



# Perspectives by Ruth Lea

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### **Budget preview: a Budget for Growth**

#### *Introduction*

The themes of the Budget of 23 March have been well-trailed as the Budget for Growth and from “rescue to reform”. The Budget is intended to be the “most pro-growth budget for a generation” as the Government aims to switch the economic policy debate from “cuts” to “growth”.

The Government’s Growth Review was announced in November 2010.<sup>1,2</sup> The Chancellor will report on the Review on Budget day as well as providing an update “on how the Government is implementing its fiscal consolidation plans aimed at eliminating the structural current deficit and placing debt on a downwards path by the end of this Parliament”. This suggests that his speech will be more than usually wide-ranging.

#### *Economic forecast*

The Office of Budget Responsibility (OBR) will provide an updated forecast for the Budget. As the Bank of England revised down its GDP forecasts and revised up its inflation forecasts between the November and February *Inflation Reports*, we expect that the OBR will do similarly.<sup>3,4</sup>

Since November the outlook for growth has been hit by the poor fourth quarter GDP figure, which shows a fall of 0.6% in the quarter. Even though the economy now appears to be growing, NIESR estimated the GDP rose by 0.2% in the three months to February compared with the previous three months, the first quarter’s GDP rise will probably be around 0.5% which suggests no underlying growth since 2010Q3. This disappointing outcome is well short of the OBR’s expectations in November. Concerning inflation the ongoing tensions in North Africa and the Middle East, with additional concerns about the economic impact of the Japanese earthquake and tsunami, continue to hang over the markets in general and oil prices in particular. Higher commodity prices have of course driven CPI inflation higher than the OBR forecast in November.

The OBR’s main forecasts are shown below with our own projections for the next two years. Much in line with the OECD’s latest UK forecasts we expect 1½% growth for this year compared with the OBR’s 2% and 2% growth for 2012 instead of the OBR’s 2.6%. The National Institute of Economic and Social Research (NIESR) GDP forecasts, also in the table, are not just more pessimistic than the OBR’s forecasts for 2011 and 2012, but also going forward until 2015.

**Table 1 OBR's main economic forecasts, November 2010**

	2009	2010	2011	2012	2013	2014	2015
GDP, YOY % change:							
OBR	-5.0	1.8	2.1	2.6	2.9	2.8	2.7
Outturn, Arbuthnot	-4.9	1.3	1.5	2.0	Na	Na	Na
NIESR	-4.9	1.4	1.5	1.8	2.4	2.5	2.4
CPI inflation, Q4, YOY, %:							
OBR	2.1	3.0	2.8	1.9	2.0	2.0	2.0
Outturn, Arbuthnot	2.1	3.4	3.9	2.0	Na	Na	Na

Sources: OBR, *Economic and fiscal outlook*, Cm7979, November 2010; NIESR, *National Institute Economic Review*, January 2011.

The OECD's recent assessment of Britain's economic outlook was fairly bleak, stating that the recovery will be "sluggish and significantly slower than previous upswings", commenting in particular on the lack-lustre export performance.<sup>5</sup> They recommended keeping interest rates low, for longer than investors currently think likely "even if headline inflation is significantly above target", and whilst they encouraged the Government to "stay the course" on fiscal retrenchment they stated that the spending cuts should not have been so heavily concentrated on capital spending. Other OECD suggestions included lessening planning restrictions to aid house-building, improving educational standards, increasing the state retirement age further, a thoroughgoing review of the tax system and widening the VAT base. As we discuss below, several of these themes will probably be picked up in the Budget speech.

The OBR will also provide an update of the fiscal projections. Table 2 shows the progress of the public finances for FY2010 to date – i.e. from April 2010 to January 2011 – compared with the previous year. Owing to the pick-up in current receipts outstripping the increase in current spending, along with a significant drop in net investment, the PSNB has improved in the first ten months of FY2010 compared with the previous year by £14bn (11%).

**Table 2 Public sector finances: financial years 2009 and 2010 compared**

	April-January, FY2009		April-January, FY2010	
	£bn		£bn	YOY, %
Public sector current budget	-91.8		-85.0	-7.4%
Public sector net investment	35.4		28.1	-20.8%
Public sector net borrowing (PSNB)	127.2		113.0	-11.1%
CG current receipts	Na		Na	+8.4%
CG current spending	Na		Na	+6.0%

Sources: ONS, *Public sector finances, January 2011*, 22 February 2011; IFS, "IFS analysis of today's public finance figures", 22 February 2011.

