# Background to the 2010 Budget


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Author: Grahame Allen and Dominic Webb

Section Economic Policy and Statistics Section


The 2010 Budget will be presented by the Chancellor on 24 March. This will be the last Budget before the General Election. It will be presented against a backdrop of a fragile economic recovery and at a time when the public finances will be an important issue in the election campaign.

This note sets out the economic and public finances background to the Budget.

A separate note, outlining the main points of the Budget and reaction to it, will be published after the Budget.

## Contents

## 1 Summary

The Budget on 24 March will be the last before the General Election. It will be presented at a time when the economy is emerging from a deep recession. The economy grew by 0.3% in the fourth quarter of 2009. This followed six quarters of falling output. Output is still 6% below its peak.

The Budget will update the Treasury's forecasts for the economy. The Treasury, in line with independent forecasters, expects a modest return to growth this year. The Treasury is more optimistic than independent forecasters for prospects in 2011 and beyond. The claimant count measure of unemployment is currently just below 1.6 million. This is lower than the 1.75 million forecast by the Treasury for the fourth quarter of 2009.

The Budget will also update the Treasury's forecasts for the public finances. While there is consensus that the budget deficit needs to be reduced, there is a difference of opinion between economists and between the political parties about the how quickly this should be done. In the Pre-Budget Report (PBR), the Treasury forecast that borrowing would be £178 billion (or 12.6% of GDP) in 2009/10. Outturn figures for the first eleven months of 2009/10 indicate that borrowing may come in around £12 billion lower than this.

Public spending is set to grow much more slowly over the next few years compared with the recent past. Given the likely growth of social security and debt interest spending, departmental spending looks set to fall in real terms. The Government has announced that certain areas of public spending will be protected. This will mean that the remaining unprotected areas will see larger reductions in spending.

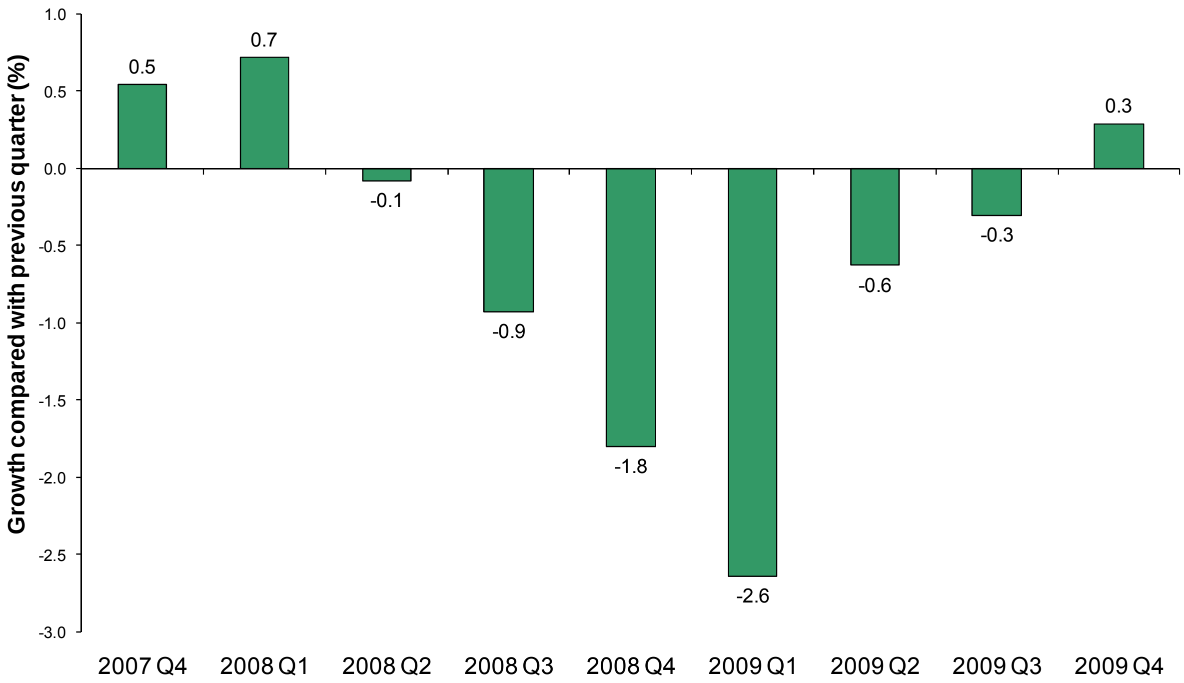
# 2 The economy

## 2.1 GDP

2009 was a very challenging year for the UK economy. The economy moved into recession in 2008 Q3 as GDP fell for a second successive quarter. The economy moved out of recession in the last quarter of 2009, following six consecutive quarters of negative growth.

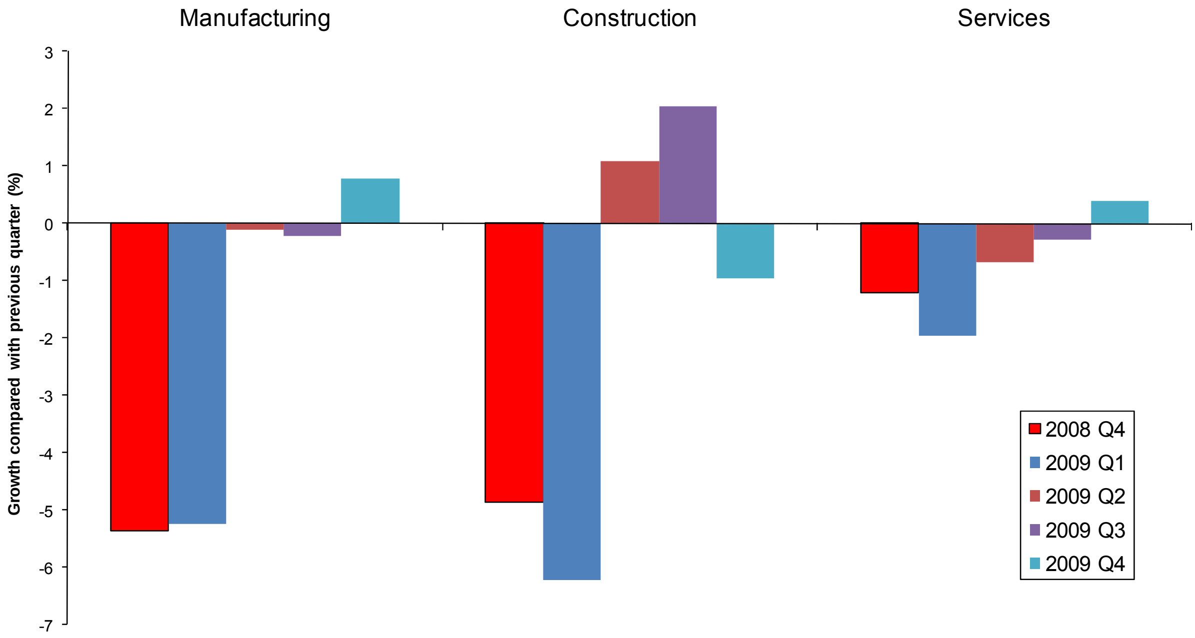
The recent path of economic growth is shown in the chart below:

**Chart 1: Quarterly Real GDP growth (%)**




The recession has affected all sectors of the economy. The chart below shows that manufacturing and construction have been particularly affected.

