HOUSE OF LORDS

Library Note

Economic Growth: Budget 2011

This Library Note has been prepared in advance of forthcoming debates in the House of Lords on economic growth. It briefly summarises the Government's announcements on growth projections, measures to support growth, and the *Plan for Growth* issued at Budget 2011, before outlining the immediate reaction to the Budget from a range of organisations and commentators. This Note complements Library Note LLN 2011/010 which provided background reading on the Government's policies and the views of various organisations on the prospects for growth and the means of achieving it.

Ian Cruse and Dorothy Leys

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1. 2011 Budget

1.1 Projections for Growth and Public Finances

On 23 March 2011, the Chancellor of the Exchequer set out the 2011 Budget (HC 836). In terms of growth, it contained projections produced by the Office for Budget Responsibility (OBR). It noted that the economy was forecast to grow by 1.7 per cent in 2011, lower than forecast in the June 2010 Budget (2.1 per cent), by 2.5 per cent in 2012 (down from the 2.6 per cent forecast in June 2010), with growth peaking at 2.9 per cent in 2013. In terms of public finances, the OBR estimated that: public sector net borrowing would decline from its peak of 11.1 per cent of GDP in 2009–10 to 1.5 per cent of GDP in 2015–16; the cyclically-adjusted or "structural" current deficit would be eliminated by 2014–15, with a projected surplus of 0.4 per cent of GDP in that year, rising to 0.8 per cent of GDP in 2015–16; public sector net debt would peak at 70.9 per cent of GDP in 2013–14, before declining to 70.5 per cent of GDP in 2014–15 and 69.1 per cent of GDP in 2015–16. For a more detailed view of these projections see Chapter 1 of the Budget (pages 7–26) and Annex C (pages 89–98).

1.2 Specific Budget Measures for Growth

The Budget stated that the Government had set itself a number of growth objectives. The first was to "create the most competitive tax system in the G20". The Government would therefore reduce the main rate of corporation tax by a further 1 per cent, from April 2011, so that the rate would be reduced to 26 per cent, falling to 23 per cent by 2014. It would implement its Corporate Tax Road Map, including the introduction of new Controlled Foreign Company (CFC) rules to allow groups based in the UK to compete more effectively with those based overseas. It would also: consult on the Patent Box; simplify the tax system, responding to the work of the Office of Tax Simplification (OTS), abolishing 43 tax reliefs; and consult in 2011 on options for integrating income tax and National Insurance Contributions (NICs). It also announced that the 50 per cent top rate of tax would remain, though there would be a review of how much it raised, and that there would be a £50,000 charge for "non-doms" resident in the UK for 12 years.

A second objective was to "make the UK the best place in Europe to start, finance and grow a business". To help achieve this, the Budget made a number of proposals:

- Drop existing proposals for specific regulations which would have cost business over £350 million a year;
- Introduce a moratorium exempting micro-business and start-ups from new domestic regulation for three years from 1 April 2011;
- Implement the proposals of Lord Young's review of Health and Safety;
- Launch a public thematic review to reduce the stock of regulation, with a presumption that burdensome regulations will be removed;
- Introduce a powerful new presumption in favour of sustainable development, so that the default is "yes" and pilot land auctions, starting with public sector land;
- Streamline the system for planning applications and introduce new fast-track planning for major infrastructure;

- Reform the Enterprise Investment Scheme (EIS) and Venture Capital Trusts, including raising the rate of EIS income tax relief to 30 per cent from April 2011;

- Increase the SME rate of R&D tax credit to 200 per cent from April 2011 and 225 per cent from April 2012;

- Double the lifetime limit for Entrepreneurs Relief to £10 million; and

- Invest £100 million in science capital development; and launch the first Technology and Innovation Centre in high value manufacturing.