If the trends of the first ten months continue then the IFS estimates that borrowing for FY2010 could be around £139bn, nearly £10bn less than the OBR forecast in November. But they warned that such extrapolation cannot be relied on. For example, the accrued receipts of the bank payroll tax are frontloaded which could mean that the £139bn would be an underestimate of the outturn.<sup>6</sup> Such caveats suggest that the Chancellor would be unwise to "bag" these potential gains for a "giveaway" Budget.

There is another strong argument against "bagging" any potential gains for a "giveaway" Budget. And that is the impact the lower-than-expected growth trajectory on the public finances. The Treasury's methodology for assessing the impact of lost output on borrowing implies that a 1% permanent loss in output structurally weakens the public finances by 0.7%

of national income.<sup>7</sup> In other words if output undershot expectations by around 1%, the finances would be weakened by about £10bn, though the full impact would not come through until the second year.<sup>8</sup>

Table 3 shows the OBR's November forecast of the key fiscal aggregates along with NIESR's borrowing forecasts.

**Table 3 OBR's forecasts for the key fiscal aggregates, November 2010**

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
PSNB (£bn):							
OBR	156.0	148.5	117	91	60	35	18
Outturn, NIESR	156.4	139.5	117	100.2	81.6	63.6	54.3
Cyclically-adjusted current surplus (% GDP):							
OBR	-5.3	-4.7	-3.3	-1.8	-0.5	0.5	0.9
PSND (£bn):							
OBR	777.2	922.9	1052	1157	1232	1284	1320
Outturn	759.5	Na	Na	Na	Na	Na	Na
PSND (% GDP):							
OBR	53.5	60.8	66.3	69.1	69.7	68.8	67.2
Outturn	52.7	Na	Na	Na	Na	Na	Na

Sources: OBR, *Economic and fiscal outlook*, Cm7979, November 2010; ONS, *Public sector finances, January 2011*, 22 February 2011; NIESR, *National Institute Economic Review*, January 2011. PSND=Public Sector Net Debt.

NIESR's projections shown in table 3 suggest that, given their rather gloomy growth forecasts, borrowing would still be a significant £54bn in FY2015 compared with the OBR's forecast of £18bn. Over the period FY2012 to FY2015 the NIESR forecasts suggest that there could be a cumulative £95bn more borrowing than projected by the OBR in November. And crucially the Chancellor would almost certainly miss his target for balancing the cyclically-adjusted current budget by FY2015.<sup>9</sup>

The dependence of the improvement in the public finances on good GDP growth makes it all the more necessary that the Chancellor delivers radical supply-side policies that help business and stimulate growth in his Budget.

#### *Policies for growth*

Press coverage to date and the smoke signals coming out of the Treasury suggest there will not be a giveaway Budget. The Budget for Growth will therefore be reliant on policies that cost very little or indeed cost nothing at all. But the Chancellor is not just constrained by the financial situation. He is also constrained by the politics of Coalition Government and the binding nature of many EU regulations, especially in the field of employment law. But whatever the Chancellor announces there will probably be little help for the "squeezed middle", who will be facing significantly higher taxes and benefits cuts. The table in the annex lists the tax-benefit changes announced to date. The 1p per litre (real terms) increase in fuel duty penciled in for April 2011 may however be frozen.

The Budget's growth policies will probably focus on:

- Tax simplification and other tax measures – traditionally the focus of budgets.
- An overhaul of the planning system and the loosening up land use controls.
- A series of measures to ease the regulatory burden on business.<sup>10</sup>

The measures, policies and plans that will be covered in the Budget can only be speculated about at this stage, but table 4 suggests "things to look out for" – or not as the case might be.