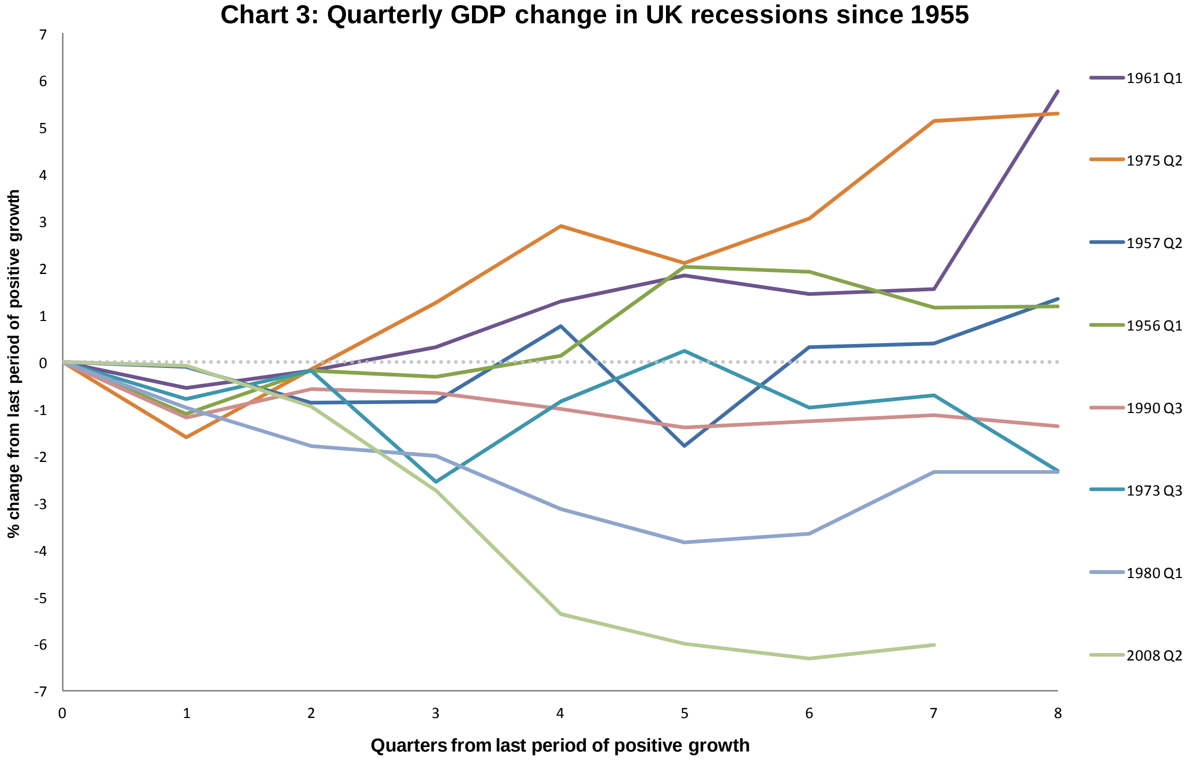
**Chart 2: Quarterly real change in GDP by sector (%)**




## Comparison with previous recessions

Chart 3 compares the path of UK GDP growth during (and following) the latest recession with previous recessions. The chart shows that this has been the 'deepest' recession (in terms of lost output) since quarterly data were first published in 1955.

**Chart 3: Quarterly GDP change in UK recessions since 1955**



**International comparisons of recessions**

The downturn in global economic activity has been felt across the world, with many countries, including all G7 economies, falling into recession during 2008. All G7 countries have since exited (at least temporarily).

Apart from its length, the severity of the downturn can also be measured by the decline in economic output that occurred during the recession. The table below summarises some features of the recessions in the G7 countries.

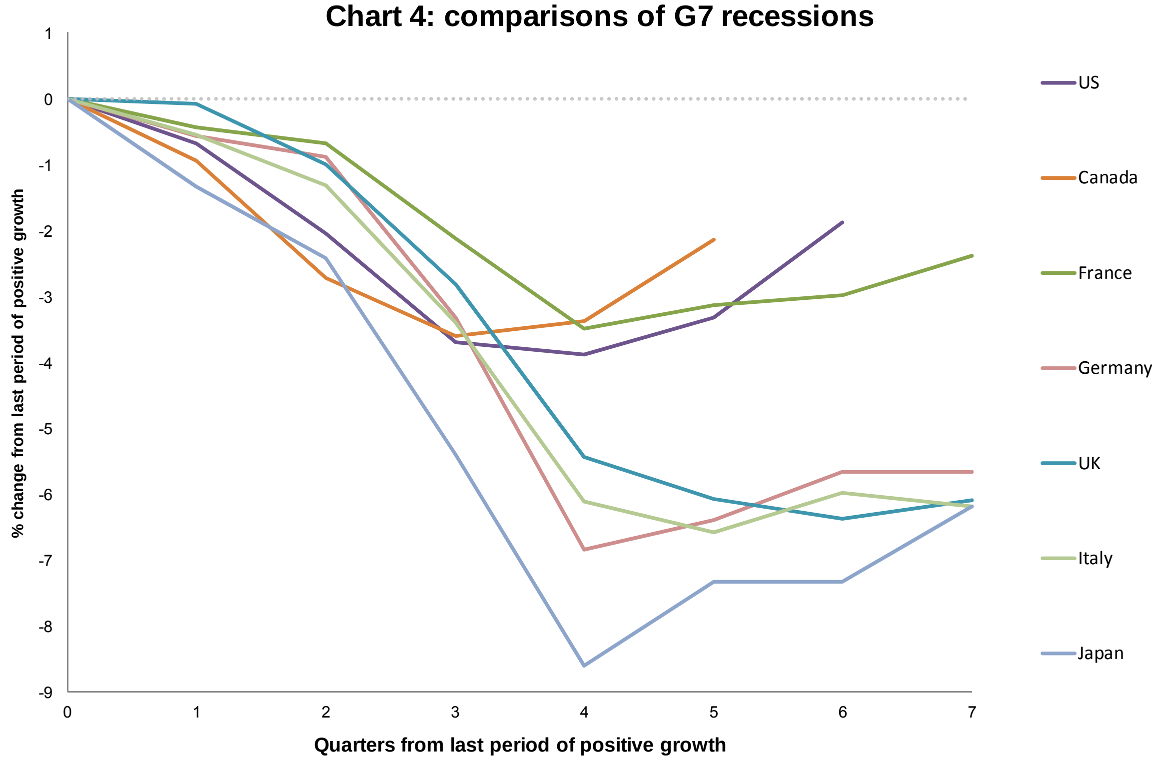
**Table 1**
**G7 recessions**

| | Recession | | | |
|---|---|---|---|---|
| | Entered(a) | Exited | Length, qtrs(b) | decline in GDP(c) |
| Canada | Q4 2008 | Q3 2009 | 3 | 3.6% |
| France | Q2 2008 | Q2 2009 | 4 | 3.5% |
| Germany | Q2 2008 | Q2 2009 | 4 | 6.7% |
| Italy | Q2 2008 | Q3 2009 | 5 | 6.4% |
| Japan | Q2 2008 | Q2 2009 | 4 | 8.4% |
| UK | Q2 2008 | Q4 2009 | 6 | 6.2% |
| US | Q3 2008 | Q3 2009 | 4 | 3.8% |

Source: OECD, *Quarterly National Accounts*

Note: (a) First quarter of contraction
(b) Total number of quarters of negative growth.
(c) From pre-recession levels

**Chart 4: comparisons of G7 recessions**



The UK remained in recession longer than the other G7 economies, with output declining for six consecutive quarters. Japan, Germany and France came out of recession in Q2 2009, with the US and Italy exiting in Q3. The UK came out of recession in Q4. However, by comparing OECD data, which shows the decline in GDP from pre-recession levels, the UK's 6.2% contraction is less severe than Japan's (-8.4%), Germany's (-6.7%) and Italy's (-6.4%). The US, France and Canada all experienced a decline in GDP of less than 4% during their recessions.