(HM Treasury, *Budget 2011*, March 2011, HC 836, page 3)

A third objective was to "encourage investment and exports as a route to a more balanced economy". The Government would: extend the limit for capital allowances short life assets election from four to eight years; provide £200 million of new funding for rail projects and £100 million for local authorities to repair potholes; establish 21 new Enterprise Zones; reform the stamp duty land tax rules applied to bulk purchases for residential properties and make Real Estate Investment Trusts easier to set up and more accessible to investors. It also announced support for green growth, proposing a carbon price floor for electricity generation from 1 April 2013 and an initial capitalisation of the Green Investment Bank of £3 billion, which would start operation in 2012–13.

A fourth objective was a "more educated workforce that is the most flexible in Europe". The Government would: fund an additional 80,000 work experience places for young people, ensuring up to 100,000 places will be available over the next two years; fund up to 50,000 additional apprenticeship places over the next four years; and expand the University Technical Colleges programme to establish at least 24 new colleges.

The Budget also announced that there would be a Government-backed shared equity scheme to help 10,000 first-time home buyers. Another set of key measures concerned fuel prices. These included a 1p per litre cut in fuel duty, the cancelling of the fuel duty escalator and delay of other planned duty rises, to be financed by increasing a supplementary charge levied on oil and gas production from 20 per cent to 32 per cent.

For a more detailed overview of the growth measures see Chapter 1 of the Budget (pages 27–34) and the relevant HM Treasury press release; for specific measures, such as the changes in fuel duty and its financing, see Chapter 2 (pages 41–72).

1.3 *Plan for Growth*

HM Treasury also published its *Plan for Growth*, which set out how the above policies and other measures would benefit the economy and specific sectors:

> **Healthcare and life sciences** will particularly benefit from: the establishment of a new health research regulatory agency to streamline regulation and improve the cost effectiveness of clinical trials; and stripping out regulations that were never meant for the social care market and are preventing market entry and flexible services. In addition, future funding by the National Institute for Health Research (NIHR) to providers of NHS services will be conditional on meeting benchmarks, including a 70 day benchmark to recruit first patients for trials;

Advanced manufacturing will particularly benefit from: changes to capital allowances; the establishment of a High Value Manufacturing Technology and Innovation Centre; the development of a new degree-equivalent Higher Level Apprenticeship; and nine new university based centres for innovative manufacturing;

Construction will particularly benefit from: the radical changes to the planning system and publication of a rolling two year programme of projects where public sector funding has been agreed as well as a long-term forward view of infrastructure; reforms in the way Government procures construction projects; and announcements on the regulatory requirements for zero carbon homes to apply from 2016;

Digital and creative industries will particularly benefit from: an overhaul of development and planning rules to support superfast broadband roll-out; substantially reducing burdens of the communications and media regulatory framework; and significantly increasing the level of support to IP-intensive businesses to ensure they can exploit their IP domestically and overseas;

Retail will particularly benefit from: the extension to the small business rates relief holiday; expansions to the Primary Authority model to apply consistent enforcement of standards; and from simplification of age-restricted sales regulations and licences for businesses;

Professional and business services will particularly benefit from: the introduction of trusted business visa service schemes and the new visa regimes for entrepreneurs and high net worth investors; and work to promote the sector in the EU and overseas and to address wider regulatory burdens and skills gaps;

The space industry will particularly benefit from: reform of the Outer Space Act, introducing an upper limit on liability for UK operators; definition of the regulations for novel space vehicles to offer low cost access to space; and £10 million of new funding to accelerate development of the International Space Innovation Centre;

Tourism will particularly benefit from: a £100 million campaign co-funded by the Government and industry to attract an additional 4 million visitors to the UK after 2012, and making tourist visas far easier to obtain.

(HM Treasury, *Plan for Growth*, March 2011, page 8)

A fuller initial analysis of the 2011 Budget and *Plan for Growth* can be found in House of Commons Library Standard Note, *The 2011 Budget*, (23 March 2011, SN/EP/5912).