**Table 4 The Budget for Growth: possible announcements**

<b>Tax measures</b>	
Personal taxation	The 50p tax rate will almost certainly not be abolished, despite its anti-growth impact, being an uncertain net revenue earner and being regarded as “temporary”. The 50p rate will probably stay as long as the 2-year public sector pay-freeze lasts.
	There are hints of higher taxes on “non-doms” and a crackdown on tax-avoidance schemes, such as employer-financed retirement benefit schemes (EFRBs).
	The already announced increase in personal allowance of £1,000 to £7,475 for basic rate taxpayers (April 2011) may be raised further. To fund this, threshold at which the higher rate is paid could be lowered further.
Corporate taxation	Possible measures to cut tax paid by major corporations on overseas earnings. Highly unlikely to cut CT more than already announced. June Budget’s cuts in investment allowances unlikely to be reversed.
Tax simplification	Response to the Office of Tax Simplification’s (OTS) final report on tax reliefs. <sup>11,12</sup>
	Response to the OTS’s interim report on the “Small Business Tax Simplification Review”. <sup>13</sup> The report specifically looked at merging income tax and NICs, the future of IR35 and a simpler tax regime for the smallest businesses. Merging income tax and NICs looks likely at some point.
National Insurance	The NICs holiday for regional start-ups, announced in the June 2010 Budget, may be expanded.
Fuel duty	The 1p per litre (real terms) increase in fuel duty due on April 2011 will probably be postponed or, less likely, a fuel duty stabiliser may be introduced.
Other duties	Probable rises in duty on cigarettes, wine, spirits and super-strength lagers, but cuts for low-strength beer.
Air Passenger Duty (APD)	The proposed switch from “per passenger” to “per plane” has been dropped. There may be a further increase in the rates announced
VAT	May start discussion on broadening the VAT base
Other tax	<ul style="list-style-type: none"> <li>• A boost for the Enterprise Investment Scheme (EIS) and venture capital trusts possible</li> <li>• Stamp duty on shares unlikely to be abolished</li> <li>• Making AIM listed shares eligible for ISAs unlikely</li> <li>• Increasing tax on CDs &amp; DVDs bought online possible</li> </ul>
<b>Non-tax policies</b>	
Planning system, infrastructure	Possible update on DCLG’s planning review, <sup>14</sup> encouragement for converting office blocks into housing, other help for housing, planning rules eased.
Local authorities	Possibly allow councils to borrow to build infrastructure projects and/or retain business rates collected (rather than sent to central government).
Enterprise zones	Confirm up to 10 zones, maybe 20, in northern England and Midlands, backed by £100m
Small firms	Possible help with government procurement and/or exporting. Business Growth Fund to go live in April 2011.
Employment law	<p>Possible reference to BIS decisions already made:<sup>15</sup></p> <ul style="list-style-type: none"> <li>• Moratorium from all new domestic regulations for 3 years for businesses of less than 10 employees, and for genuine new start-ups. This clearly does not stop any EU regulations.</li> <li>• Continue to exempt companies with less than 250 staff from the Right to Request Time to Train.</li> <li>• Withdraw proposed extension of the right to request flexible working to parents of 17 year olds (currently 16 year olds). There are doubts about the Coalition pledge to extend flexibility to all.</li> </ul>
Red tape, employment law	<p>Possible reference to other regulatory issues:</p> <ul style="list-style-type: none"> <li>• Possible amendments to changes in maternity/paternity rights, planned for April 2011 (if a mother returns to work without taking full year’s maternity leave, then the father will be able to take the</li> </ul>

	<p>remaining time, up to a maximum of 6 months).</p> <ul style="list-style-type: none"> <li>• Possibility of giving small businesses the right to negotiate parental (maternity) deals directly with employees.</li> <li>• Consultation on the 21,000 laws affecting firms.</li> </ul>
Equality Act	Possible reference to equality audits for the public sector being watered down, <sup>16</sup> the Equality Act unlikely to be repealed
Health and Safety	Possible response to the Young report on Health and Safety. <sup>17</sup>
Employment tribunals	Possible reference to the BIS consultation on the working of the “costly and time-consuming” tribunal system
Education, skills	Possible replacement for Educational Maintenance Allowance. Probably measures to improve the skills of younger workers & combat youth unemployment including £300m package to help fund 50,000 apprenticeships & 100,000 work experience places. Announcement of 12 more technical colleges (to 24).
Energy policy	No changes expected, but may be a reference to nuclear power in the wake of the Japanese crisis. Probable announcement of a “carbon floor”, the minimum price for the carbon emissions permits that power generators have to buy.
Defence	Possible reference for need to review the Strategic Defence and Security Review (October 2010) in the light of the crisis of the Middle East/North Africa. Higher pay for low-paid troops.
Public services	Possible announcement of private companies having new powers to run hospitals, schools & local council services
Other issues	<ul style="list-style-type: none"> <li>• The launch of a Creative Industries Council.</li> <li>• Possibly more funding for science and technology</li> </ul>

