announced today, such goals would be achieved by the fiscal year 2014-2015. Could the chancellor's ambition to meet these goals a year early be driven more by politics than economics? It would certainly place the coalition government in a position to cut taxes in a pre-election year.

Announcing the latest forecasts from the OBR, the chancellor said that as a result of measures taken today, revised growth figures would be slightly lower in the next couple of years: 1.2 percent this year and 2.3 percent next year. Unemployment is predicted to peak this year at 8.1 percent, before falling back to 6.1 percent in 2015.

Although the outline of the budget has been trailed in recent days through extensive press briefings, there was still much for the analysts and commentators to mull over. The headlines tomorrow will probably be taken by the increase in VAT from 17.5 percent to 20 percent, effective from 4 January 2011. This measure alone is expected to raise £13bn a year, but has already been criticised by those who regard this form of taxation as regressive. It is worth noting, though, that the new rate will be similar to the rate levied in many other EU countries.

One of the most difficult areas for the new government to address today was capital gains tax (CGT). The Liberal Democrats had made it clear that they wanted to see CGT levied at the same rate as income tax, while John Redwood MP had led a revolt by some backbench Conservative MPs who wanted to keep CGT rates low. The Chancellor today rowed a middle course: preserving CGT at lower rates for basic-rate taxpayers, increasing it for higher-rate earners to 28 percent and extending the 10-percent CGT rate for entrepreneurs to the first £5m of lifetime gains. Corporation tax will be reduced year-on-year from 28 percent to 24 percent, with the small companies' rate reduced to 20 percent, measures partly paid for by reducing capital allowances.

As trailed in his Mansion House speech, the chancellor confirmed that there would be a new bank levy, applying from January 2011 to the balance sheets of UK banks and building societies and to the UK operations of banks from abroad. Osborne stressed that France and Germany today agreed to introduce a similar levy. The detail on this will follow at a later date.

On public expenditure, the chancellor confirmed that spending on health and international development would be protected. He said that this implied an average real-terms cut in other departments of 25 percent, although in practice this will vary, with defence and education being singled out by Osborne as facing particular pressures and therefore lower cuts. For the detail and allocation by department, we will have to await the outcome of the comprehensive spending review, which will be announced on 20 October. Expect a summer of tough departmental negotiations. Expect also a summer of unrest in the public sector with a 2-year pay freeze on public-sector pay on those earning more than £21,000 and an independent commission chaired by John Hutton looking at the future of public-sector pensions.

In many ways the toughest element of today's budget was a series of measures designed to reduce the welfare bill. Benefits, tax credits and public sector pensions in future will be uprated in line with the lower-level consumer prices index rather than retail prices. Tax credits will be restricted, housing benefit reformed, child benefit frozen for three years and a new medical assessment for disability living allowance introduced.

In recent weeks, Osborne has been keen to bind the Liberal Democrats into the difficult decisions being taken on tax and spending and to do so publicly. He has allowed, perhaps encouraged, his Liberal Democrat Chief Secretary to make difficult announcements on spending cuts for this fiscal year, and the contents of today's budget were signed off not only by the Prime Minister David Cameron MP, but also by Nick Clegg MP and Danny Alexander MP. In a tough reply to the Budget statement, the acting Leader of the Labour Party, Harriet Harman MP, argued that the Liberal Democrats were being used as political cover for Conservative policies, saying "this reckless Tory budget would not be possible without the Lib Dems."

Although the Liberal Democrats will point to the £1,000 increase in the personal allowance as a first step toward their goal of the first £10,000 of income being free of tax, there will be some nervousness within the party that they are taking the risk of being tarnished by unpopular policies, without being in a position to claim the credit should these tough measures work. This is a very new set of political circumstances for the Liberal Democrats and only time will tell if they can keep their nerve, their MPs and party together and their popular appeal with the public.

Certainly it is likely that the budget and the CSR will make the government unpopular in the short to medium term as the full impact of the changes comes into effect. It is at that point that the strength of the coalition will truly be tested: whether the coalition partners can withstand the pressure that will be inflicted from within and without their parties, and whether they have the resolve to see through the strategy which they outlined today. If they can do so, Cameron and Osborne will hope that making decisions early in the Parliament will mean that as we approach the next election, the economy will start to improve and they will receive the credit from voters for dispensing tough but necessary medicine. Nick Clegg will hope that the Liberal Democrats will be seen as having acted responsibly at a difficult time for the country.

Yet some commentators fear that the government's decision to go for an early squeeze may tip the economy back into negative growth, resulting in a "double-dip recession." This, of course, was the central argument of the last election, with Labour arguing that to cut now would put the recovery at risk. Time will tell, but this remains the central political argument for now.