2. Reaction

2.1 Labour Party

The Leader of the Labour Party, Ed Miliband, in responding to the Budget, argued that the measures already taken by the Government had undermined growth:

What is the Chancellor's singular achievement? To deliver a budget for growth that downgrades the growth forecasts. Growth is down this year to 1.8 per cent, and it is downgraded next year too. That did not happen by chance; it happened

> by choice—the Chancellor's choice—and it was the wrong choice: to go too far and too fast. In the Chancellor's own words in the June Budget, he chose to go £40 billion further and faster in tax rises and spending cuts than our plan to halve the deficit over four years. That pace of cuts has seen consumer confidence fall in almost every month since the general election.
>
> ...At this stage of the recovery, growth should be powering ahead and unemployment should be falling fast. Every month that unemployment is higher than it should be stores up long-term damage for our country. Every month when growth is lower than it should be, that hits the future potential of our economy. The problem is that, instead of admitting it, the Chancellor refuses to change course.
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> (HC *Hansard*, 23 March 2011, cols 967 and 968)

In terms of specific proposals, he argued that the National Insurance holiday for small business, announced in June had by mid-January helped only 1,500 businesses of the 400,000 initially envisaged. He also thought it "extraordinary" to "cancel flexible working for families with children aged between 16 and 18" and was critical when comparing the previous Government's bonus tax, which raised £3.5 billion, with the bank levy proposed by the Chancellor, which "raises just £1.9 billion". He was also sceptical about the proposals on petrol: "He has cut duty by 1p, but he has whacked up VAT on fuel by 3p. Families won't be fooled; it's Del Boy economics". Ed Miliband concluded that overall the Budget reflected the Government's economic approach: "it's hurting but it isn't working" (HC *Hansard*, 23 March 2011, col 970).

2.2 BBC—Robert Peston

Robert Peston, BBC Business Editor, writing on his blog, thought that George Osborne had not opted for "a crowd-pleasing" Budget and had sought to demonstrate the "Government's belief that the rehabilitation of the British economy can only come from the liberation of private enterprise". Cuts in the burden of corporation tax worth around £2 billion per annum when implemented over the coming years would be particularly beneficial for big multinational companies, while a significant lifting of planning and regulatory constraints would "delight much of the corporate sector". Peston also noted that after a lengthy review of the Controlled Foreign Company rules, the Treasury had "opted to apply a very low rate of just 5.75 per cent on cash held by multinationals in non-trading entities overseas... which is lower than the 8 per cent rate which business had expected to be levied", costing the Exchequer £840 million per annum compared with the current tax system. In addition, a further £80 million a year of revenue would be lost by a decision not to levy tax on dividends brought into the UK from branches of multinationals. Peston argued that such measures could be seen in one of two ways; either as "the Tory members of the Government unfairly rewarding their corporate pals, while millions of individuals are struggling to make ends meet" or as an attempt by the Chancellor to encourage companies to invest in the UK and not elsewhere. Peston suggested that this might have been why the Chancellor was also raising around £1 billion from tackling what he called disguised income, or tax loopholes exploited by the super-wealthy along with the tariff imposed on "non-doms". He also noted that the oil and gas companies, who will be required to pay an extra £1.8 billion in tax this year and £2.24 billion next year on their North Sea oil and gas production, would not be pleased.

2.3 British Bankers Association (BBA)

Angela Knight, Chief Executive of the BBA, in her initial reaction to the Budget, was critical of the bank levy. This represented "an additional fixed cost for larger banks operating in the UK" but could also "include the business that banks are doing outside the UK". Without satisfactory double taxation arrangements in place, Knight was concerned that this "might put banks operating in the UK at a long term disadvantage—both internationally, as they compete against banks not paying such a levy, and domestically, as they compete with other sectors of the financial services industry".

2.4 Institute of Directors (IoD)

The IoD issued a press release, which supported the general thrust of the Budget's supply side measures, with IoD Director-General, Miles Templeman, stating that while the Chancellor "didn't have much money to play with... he played his hand well". The IoD particularly welcomed measures regarding Corporation Tax, "the very clear statement that the 50 per cent rate of Income Tax is a temporary measure" and the reduction in fuel duty. Other measures it approved of included: the reform of the controlled foreign companies regime and offer of an optional exemption for foreign branches; the doubling of the limit on entrepreneurs' relief; the decision not to link the 2012 increase in the income tax personal allowance to a decrease in the threshold at which people start to pay higher-rate tax; and the move to a flat rate pension. However, there were some reservations. Miles Templeman thought that "the scale of deregulation in areas that really matter to business in general, such as employment law, is still very limited" and wondered why the remit of the new enterprise zones could not go further. And though the IoD believed it was sensible to consult on merging the operation of income tax and national insurance it hoped that the Government "will still have the courage to explore the scope for radical simplification short of a full merger".