## References

1. HM Treasury and BIS, *The path to strong, sustainable and balanced growth*, November 2010.
2. Ruth Lea, “Britain needs a radical pro-growth strategy”, Arbuthnot Banking Group, 7 February 2011.
3. Bank of England, *Inflation Report*, February 2011, [www.bankofengland.co.uk](http://www.bankofengland.co.uk)
4. Ruth Lea, “The economic background to the Budget: weaker growth, higher inflation”, Arbuthnot Banking Group, 7 March 2011.
5. OECD, *Economic Surveys, United Kingdom*, March 2011, [www.oecd.org.uk](http://www.oecd.org.uk).
6. IFS, “IFS analysis of today’s public finance figures”, 22 February 2011.
7. IFS, *The IFS Green Budget: February 2011*, [www.ifs.org.uk](http://www.ifs.org.uk)
8. “Counting the cost”, *Economist*, 18 October 2008.
9. See HM Treasury, *Budget 2010*, HC61, June 2010. The 2 current fiscal targets are: (i) a forward-looking fiscal mandate to achieve a cyclically-adjusted current balance by the end of the rolling, 5-year forecast period; for the current Budget, the end of the forecast period is FY2015; (ii) a target for Public Sector Net Debt (as a % of GDP) “to be falling at the fixed date of FY2015”.
10. Ruth Lea, “The Coalition Government’s approach to reducing the regulatory burden”, Arbuthnot Banking Group, 21 February 2011.
11. The Chancellor and Exchequer Secretary launched the Office of Tax Simplification on 20 July 2010 to provide the Government with independent advice on simplifying the UK tax system.
12. Office of Tax Simplification (OTS), *Review of tax reliefs, final report*, March 2011, [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk). The report said that “out of the total of 155 looked at we are recommending that 54 remain unchanged, 37 be looked at in more detail, and 47 be abolished on the basis that they are either time expired, there is no on-going policy rationale, the value is negligible, or the benefit is outweighed by the administrative burden. We also suggest that 17 reliefs be simplified including: the Enterprise investment scheme, Venture capital trusts, Entrepreneurs’ relief and Surplus advance corporation tax.
13. Office of Tax Simplification, *Small Business Tax Simplification Review*, interim report, March 2011, [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk). The report said “the overwhelming conclusion is

that genuine and long lasting simplification can only be brought about through major structural changes to the UK tax system. Two key areas: (i) the integration of income tax and NICs and (ii) a radical new approach to taxation for the very smallest unincorporated businesses.

14. See (i) DCLG, "National Planning Policy Framework", planning review, December 2010; (ii) HM Treasury, *National Infrastructure Plan 2010*, October 2010; (iii) DCLG, *Major infrastructure planning reform: Work plan*, December 2010.
15. "Creating the most entrepreneurial decade", Mark Prisk, 18 March 2011, speech to FSB.
16. Government Equalities Office, *Equality Act 2010, the public sector Equality Duty: reducing bureaucracy, Policy review paper*, March 2011.
17. HM Government, *Common sense, common safety, Young report*, October 2010.