Chart 4 above tracks the path of GDP growth in the G7 economies during and since their recessions. The chart suggests that, so far, GDP in none of the G7 countries has returned to pre-recession levels.[1]

### Forecasts of future growth

In the Pre-Budget Report (PBR), the Treasury forecast a fall in GDP of 4¾% in 2009. The economy was forecast to grow by 1½% in 2010 and 3½% in 2011. The PBR stated:

> The 2009 Pre-Budget Report economic forecast is for GDP to contract by 4¾ per cent over the year in 2009, larger than the 3½ per cent forecast at Budget 2009. However, given signs of stabilisation in recent economic data, growth is expected to return by the end of the year, in line with the Budget forecast. GDP growth is forecast to pick up through 2010 and 2011, as credit conditions continue to ease and the continuing and lagged effects of the significant monetary policy support and the depreciation of sterling take hold.[2]

**Table 2**
**Pre-Budget Report economic forecasts**

| | 2009 | 2010 | 2011 |
|---|---|---|---|
| GDP growth, % | -4.75 | 1.25 | 3.50 |
| CPI inflation, % | 2.00 | 1.75 | 1.50 |

Source: HM Treasury, *Pre-Budget Report* , December 2009, Table 2.1

The PBR forecast for growth in 2009 was broadly in line with independent forecasts at the time. In December, the average independent forecast was a fall in GDP of 4½% in 2009 and 1.3% in 2010.[3] The latest average independent forecast is for growth of 1.3% in 2010.[4]

Actual growth in 2009 saw the sharpest fall in GDP (-5.0%) in a calendar year since official figures began in 1949 and the highest fall since 1931, excluding the recession following the Second World War. The chart below shows GDP growth since 1970 together with the average of independent forecasts to 2014.[5]

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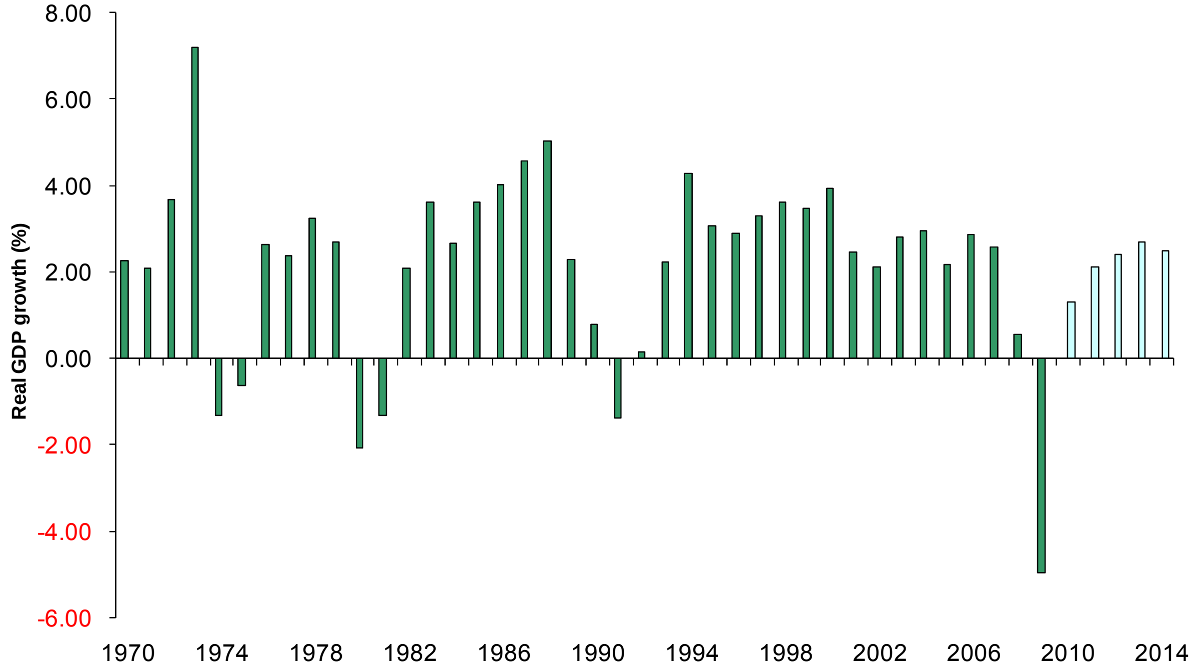
1 Please note that not all countries' recessions started in the same quarter.
2 HM Treasury, *2009 Pre-Budget Report*, para 2.15
3 HM Treasury, *Forecasts for the UK economy: a comparison of independent forecasts*, December 2009.
4 HM Treasury, *Forecasts for the UK economy: a comparison of independent forecasts,* March 2010
5 HM Treasury, *Forecasts for the UK economy: a comparison of independent forecasts*, February 2010.

**Chart 5: Real GDP growth 1970-2014**




Many advanced economies also saw a fall in GDP in 2009 and growth in 2010 is expected to remain slow. Forecasts by the OECD, published in November, show that the UK economy is expected to grow by 1.2% in 2010, the lowest forecast of growth amongst the G7 except Italy (see table 3 below).

**Table 3**
**OECD forecasts for real GDP growth, %**

| | 2010 | 2011 |
|---|---|---|
| Canada | 2.0 | 3.0 |
| France | 1.4 | 1.7 |
| Germany | 1.4 | 1.9 |
| Italy | 1.1 | 1.5 |
| Japan | 1.8 | 2.0 |
| UK | 1.2 | 2.2 |
| US | 2.5 | 2.8 |
| Euro area | 0.9 | 1.7 |
| Total OECD | 1.9 | 2.5 |

Source: OECD, *Economic Outlook,* November 2009

While the outlook remains uncertain, there are a number of factors which should work to boost the economy. Interest rates have been cut to historically low levels; sterling has declined by 17% since the beginning of 2008, which should provide a boost to exporters; and energy prices are now lower than this time last year. The latest average independent forecast is for a rise in GDP of 1.3% in 2010 and 2.1% in 2011.[6]