2.5 Confederation of British Industry (CBI)

John Cridland, Director-General of the CBI, in a press release issued immediately after the Budget, welcomed certain aspects. He predicted that the cut in corporation tax, changes to entrepreneurs' taxation and reduced fuel taxes would all aid growth. However, he expressed concern that "the increased tax on North Sea oil and gas could be counterproductive, and will create uncertainty for future investment".

2.6 Federation of Small Businesses (FSB)

The FSB stated that they were "pleased that the Chancellor has introduced a fuel duty stabiliser, has committed to cutting fuel duty and has introduced 21 new Enterprise Zones. This will provide much needed stability for struggling small businesses". However, they argued that the Government should have extended the National Insurance Contributions holiday to existing businesses, suggesting: "this is a missed opportunity. This policy would have been cheaper to implement than keeping people on benefits".

2.7 EEF (Manufacturers Organisation)

Terry Scuoler, Chief Executive of EEF, said that the Chancellor had given "a clear recognition that we are in an international race for investment and that manufacturing is at the heart of this" and had "made a crucial down payment on creating a stronger and more balanced economy with measures to boost investment in technology, research and development, and skills". In addition, the Growth Review had "now started to deliver tangible process in removing the barriers to growth, investment and job creation in the UK". However, he added that "despite the encouraging measures on investment, the significant rise in energy bills threatened by the Carbon Price Floor is unwelcome" and that the next stage of the Growth Review "must seek to develop a more co-ordinated and cost effective approach to creating a low carbon economy". In terms of other measures, EEF welcomed the extension of the short life asset election, which would "make the tax system more efficient and remove in part barriers to investment", while raising the rate of the SME credit would "provide a much needed cash flow boost to innovative manufacturers". It welcomed the Enterprise Investment Scheme, though it felt it did not fully "address growing firms' aversion to equity finance". While it supported measures on regulation and apprenticeships, it thought the Government could go further. It suggested that the Green Investment Bank should focus on the best green economy prospects.

2.8 TUC

Brendan Barber, TUC General Secretary, speaking after the delivery of the Budget, said that it was "a no-change" Budget and that the Chancellor had "been forced to reveal the evidence that his policies aren't working but has not had the courage to change them". The Budget had not reversed "the basic error of imposing deep, rapid and unfair spending cuts on an economy where unemployment is rising and growth faltering". Though there were "some welcome measures on funding for apprenticeships and much needed relief on fuel duty" much of the Budget was "about taking us back to the 1980s with deregulation gimmicks, hand-outs to big business and a deterioration of working conditions that failed to deliver jobs or growth then and won't today".

2.9 Institute for Fiscal studies (IFS)

IFS initial reaction to the Budget noted that the forecasts contained within it had left the Chancellor in a position where he did not feel able to engage in a net giveaway, while going forward he would be "uncomfortably dependent on the judgments that the (independent) OBR makes over the (unobservable) potential output of the economy". The IFS thought that moves to integrate the operation of income tax and NICs were welcome, though the value of reform depended heavily on the details. In terms of the carbon price support rate, which would directly affect households and businesses, this would help improve certainty and hence might encourage investment in renewable generation. However, the IFS was concerned that "it adds another layer of carbon pricing to an already complex structure of rates applying to different fuels and energy users and does not bring us any closer to a consistent economy-wide price for carbon". The IFS was guarded about the proposed "Fair Fuel Stabiliser": "If oil prices stay high but volatile, this policy will do little to stabilise pump prices". Finally, on measures for growth, the IFS saw a mixed picture. The planned reductions in corporation tax were "likely to boost corporate activity in the UK", while reforming planning regulation and simplifying the tax regime were "welcome moves that could have positive long term effects on economic activity". However, policies for specific industries or geographic areas had not always been successful; past UK experience with enterprise zones had suggested "that their main effect may be to cause activity to relocate rather than to create new activity".