## Annex

### The squeeze on incomes: selected changes to taxes and benefits

Month	Selected tax-benefit changes
April 2010	Income tax additional 50% rate introduced, above £150,000
	Personal allowances, for earnings greater than £100,000 phased out.
June 2010	CGT raised from 18% to 28% for high earners
November 2010	Increase in Air Passenger Duty rates
January 2011	Standard VAT rate rose from 17.5% to 20%
	The standard rate of Insurance Premium Tax rose to 6% (from 5%) and the higher rate to 20% (from 17.5%).
	Bank levy based on banks' balance sheets introduced. The rates announced in the June 2010 Budget were 0.07%, with a lower initial rate of 0.04% cent for 2011. The rates were increased to 0.075% and 0.05% respectively in December 2010. In February 2011 it was announced that the 0.075% rate would be effective from May 2011 and the rate would be 0.1% for March and April, to offset the lower rate of 0.05% charged in January and February.
<b>Proposed changes</b>	
April 2011	Introduction of 5% stamp duty band on homes worth more than £1m (meaning 25% increase for houses of this value).
	IHT allowance frozen at £325,000 until FY2014 (IHT tax rate is 40%).
	Corporation tax rate cut from 28% to 27%
	Small companies corporation tax cut from 21% to 20%
	Threshold for paying 40% income tax falls from £43,875 to £42,475 (meaning an extra 20% tax rate for £1,400) – an estimated 700,000 more higher rate taxpayers.
	Personal allowance will be increased by £1,000 to £7,475 for basic rate taxpayers – though this may be raised further.
	The employee NI rate rises by 1%, though threshold rises.
	The employer NI rate rises by 1%, though threshold rises (£21 in addition to indexation) and other concessions for companies outside London and South East.
	Alcohol duty to rise by inflation + 2%
	HMT begins increasing fuel duty by 1p a litre (real terms) each year from April 2011 to April 2014 (March 2010 Budget, p 132) – though will probably be amended
	2-year public sector pay freeze begins
	Local housing allowance rate to be capped at £250 a week for a one-bedroomed property, £400 a week for 4 bedrooms or more
	Benefit deductions for non-dependants will be increased (meaning claimants who have adult children living with them will be hit).
	Indexation of all benefits, tax credits & public service pensions to be uprated in line with the CPI rather than the RPI. In practice, this means a lower level of uprating.
	Universal child benefit is frozen at current levels for 3 years, at £20.30 for the first or only child & £13.40 for each other child
	Cut of 10% in childcare support provided under tax credits

	Payment of the £500 SureStart maternity grant, restricted to first child
	The withdrawal rate (the amount deducted when income exceeds a certain limit) for tax credits increased to 41%
	The weekly amount parents joining an employer-supported childcare scheme will be able to claim exempt of income tax & NICs will remain at £55 for basic rate taxpayers, but fall to £28 and £22 a week for higher rate and additional rate taxpayers respectively.
	The 2 <sup>nd</sup> income threshold for the family element of the child tax credit falls from £50,000 to £40,000. The baby element, which was worth up to £545 to families with a new baby, is abolished
September 2011	The educational maintenance allowance (EMA), worth £30 a week for low income students aged 16-18 who stay in education is withdrawn. People on “non-active” benefits start paying full fees for further education courses.
October 2011	Local housing allowance rate is set at the 30 <sup>th</sup> percentile of local rents.
	Lone parents whose youngest child is aged 5 or over will be eligible for job seekers’ allowance, rather than income support, meaning they will be obliged to search for a job or lose benefits.
April 2012	Average 3% rise in employees’ contributions in public sector pension.
	Cap on rail fare rises to RPI inflation + 3%
	Corporation tax rate cut from 27% to 26%
	The capital allowance rate is cut from 20% to 18%, the annual investment allowance is cut from £100,000 to £25,000
	The 50 Plus element of tax credits is cut
	The family element of the child tax credit will be withdrawn immediately after the child element
	Cut in NI rebate for defined benefit pension schemes. This will add to the costs employers face providing them
	Threshold for paying 40% income tax frozen
October 2012	Automatic enrolment into workplace pension schemes. Initially 1% employer & 1% employee contributions, starting with large companies, medium-sized companies (April 2014), small (August 2014). Full minimum contribution of 3% from employers & employees reached in October 2017.
	Students start paying higher tuition fees of up to £9,000 a year
January 2013	Child benefit will be taken from families with at least one parent earning over £44,000 a year
April 2013	The cap on rail fares will again be RPI inflation + 3%
	Corporation tax rate cut from 26% to 25%
	A new cap on the total benefit people can receive to ensure they never get more than the average working family brings home in pay – estimated at about £26,000 a year – is introduced. This would mean benefits would be restricted to £500 a week from 2013, a change thought to affect 50,000 homes, which would lose an average of £93 a week.
	Centrally administered council tax benefit scrapped & responsibility devolved to local authorities
	Local housing allowance uprated by CPI rather than local rents
April 2014	Corporation tax rate cut from 25% to 24%, an aspiration

Sources: “Calendar of cuts and costs about to kick in”, *FT*, 25 February 2011, amended and with additional information from HM Treasury website.

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