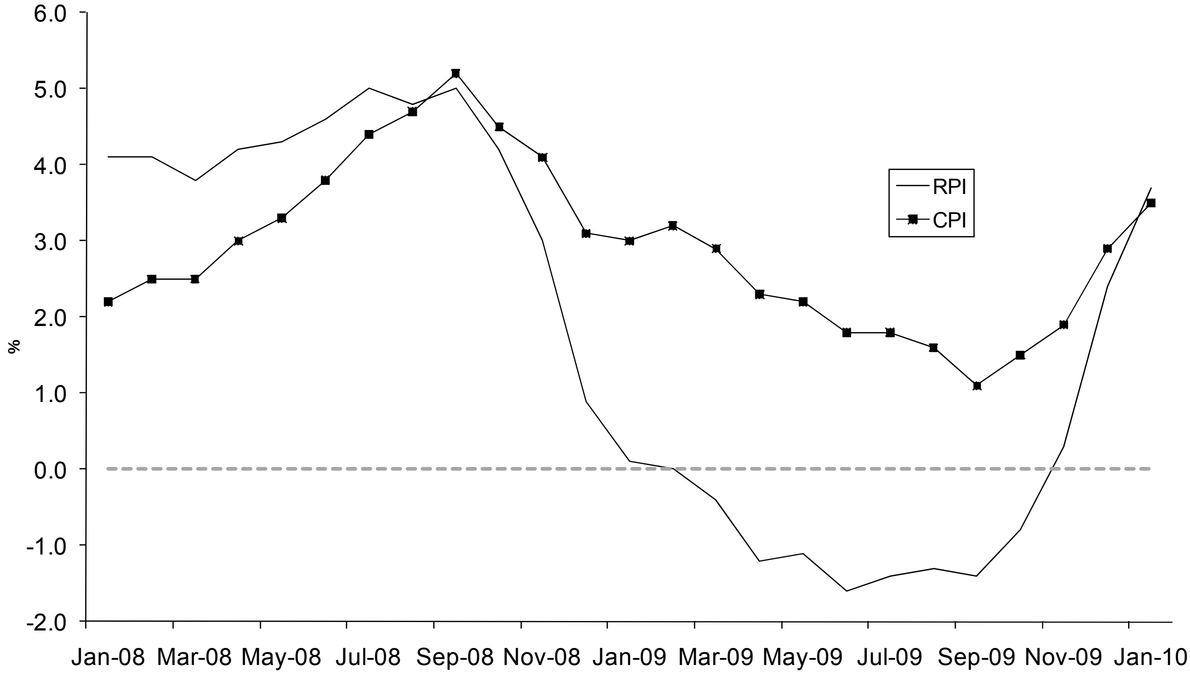
[6] HM Treasury, *Forecasts for the UK economy: a comparison of independent forecasts*, March 2010.

## 2.2 Inflation and deflation

Retail prices index (RPI) inflation remained negative (deflation) for most of 2009 but inflation has risen sharply since the Pre-Budget Report, measured by both the RPI and the consumer prices index (CPI).

RPI inflation has risen from -0.8% in October 2009 to 3.7% in January 2010. CPI inflation has increased from 1.5% to 3.5% over the same period (see chart 6 below). The steep rise in inflation has been mainly due to the January 2010 increase in the standard rate of VAT and the continued increase in the price of crude oil feeding through to transport costs.

**Chart 6: Inflation**




Most forecasters expect RPI inflation to remain high for the immediate future as the impact of the restoration of VAT to 17.5% and high import prices remains. However, CPI inflation is expected to fall back towards the 2% target rate as these effects subside and spare capacity in the economy persists. The OECD forecasts CPI inflation in the UK of 1.0% this year and 0.6% next year, higher than most other G7 countries.

**Table 4**
**OECD forecasts for inflation, %**

| | 2010 | 2011 |
|---|---|---|
| Canada | 1.2 | 1.0 |
| France | 0.8 | 0.7 |
| Germany | 0.9 | 0.9 |
| Italy | 1.0 | 0.8 |
| Japan | -0.8 | -0.3 |
| UK (CPI) | 1.0 | 0.6 |
| US | 1.3 | 1.4 |
| Euro area | 0.9 | 0.7 |

Source: OECD, *Economic Outlook* , November 2009

## 2.3 Unemployment

Unemployment stood at 2.45 million in the three months to January 2010, down 33,000 from the three months to October 2009 but up 383,000 from a year earlier.[7] The unemployment rate has remained steady since mid-2009. However, at 7.8% in the three months to January 2010, it is higher than a year ago when it was 6.6%.

Latest OECD forecasts from November 2009 expect unemployment to rise from (its estimate at the time) of 8.0% in 2009 to 9.3% in 2010 and 9.5% in 2011. This would take the UK unemployment rate above that of the US by the end of the forecast horizon, but still below that of some other major economies.

**Table 5**
**OECD forecasts for unemployment, %**

| | 2010 | 2011 |
|---|---|---|
| Canada | 8.7 | 8.1 |
| France | 9.9 | 10.1 |
| Germany | 9.2 | 9.7 |
| Italy | 8.5 | 8.7 |
| Japan | 5.6 | 5.4 |
| UK | 9.3 | 9.5 |
| US | 9.9 | 9.1 |
| Euro area | 10.6 | 10.8 |
| Total OECD | 9.0 | 8.8 |

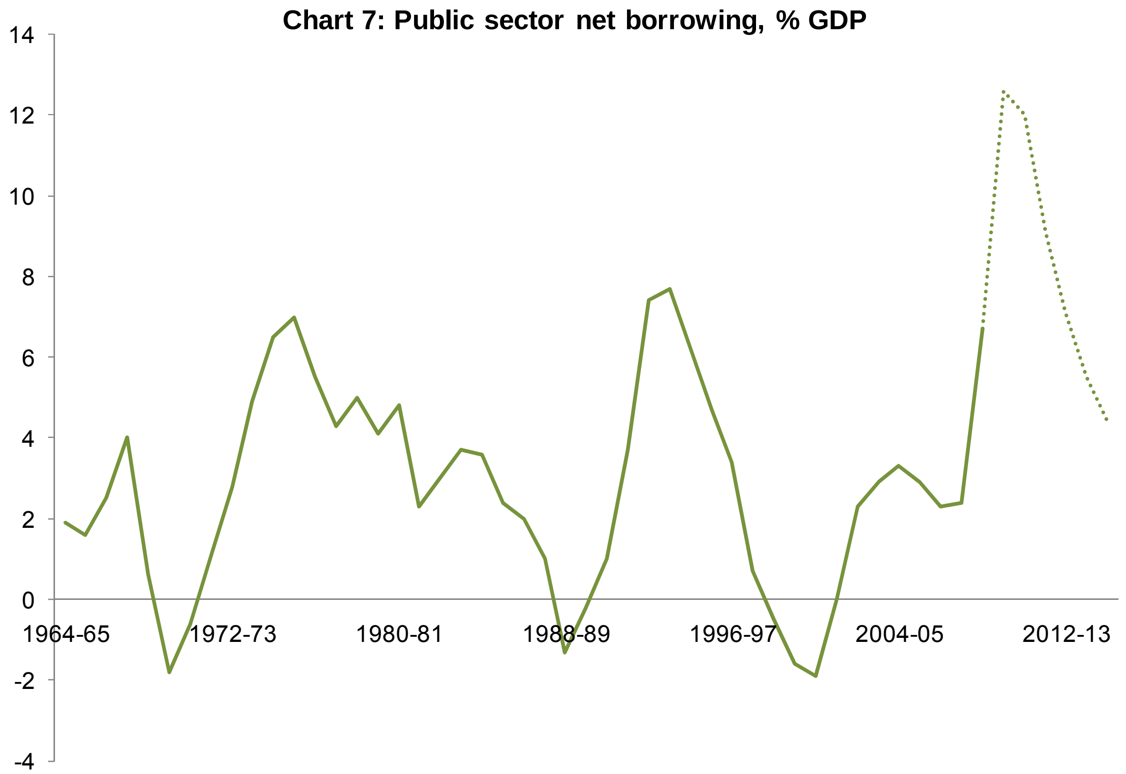
Source: OECD, *Economic Outlook* , November 2009