2.10 Institute for Economic Affairs (IEA)

Richard Wellings, writing on the IEA blog, thought that though there were some welcome proposals in the Budget, it "unfortunately also introduced a series of gimmicks that do little to address the high levels of tax and regulation that severely hamper UK entrepreneurs". Though the Chancellor had reduced corporate taxation he should have been "more specific about abolishing the 50p Income Tax Rate and should have reversed the increase in Capital Gains Tax". Similarly, proposals regarding tax simplification and the reform of the planning system were "insignificant in terms of the overall burden of red tape" while "hugely expensive regulations to meet environmental targets, for example, remain in the pipeline". A chance had also been missed to radically liberalise labour markets. The Budget should have abolished the minimum wage and removed "reams of burdensome employment law", while the announced expansion of subsidised apprenticeships "would do nothing to address the fundamental problem that state intervention has priced low-skilled young people out of the labour market". He also criticised enterprise zones, which would "create economic inefficiencies by artificially distorting the spatial pattern of economic activity".

2.11 Institute for Public Policy Research (IPPR)

Nick Pearce, Director of the IPPR, writing in the *Financial Times*, argued that it was on the question of economic growth that the Budget was "most lacking". It was a "mix of standard 1980s thinking—cutting taxes, red tape and regulation—and the odds and sods of a Whitehall machine that is bereft of new ideas for shaping Britain's economic future", while in style it "was reminiscent of one of Gordon Brown's shopping list of Budget measures". Specifically, he questioned whether enterprise zones, relaxation of planning laws, a bit of deregulation here and there amounted "to a serious long-term plan for growth". Instead, there was a need to appreciate "the potential for a modern industrial strategy, state investment in infrastructure and business growth, a structured approach to innovation, and new ways of thinking about skills and productivity".

2.12 Adam Smith Institute (ASI)

Eammon Butler, Director of the ASI, contended in the *Guardian*, that the Budget did not address the UK's "high taxes and daunting regulation" which had not sent out a signal of "come and invest". It had actually raised taxes for "non-doms" and had missed the opportunity to scrap the 50p tax band. He also said that regulatory burdens would still remain despite the commitment to exempt small firms from new regulations for three years. Instead, the Government should have taken "small businesses out of employment regulation entirely, replacing it with a general 'fair treatment' rule". He also questioned whether rises in tax credits for small business research and development, expanding the enterprise investment scheme and extra funding for apprenticeships would actually promote growth. The aim he believed should be "to turn the whole country into an enterprise zone, with easier planning rules, more local decision-making and lighter regulation". And he also thought that while tax cuts might have lost the Treasury immediate revenue, "within 30 months they would pay for themselves in terms of rising business and employment". Additional commentary was also provided on the ASI blog.

2.13 Demos

Kitty Usher, a former Economic Secretary to the Treasury and chief economist at Demos, writing in the *Guardian*, argued that there was little in the Budget that altered "the fundamental picture" of a loss of confidence in the economy. The pro-business measures that were announced would only have "a medium-term effect" and did not put any more money into the economy. This, in her opinion, revealed a "fundamental contradiction" at the heart of the Government's economic policy. On the one hand the Government wanted to "rebalance growth away from cheap credit to real business activity", which was absolutely right, but "at some point customers need to purchase things to get the economy moving again". She was concerned that "with real wages falling and public sector job cuts still to come, this doesn't look like it will happen any time soon, despite the Chancellor's attempt to start talking things up a bit today".