There are times in politics when the sea-change is palpable. Today's budget shows just how much times have changed: after a decade where Gordon Brown used his budgets to trumpet ever-higher public spending, today saw a chancellor making virtue out of the necessity to cut it back. From today's budget Britain's public spending and public services exist in an entirely different political environment from the last 13 years. The times have well and truly changed.

Economy

- The UK economy is predicted to grow by 2.3 percent in 2011 and by 2.7 percent in 2014 and 2015.
- Unemployment is predicted to fall from 8.0 percent in 2011 to 6.1 percent in 2015.
- Consumer price inflation is expected to reach 2.7 percent by the end of 2010 before returning to target in the medium term.
- The inflation target remains at 2 percent, as measured by the Consumer Prices Index.
- The structural current deficit will be eliminated by 2014-2015, with a projected structural surplus of 0.8 percent of GDP in 2015-2016.
- The government will abolish the euro entry preparations unit.

Public Debt

- Public-sector net borrowing is expected to decrease from 10.1 percent in 2010-2011 to 1.1 percent in 2015-2016.
- Public-sector net debt will increase from 61.9 percent in 2010-2011 to 67.4 percent in 2015-2016.
- The government expects to save £32 billion per year by 2014-2015 from spending reductions, and the spending review will be on 20 October 2010.
- Lower spending rather than higher taxes is the priority; savings will come from 77 percent lower spending and 23 percent from higher taxes by 2015-2016.

Public Sector

- The government confirmed its commitment to deliver annual efficiency savings in the public sector of £6.2 billion in 2010-2011.
- A two-year pay freeze will be introduced from 2011-2012 for public-sector workers, except for those earning £21,000 or less, who will receive an increase of at least £250 a year, for savings of £3.3 billion a year by 2014-2015.
- Former *Observer* editor Will Hutton will be leading a review of high pay in the public sector.
- The government announced a further £17 billion cuts in departmental spending by 2014-2015, with unprotected departments facing average real cuts of around 25 percent over the next four years.

Tax

VAT

- Value Added Tax (VAT) will increase from 17.5 percent to 20 percent on 4 January 2011.

Capital Gains Tax

- Capital Gains Tax (CGT) remains at 18 percent for basic-rate taxpayers, but higher-rate taxpayers will pay 28 percent. There will be an increase in the entrepreneurs' relief lifetime limit from £2 million to £5 million.

Corporation Tax

- The main corporation tax rate will be cut by 1 percent to 27 percent, and by 1 percent annually for the next three years, until it reaches 24 percent.
- The small companies' corporation tax rate will be cut to 20 percent, and there will be a reduction in the main and special rate of capital allowances to 18 percent and 8 percent respectively in April 2012.

Income Tax

- The tax-free personal allowance for under-65s will be increased by £1,000 to £7,475 in 2011-2012.
- The 50p rate of income tax took effect from April 2010 and will remain in place for the time being.
- The government will review the taxation of non-domiciled individuals.

Other Taxes

- The government hopes to freeze council tax levels in England in 2011-2012 with details to be announced later.
- The standard and the higher rate of Insurance Premium Tax (IPT) will increase to 6 percent and 20 percent.
- The Corporation Tax Annual Investment Allowance will be reduced from £100,000 to £25,000 from April 2012.
- Significant restrictions in tax credits have been announced and they will no longer be paid to those with incomes over £40,000 per annum.
- The child element in the tax credit system will increase by £150 above inflation.
- Controlled Foreign Company (CFC) rules will be reformed, along with moves toward a more territorial basis for taxing the profits of foreign branches.

- The government also confirmed its intention to create an independent Office of Tax Simplification, details of which are to follow.

Business

- From April 2011, the threshold at which employers start to pay National Insurance will rise by £21 per week, above indexation.
- The government will shortly announce details of a scheme to help new businesses in targeted areas of the UK. During a three-year qualifying period, new businesses which start up in selected areas will get a substantial reduction in their employer National Insurance Contributions (NICs).
- Within the qualifying period, these employers will not have to pay the first £5,000 of Class 1 employer NICs due in the first 12 months of employment. This will apply for each of the first 10 employees hired in the first year of business and operate in selected countries and regions.
- The government will create a Regional Growth Fund in 2011-2012 and 2012-2013. This Fund will operate in England only and support increases in business employment and growth.
- The Enterprise Finance Guarantee (EFG) will be increased by £200 million to support additional lending of up to £700 million for small businesses until 31 March 2011.
- The government confirms that it will proceed with the establishment of a Growth Capital Fund to provide growth capital in the £2-10 million range to fast-growing SMEs currently not served by the market.
- A new Enterprise Capital Fund of £37.5 million will also be introduced to provide additional equity finance for small businesses.
- The government will publish a Green Paper on business finance before the summer recess.
- Tax relief for the video games industry will be abolished.