7 Based on the ILO definition of unemployment. Source: ONS, *Labour Market Statistics March 2010*

# 3 The public finances

## 3.1 Borrowing

Public sector borrowing is forecast to reach extremely high levels. The PBR forecast that borrowing would reach £178 billion or 12.6% of GDP in 2009/10. The chart below shows that this is considerably higher than the previous peak of 7.7% in 1993/94.[8] As recently as 2006/07, borrowing was 2.3% of GDP.




Figures for the period April 2009 to February 2010 indicate that borrowing may be below the PBR forecast for the current fiscal year. Over this period, borrowing was £131.9 billion compared with a Treasury forecast of £170 billion.[9] This is still nearly twice the level of borrowing in the same period last year. Commenting on these figures, the IFS said:

> As the Chancellor, Alistair Darling, prepares for next week's Budget he will doubtless be pleased by today's figures. Tax receipts were higher than the same month last year - with growth in receipts of income tax, national insurance and capital gains tax being particularly strong relative to his December 2009 Pre-Budget Report forecast – and there have been downward revisions to figures for borrowing in earlier months of this financial year. The stronger growth in tax receipts last month will reduce borrowing, but offsetting this is the fact that non-investment spending by central government on the delivery of public services was almost one-sixth higher last month than in the same month last year.

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8 Data for this series are available back to 1964/65.

9 The 2009 PBR introduced a new measure of borrowing ("PSNB ex"). This excludes the effect of temporary interventions in the financial sector and is the measure used in the government's plans to cut the deficit. The PBR forecast borrowing to be £178 billion on this measure. PSNB including these effects is forecast to be £170 billion. The ONS' monthly figures for borrowing are for this latter measure. The PBR sets out the difference between these two measures in Table B18, page 198.

> Overall the figures from the first eleven months this year suggest that borrowing is on course to come in at £166 billion, which would be £12 billion lower than Mr Darling forecast in the Pre-Budget Report. Despite these figures the overall state of the public finances – and the fact that lower borrowing this year might not translate into lower borrowing going forwards – means the Chancellor should not announce a significant permanent net giveaway in next week's Budget.[10]

Borrowing is forecast to fall slightly in 2010/11 to 12.0% of GDP before declining to 4.4% of GDP by 2014/15. The *Fiscal Responsibility Act 2010* requires borrowing in every year from 2010/11 to 2015/16 to be lower than the previous year, as a percentage of GDP. It also requires borrowing in 2013/14 to be no more than half its 2009/10 level, as a percentage of GDP. The table below shows that, on the Treasury's forecasts, these requirements would be met.

**Table 6**

**Public sector net borrowing**

| | £bn | % GDP |
|---|---|---|
| 2008/09 | 96 | 6.7 |
| 2009/10 | 178 | 12.6 |
| 2010/11 | 176 | 12.0 |
| 2011/12 | 140 | 9.1 |
| 2012/13 | 117 | 7.1 |
| 2013/14 | 96 | 5.5 |
| 2014/15 | 82 | 4.4 |

Source: ONS, HM Treasury

### Cyclical and structural elements of the deficit

A distinction is often drawn between the "cyclical" and "structural" elements of the budget deficit:

- **Cyclical** elements of the deficit refer to the effect of the economic cycle on the level of government borrowing. In a recession, government borrowing tends to increase as tax receipts are reduced and spending on unemployment benefit increases. The reverse happens when the economy is growing strongly. These effects are sometimes known as the economy's "automatic stabilisers".

- **Structural** elements of the deficit refer to underlying or persistent elements of government borrowing which are unrelated to the economic cycle. The structural deficit is measured by cyclically-adjusted measures of borrowing.

The distinction is important as the "headline" borrowing figures may mask underlying trends unless the economy's position in the economic cycle is taken into consideration. It should be pointed out, however, that estimating how much of the deficit is cyclical and how much is structural is far from easy. This requires an assessment of where the economy is in the economic cycle. It can be difficult to determine where the economy is in relation to its "trend" level of output. This is particularly the case when the economy is coming out of recession as it requires a calculation of how much of the lost output is purely cyclical and how much is

[10] IFS Press Release, *IFS analysis of today's public finance figures*, 18 March 2010

permanent. These problems mean that estimates of the structural deficit need to be treated with a degree of caution.

The Treasury forecasts that the structural deficit will be 9.0% of GDP in 2009/10 before falling to 3.1% in 2014/15 (see table below). The structural element thus accounts for around 70% of the overall deficit (12.6% of GDP) in 2009/10. The structural deficit is large because the financial crisis is assumed to have had a *permanent* negative effect on the economy's productive potential. In its forecasts for the public finances, the Treasury has assumed that the financial crisis reduced the trend level of output in the economy by around 5% between 2007 and 2010.[11] The crisis is also assumed to have led to a permanent loss of tax revenue from the financial and housing sectors of the economy.[12]

**Table 7**

**Total and Structural deficit, % GDP**

| | Total | Structural (a) |
|---|---|---|
| 2009/10 | 12.6 | 9.0 |
| 2010/11 | 12.0 | 8.0 |
| 2011/12 | 9.1 | 5.8 |
| 2012/13 | 7.1 | 4.5 |
| 2013/14 | 5.5 | 3.6 |
| 2014/15 | 4.4 | 3.1 |

Source: HM Treasury, 2009 PBR, Table B2, p168

Note: (a) cyclically-adjusted PSNB

The Treasury Committee commented on the PBR forecast for the structural deficit as follows:

> Some economists consider the structural deficit forecast is overly optimistic, many are concerned about the large uncertainties surrounding this forecast in particular and some doubt whether sufficient attention has been given to the structural deficit existing before the recession. Future Budgets and PBRs should attempt to quantify the downside risks around the structural deficit forecast.[13]

If the economy were to grow more slowly than assumed by the Treasury, it is highly likely that the deficit would fall more slowly than forecast. If this were to happen, the requirements of the *Fiscal Responsibility Act* might be breached without further fiscal tightening.[14]

## 3.2 Debt

Government debt is forecast to increase to very high levels by the standards of recent years. The Treasury forecasts that public sector debt will increase from 44% of GDP in 2008/09 to 56% in 2009/10 and 78% in 2014/15 (see chart below). These levels of debt compare with the 40% of GDP ceiling imposed under the Government's earlier fiscal rules. Debt has not

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11 HM Treasury, *2009 Pre-Budget Report* p167

12 HM Treasury, *2009 Pre-Budget Report* para 2.53

13 Treasury Committee, *Pre-Budget Report 2009*, HC 180, 6 January 2009, para 53

14 For more detail on this issue, see "The budget deficit and the economic cycle" in the March 2010 edition of the Library's *Economic Indicators* Research Paper (RP 10/20)

been at this level for over 40 years.[15] In cash terms, debt is forecast to increase from £617 billion in 2008/09, £799 billion in 2009/10 to £1,473 billion in 2014/15.