2.14 *Economist*

The *Economist* noted that with the exception of growth, down from 2.1 per cent to 1.7 per cent, most of the Budget's fiscal projections were little changed from those outlined in the *Pre-Budget Report*. It noted a number of "crowd pleasers", such as the abandonment of the fuel duty escalator, the tax on private jets and a "crackdown" on tax avoidance schemes that aimed to raise around £1 billion a year. On growth, it noted that the idea of a "pro-growth budget" "was difficult for many Tories, who cleave to the view that the best thing the Government can do when managing the economy is to adopt the Hippocratic principle of 'do no harm', and then get out of the way while the general population gets on with the business of wealth creation". However, it acknowledged a number of measures. This included a new generation of enterprise zones, which represented "a flashback to the 1980s under which firms in the designated areas (mostly poor urban places with state-dominated economies) will have their rents paid by the Government, discounts on businesses rates and access to "super-fast" broadband". It also noted the presumption in favour of economic growth in planning law and the cutting of corporation tax. The next key test of the Government's course would be the publication of growth figures for the first quarter of the year due in a month. The *Economist* suggested that if the figures were to be substantially lower than projected, "the pressure on the Chancellor to change his mind will grow", though "having argued so strongly for austerity, Mr Osborne will find it hard to change course even if he wants to".

2.15 *Daily Telegraph*

David Hughes, writing in the *Daily Telegraph*, noted that George Osborne's room for manoeuvre was "pretty restricted" but that he had "used it well". In terms of petrol prices, the Chancellor had been "cute and made the oil companies—currently posting record profits—foot the bill" to fund a delay in the planned inflation rise in fuel duty until 2012 and scrap the annual 1p above inflation "fuel escalator" rise until 2015. Similarly, Mr Osborne had used the "levy on the banks to fund the other micro-measures aimed at fostering growth that formed the core of his speech". This represented "pretty astute politics". Jeremy Warner, writing in the same paper, said that though there was quite a lot in the Budget for ordinary business, and in particular SMEs, the overall tax burden on business was not being reduced and that increased taxes on bankers and energy would ultimately be passed on to customers. The Chancellor did, however, display "the correct degree of scepticism over the 50p tax rate", and had "stuck to his guns on fiscal consolidation", though "in itself this was not the Budget for growth that was promised".

2.16 *Spectator*

Fraser Nelson, writing on the *Spectator's* blog, argued that the Chancellor had constructed a Budget to help people cope with the rising cost of living. He suggested that oil companies and banks had been targeted in order to fund tax cuts for the rest of the population, with the overall effect being "to make the cuts programme even milder than it already was". However, he warned: "Osborne has back-shifted a lot of the pain. Originally, total spending was going to be down 1.7 per cent this year. Now, it's just 0.2 per cent. This is in the margin of error so it can be said that there are, in effect, no cuts in total spending this year. Pain has been shifted to the end—so the tax burden for 2015–16 has been revised up by £335 billion".

2.17 *New Statesman*

Gavin Kelly, commenting on the *New Statesman* blog, was generally critical of the Budget. He maintained that the personal tax changes in the Budget were skewed towards those in the top half of the income distribution, while proposals to reform and simplify the whole of our tax and National Insurance system "immediately gets submerged in a sea of tax wheezes". In terms of plans for growth, he was disappointed that they had been "fleshed out with a set of micro-measures that will be wearily familiar to anyone who has spent time in Whitehall over the past decade". He did accept that there were positive aspects to the Budget, such as: a steady growth in apprenticeships;

extra support for science; a helping hand for first-time house buyers; the taxing of private jets; and the extension of mortgage interest support. There would perhaps also be some “begrudging acknowledgement from an angry public for the cut in fuel duty”. However, his overall sense was that it lacked “a compelling account of what really underpins shared growth, in which the gains are more fairly spread across the working population”.

2.18 Left Foot Forward Blog

Sally Hunt, writing on the Left Foot Forward blog, thought that the Budget had “made it quite clear, for anyone still unsure, that we are not ‘all in this together’”. Rather than cutting corporation tax as the Budget proposed, she urged the Government to increase it and spend the revenue accrued on higher education: “a modest increase in corporation tax, just to bring us in line with the G7 average, would generate considerable money that could be ring fenced for our universities”. Writing elsewhere on the same website, Will Straw noted the OBR’s downgrading of the growth figures from 2.6 per cent last June to 1.7 per cent, but questioned why the Chancellor had failed to mention in his speech that the OBR had anticipated that an additional 130,000 people would be unemployed in 2012.

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