Financial Services Reform

- A bank levy based on total consolidated liabilities will be introduced in January 2011. France and Germany have agreed to introduce a similar levy.
- Once fully in place, the levy will be set at 0.04 percent of liabilities in 2011 and increasing to 0.07 percent thereafter. It is expected to bring in £2 billion in revenues.
- The levy will apply to UK banking groups and building societies as well as foreign banks operating in the UK. The government will consult over the summer with the final details of the levy to be published later this year.

Pensions

- From April 2011, the basic state pension will be uprated by a triple guarantee of earnings, prices or 2.5 percent, whichever is highest.
- The government will increase the basic state pension in April 2011 by at least the equivalent of RPI.
- The government will review the date at which the state pension age increases to 66.
- In April 2011, the standard minimum income guarantee in pension credit will increase by the cash increase in a full basic state pension.
- John Hutton, former secretary of state for work and pensions, will undertake a fundamental structural review of public service pension provision by the 2011 budget.
- In line with commitment to tackling the fiscal deficit, the government will seek to ensure that it raises at least the same amount of revenue through restricting pensions tax relief as has already been accounted for in the public finances before 2015.

Housing

- The government will review the stamp duty land tax relief for first-time buyers.
- Support for Mortgage Interest (SMI) will be paid at the level of the Bank of England's published Average Mortgage Rate from October 2010.
- From October 2011, Local Housing Allowance rates will be set at the 30th percentile of local rents.
- Deductions for non-dependents will be uprated in April 2011 on the basis of prices. This will reverse the freeze in these rates since 2001-2002.
- From 2013-14, Local Housing Allowance rates will be uprated in line with the Consumer Prices Index (CPI).
- From April 2013, housing entitlements for working age people in the social sector will reflect family size.
- Housing Benefit awards will be reduced to 90 percent of the initial award after 12 months for claimants receiving Jobseekers Allowance. This will be introduced in April 2013.
- From April 2011, Local Housing Allowance Rates will be capped at £250 per week for a one-bedroom property, £290 per week for a two-bedroom property, £340 per week for a three-bedroom property and £400 per week for four bedrooms or more.
- The government contribution to Discretionary Housing Payments will be increased by £10 million in 2011-12 and £40 million in each year from 2012-2013.

Families

- From January 2011, the Health in Pregnancy Grant will be abolished.
- From April 2011, payment of a Sure Start Maternity Grant will be restricted to a first child (or children where the first is a multiple birth).
- The rates of Child Benefit for the first and subsequent children will be frozen for three years from April.
- As announced on 24 May 2010, the government will reduce and then stop government contributions to Child Trust Funds.
- In Spring 2011, an annual family financial health check developed by the Consumer Financial Education Body will be launched.
- From October 2011, single parents whose youngest child is 5 or older will be eligible for Jobseekers Allowance rather than Income Support, and existing customers will be transferred from Income Support to Jobseekers Allowance from April 2012.
- From April 2011, tax credits will be reduced for families with household income above £40,000. In 2012-2013, further changes will be made to this threshold to focus tax credits on lower income families.
- The rate at which tax credits are withdrawn once household incomes rise will be increased.

Environment & Transport

- The government announced the creation of a Green Investment Bank to invest in environmentally-friendly ventures and help the UK meet the low-carbon investment challenge.
- The Office for Budget Responsibility will undertake an assessment over the summer of the effect of oil price fluctuations on the public finances. The government will then examine options for the design of a fair fuel stabiliser.
- The government is considering the case for introducing a fuel duty discount in remote rural areas. This includes possible pilot schemes in Scotland.
- In the autumn, the government will publish proposals to reform the climate change levy. Subject to consultation, the government intends to bring forward relevant legislation in Finance Bill 2011.
- The government will explore changes to the aviation tax system, including switching from a per-passenger to a per-plane duty, which could encourage fuller planes.

Defence

- In recognition of the work of the armed services, the government will also double operational allowance to £4,800.

Skills

- The government will support the creation of strong local partnerships, particularly those based around England's major cities and other natural economic areas, to enable improved coordination of public and private investment in skills.

Infrastructure

- The government confirmed the establishment of Infrastructure UK (IUK) to lead work within HM Treasury to enable greater private sector investment in infrastructure, and improve the government's long-term planning and delivery. In the autumn, the government will publish a national infrastructure plan that will set out IUK's goals.
- The planned landline duty, "broadband tax," will be abolished. Instead, the government will use unspent TV license monies meant for digital switchover and will drive private-sector investment in superfast broadband by making regulatory changes to reduce the cost of roll-out.
- The government will also fund three pilots to bring superfast broadband to hard-to-reach areas while working toward a universal broadband service at two megabits per second.