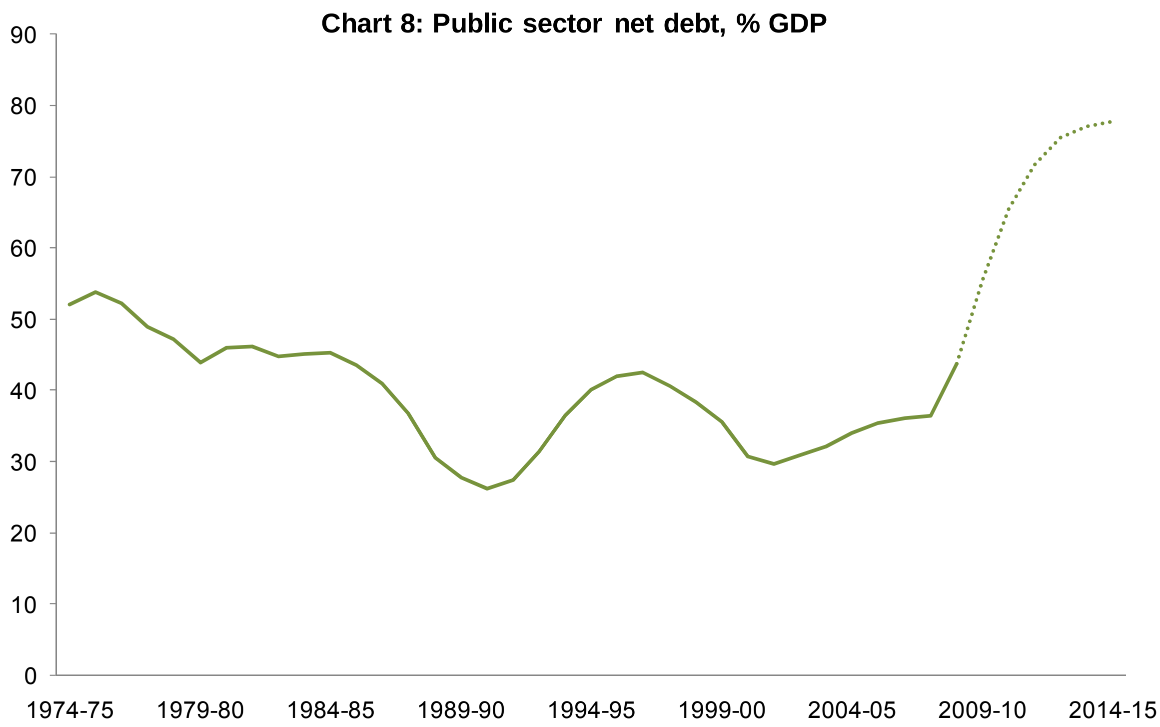


**Table 8**
**Public sector net debt**

| | £ billion | % GDP |
|---|---|---|
| 2008/09 | 617 | 43.8 |
| 2009/10 | 799 | 55.6 |
| 2010/11 | 986 | 65.4 |
| 2011/12 | 1,139 | 71.7 |
| 2012/13 | 1,270 | 75.4 |
| 2013/14 | 1,379 | 77.1 |
| 2014/15 | 1,473 | 77.7 |

Sources: ONS and 2009 PBR, Tables B13 and B14
Note: excludes financial interventions

The *Fiscal Responsibility Act* requires public sector net debt, as a percentage of GDP, to be lower in 2015/16 than 2014/15. The Treasury's public finance projections cover only the period to 2014/15 but its illustrative projections show debt falling as a share of GDP in 2015/16.[16]

15 The current measure of debt is public sector net debt. Data are available for this measure back to 1974/75. For earlier years, data are available for the national debt. This was 80.8% of GDP in 1968 (see HM Treasury Public Finances Databank, Table A10).
16 HM Treasury, *2009 Pre-Budget Report* Chart 2.3, p35

### 3.3 Public spending

The Government has set out projections for total public spending up to 2014/15. These show that public spending will grow much more slowly over the next few years compared with the recent past. The last spending review was held in 2007 and set departmental spending limits to 2010/11. The Government has argued that it does not make sense to set departmental spending plans for later years in the current uncertain economic climate. Nevertheless, the Government has said that some areas of spending will not see cuts in real terms.

#### Protected areas of spending

Despite the pressure on public spending, the Government has said that certain areas of spending will be not be cut in real terms. These include NHS front-line spending and certain areas of education spending. Commitments have also been given on police numbers and the overseas aid budget. Specifically the following commitments have been given for 2011/12 and 2012/13:

- NHS front-line spending (the 95% of spending which supports patient care) will be held constant in real terms
- Spending on front-line schools will increase by 0.7% a year in real terms
- Spending on 16-19 participation in education will increase in real terms by 0.9% a year
- Spending on Sure Start Children's Centres will be held constant in real terms
- Police authorities will be given enough funding to maintain the number of police officers and community support officers
- Overseas aid spending will remain on course to reach 0.7% of gross national income by 2013.[17]

#### Public spending projections

Public spending is set for a sharp slowdown in the coming years. The Government has set out firm spending plans up to 2010/11 and projections to 2014/15. The projections assume that current spending grows at an annual average rate of 0.8% between 2011/12 and 2014/15 and that public sector net investment falls to 1.25% of GDP in 2013/14.[18] Spending is forecast to grow by 2.3% in 2010/11 but, on the basis of these assumptions, there will be very little growth in real terms in the following four years. According to the IFS, this would be the slowest growth in public spending in a four year period since 1996/97 to 1999/00.[19]

Investment spending is projected to fall particularly sharply from £38.1 billion in 2010/11 to £20.5bn in 2014/15 (in 2009/10 prices). This is an average annual fall of over 14% in real terms over this period. It is worth remembering that investment has increased sharply in recent years and the projected figures represent a return to the level of investment seen in 2001/02 to 2003/04, as a share of GDP.

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17 HM Treasury, *2009 Pre-Budget Report* p97
18 HM Treasury, *2009 Pre-Budget Report* para B.7
19 IFS, *The IFS Green Budget*, February 2010, p191

The composition of government spending is also likely to change over the coming years as more is spent on items such as benefits and debt interest. As overall public spending is projected to remain constant in real terms, this means that departmental spending will have to be cut. The Treasury has not published spending totals for departments beyond 2010/11 so the detail of where these cuts will fall is not yet known. Nevertheless, press reports indicate that the Budget may give more detail about where the cuts will fall.[20]

The IFS has, however, published some projections of debt interest and social security spending. In evidence to the Treasury Committee, it estimated that gross debt interest payments would more than double in cash terms from £31.5 billion in 2009/10 to £71.5 billion in 2014/15.[21] After making certain assumptions about the growth of other areas of spending, the IFS concludes:

> [...] on current policies, real-terms DELs [Departmental Expenditure Limits] would need to be cut by 4.0% in 2011–12, 2.0% in 2012–13, 3.6% in 2013–14 and 1.8% in 2014–15 – or by 2.9% a year on average over the four years. This gives a cumulative real cut over the four years of 10.9% or £42.0 billion a year in 2009–10 prices by 2014–15. Taking into account the 0.5% cut in DELs the Treasury has confirmed for 2010−11, current plans imply DEL falling in real terms in every year of the next five-year parliament. The cumulative real cut over the five years is 11.4%, or £43.8 billion in 2009−10 prices. These real cuts in spending would be in sharp contrast to the increases seen over the years between 1999–2000 and 2009–10.[22]

Using a slightly different measure of public spending on services, the IFS say:

> This measure of spending is projected to be cut, in real terms, each year from 2010–11 to 2014–15 (inclusive). If this is delivered, it would be the first time there have been five consecutive years of real spending cuts on this measure since the data began in 1948–49. The average annual cut over the four years 2011−12 to 2014−15 is projected to be 1.7% a year, which would be the lowest average increase over a four-year period since the four years from April 1976 to March 1980 – the period following the UK's loan from the IMF.[23]

Protecting certain areas of spending, as the Government has announced, means that the cuts in other areas must be deeper to meet the overall spending totals. The IFS estimate that these non-protected budgets could be cut by 12.9% in real terms over the two years 2011/12 and 2012/13.[24]

### 3.4 Government plans to cut the budget deficit

The *Fiscal Responsibility Act* requires the Government to halve the budget deficit by 2013/14. The level of the budget deficit will be affected by strength of the economic recovery. Growth will cut the deficit by boosting tax revenues and reducing unemployment benefit payments. In addition to this, a number of discretionary measures to reduce the deficit have been announced by the Government. These measures include the following:

- Efficiency savings
- Control of public sector pay and pensions

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[20] "Darling to reveal where cuts will fall", *Financial Times*, 22 March 2010

[21] Treasury Committee, *Pre-Budget Report 2009*, HC180, 6 January 2010, Ev 77

[22] IFS, *The IFS Green Budget,* February 2010, p194

[23] IFS, *The IFS Green Budget,* February 2010, p196

[24] IFS, *The IFS Green Budget,* February 2010, p183

- Tax increases
- Asset sales

The Treasury has stated that the measures announced in the 2009 Pre-Budget Report, the 2009 Budget and the 2008 Pre-Budget Report will reduce borrowing by £57 billion in 2013/14. Of this, two thirds is a result of changes to spending plans and one third results from tax increases.[25] The 2009 Pre-Budget Report comments on the pace of consolidation as follows:

> The annual pace of consolidation set out in this Pre-Budget Report is faster than the pace of deficit reduction forecast by the IMF for all other G7 economies in the period up to 2014, reflecting the size of the deficit and the Government's commitment to addressing it. The average pace of consolidation over the 2009-10 to 2013-14 period, albeit from a higher level, is comparable to the speed at which the deficit was reduced during the period of consolidation in the 1990s, when growth averaged 3¼ per cent a year for 5 years from 1993.[26]

### Efficiency savings

The PBR set out a number of planned efficiency savings. £11 billion of savings are to come from "smarter government", through, for example, cutting spending on consultants by 50% and greater use of the internet to provide advice and information to the public. £5 billion of savings are to come from targeting and prioritising spending, including reform of the criminal justice system and legal aid and cutting back on the NHS IT programme.[27]

### Public sector pay and pensions

The PBR announced that the Government would seek a 1% cap on basic pay uplifts in the public sector in 2011/12 and 2012/13. This would save up to £3.4 billion by 2012/13.[28] There will be a pay freeze for senior civil servants, senior military staff, judiciary, senior NHS staff, consultants, GPs and dentists.[29] According to the PBR, reforms to public sector pensions will save £1 billion from 2012/13 and twice this level in the longer term.[30]

### Tax changes

A number of tax increases have also been announced. Examples of these include:

- **Income tax:** the introduction of a 50p rate of tax on income over £150,000 from April 2010;
- **National insurance:** increases of 1% in the rate of National Insurance Contributions for employees, the self-employed and employers from April 2011, together with an increase in the threshold at which individuals start to pay NICs;
- **Fuel duty**: increased by 2p a litre on 1 September 2009 and will increase by 1p a litre in real terms each year from 2010 to 2013; and

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25 HM Treasury, *2009 Pre-Budget Report*, Box 2.4, p33
26 HM Treasury, *2009 Pre-Budget Report* Box 2.4, p33
27 HM Treasury, *2009 Pre-Budget Report*, p97
28 HM Treasury, *2009 Pre-Budget Report* para 6.49
29 Gordon Brown, Speech on the economy, 10 March 2010
30 HM Treasury, *2009 Pre-Budget Report* para 6.51

- **Bank bonus tax**: the 2009 PBR introduced a temporary bank payroll tax on discretionary bonuses over £25,000.[31] According to the *Financial Times*, revenues from this tax could be higher than expected at £1.5 billion.[32]

### Asset sales

In December 2009, the Government published the *Operational Efficiency Programme: asset portfolio.* This set out the next steps to raise £16 billion from asset and property sales by 2013/14. The following businesses have been earmarked for full or partial sale:

- The Tote
- Students Loans Portfolio
- Dartford Crossing
- High Speed 1 (operates high speed rail link between St Pancras and the Channel Tunnel)
- URENCO (provides uranium enrichment and technology services to the nuclear industry).[33]

## 3.5 Commentary

### Economists' letters to newspapers

The issue of the appropriate speed by which to cut the deficit has divided economists. In a letter to the *Sunday Times* on 14 February 2010, one group of economists called for a "credible medium-term fiscal consolidation plan [which] would make a sustainable recovery more likely". They called on the next government to provide a plan to reduce the structural budget deficit more quickly than set out in the PBR.[34] Two further letters were published in the *Financial Times* on 18 February taking an alternative view. One, from Lord Skidelsky and others, argued that the timing of fiscal consolidation measures should depend on the strength of the economy and that the deficit would automatically be cut as growth in the economy resumed.[35] The other, from Lord Layard and others, said that a sharp shock to the economy would be "positively dangerous" and that further immediate cuts could reduce the level of demand in the economy.[36]

### European Commission

The European Commission has recently commented on the Government's plans for reducing the deficit. The Commission said that the absence of detailed departmental spending plans was "a source of uncertainty" and the economic outlook might be "distinctly less favourable than envisaged". The Commission urged the UK to do more to reduce the level of

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[31] HM Treasury, *2009 Pre-Budget Report* para 3.6
[32] "Election countdown as Budget date fixed", *Financial Times*, 11 March 2010
[33] HM Treasury, *2009 Pre-Budget Report*, p111
[34] "UK economy cries out for credible rescue plan" [letter from Tim Besley and others], *Sunday Times*, 14 February 2010
[35] "First priority must be to restore robust growth", [letter from Lord Skidelsky and others] *Financial Times*, 18 February 2010
[36] "Sharp shock now would be dangerous" [letter from Lord Layard and others], *Financial Times,* 18 February 2010

borrowing.[37] The EU also warned Germany, France, Italy and Spain that their growth forecasts were too optimistic.[38]

### IFS

In its annual *Green Budget*, the IFS argued that the Treasury may be optimistic about the recovery. It pointed to the significant fiscal tightening between 2009/10 and 2010/11 and suggested that no further fiscal tightening is implemented in 2010/11, given the fragile state of the economy and the current expansionary stance of monetary policy. The IFS argue that completing the fiscal "repair job" within one Parliament would be more credible than the eight year timetable envisaged by the Government. Both parties' plans would be more credible if they explained how they might need to change in response to changing economic circumstances.[39]

### Treasury Committee

In its report on the 2009 PBR, the Treasury Committee noted the fine judgement needed in balancing the need for fiscal consolidation with the resilience of the economy and the uncertainty of the economic outlook. It recommended that "greater detail and clarity" be added to the fiscal consolidation plan sooner rather than later. It also noted that some economists regarded the forecast for the structural deficit as too optimistic and called on the Treasury to quantify the downside risks relating to this forecast. With regard to future levels of public spending, the Committee argued that the Treasury should produce "illustrative" figures for future expenditure, at least for the split between DEL and AME.[40] It said that there was a sense in which the Treasury was using uncertainty as a reason for not having a spending review to suit itself as it had been able to produce fiscal forecasts to 2014/15.[41]

## 3.6 Conservatives' proposals

The Conservatives have said that they would cut the budget deficit more quickly than the Government arguing that this is the best way to help the economy, through lower interest rates, for example. Their position was set out in an article in the *Financial Times* on Monday 15 March 2010 by George Osborne, co-written with Jeffrey Sachs of Columbia University. This argued that where an economy has a large structural deficit, further fiscal stimulus could be counterproductive as it could affect confidence and raise borrowing costs. The article argued that the "priority should be a medium-term fiscal framework, with the first steps starting this year."[42]

If elected the Conservatives would hold an emergency budget within 50 days of taking office. They would also establish an independent Office for Budget Responsibility. This would publish independent fiscal forecasts. It would also publish recommendations for fiscal policy based on a mandate set by the Chancellor.[43] Health spending would be protected in real

37 European Commission Press Release, Commission assesses stability and convergence programmes of fourteen EU member states, IP/10/288, 17 March 2010
38 ""Brussels warns forecasts too optimistic", *Financial Times*, 18 March 2010
39 IFS, *The IFS Green Budget,* February 2010, pp S1-5
40 Departmental Expenditure Limits (DEL)s are the spending limits set for departments while Annually Managed Expenditure( AME) covers spending which is less amenable to multi-year spending limits, such as social security spending.
41 Treasury Committee, *Pre-Budget Report 2009*, HC 180, 6 January 2010
42 "A frugal budgetary policy is the better solution", Financial Times, 15 March 2010
43 Speech by George Osborne, A New Economic Model [Mais lecture], 24 February 2010

terms and commitments on international aid honoured but there would be cuts in other areas of public spending. The Conservative Party website gives further details of their plans:

- A one year public sector pay freeze in 2011 (this won't affect the one million lowest paid workers);
- Bringing forward the date at which the state pension age starts to rise to 66, to no earlier than 2016 for men and 2020 for women;
- Stopping tax credits to families with incomes over £50,000;
- Cutting spending on Child Trust Funds for all but the poorest third of families and families with disabled children;
- Capping the biggest public sector pensions above £50,000;
- A 5% pay cut for Ministers followed by a 5 year freeze, and a 10% reduction in the number of MPs.[44]

### 3.7 Liberal Democrat proposals

In his speech to the Liberal Democrats' Spring conference Vince Cable said:

> Spending cuts must not be forced through too soon, making the recession worse. [...] The timing and speed of cuts must reflect the state of the economy, not political dogma. But cuts there will be. We have spelled out some of them.

The Lib Dems have also set out a number of areas where public spending could be cut, including:

- Public sector pay: no pay increases over £8 a week and no bonuses to be paid
- Government contributions to the Child Trust Fund would end and tax credits for high earners would be cut
- Cancellation of some defence contracts such as the Trident replacement
- Cancellation of the ID cards scheme

The Lib Dems say they have identified over £15 billion a year of savings. Details will be set out in full in their manifesto. They would look for savings across all government departments – there would be no ring-fencing of budgets. The Lib Dems would also take 3.6 million people out of income tax paid for by the "mansion tax" and the closure of tax loopholes.[45]

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44 http://www.conservatives.com/Policy/Where_we_stand/Economy.aspx
45 Speech by Vince Cable at Lib Dems Spring Conference, 13 March 2010

## 4 The Finance Bill and the General Election

The Finance Bill which follows the Budget is usually scrutinised over a two month period in the early summer. This timetable will be significantly shortened this year by the timing of the General Election. Finance Bills cannot be carried over from one Parliament to the next. In addition, there are a small number of measures which must be legislated for in a Bill, relatively soon after the beginning of the new tax year.

Income tax – and corporation tax – are annual taxes, and the authority to collect them expires at the end of the tax year, on 5 April. Under the Provisional Collection of Taxes Act 1968, annual taxes may continue to be collected, after the date of expiry, if the House approves a resolution to this effect within a month of the end of the tax year. However, it would be insufficient for the House to have only approved a Budget resolution to set the charge to tax before the Election, because these resolutions would be invalidated by Parliament's being dissolved. So, in these circumstances, a Finance Bill must be passed by 5 May.

Having a deadline of 5 May suggests that Governments have three possible options, when a General Election is held soon after Budget day in March:

> 1. To have a Budget mainly for publicity purposes but no Finance Bill, on the assumption that the Election could be held, and a new Parliament could meet and pass a Finance Bill before 5 May. In practice this would be an extremely tight timetable [...] with the election of a new Speaker, Members taking the oath, the need to arrange a state opening and Easter, even assuming one party has an overall majority and was able to form a government immediately after the election. It would also mean a new Chancellor would have to introduce a Budget and Finance Bill as soon as he had taken on the job. For these reasons, it seems likely that a Finance Bill would be passed before the dissolution.
>
> 2. To introduce a 'holding' Finance Bill once the election was called. This was done in 1979. The Labour Government lost a vote of no confidence on 28 March and called an election for 3 May. The Government and Opposition agreed on the measures which should become law before the dissolution. A Finance Bill was introduced on 3 April and received Royal Assent the next day. It was designed primarily to give the legislative authority necessary for the continued collection of income tax, corporation tax and advance corporation tax in 1979-80 without in any way prejudicing the tax changes that a new Government might wish to make on assuming office. Following the Conservative party's victory in the General Election, the new Chancellor, Geoffrey Howe, presented his Budget on 12 June.
>
> 3. To have the Budget and produce the Finance Bill without a delay, to have it passed before the dissolution for the election. This was done in 1992, when the then Conservative Government presented a shortened Bill with only certain key proposals included for political reasons. The problems with such a Bill is that the Government either needs the agreement of the Opposition to pass it or must have it passed despite them, using a guillotine motion to ensure the Bill is passed by its chosen deadline.[46]

Finance Bills have been guillotined very occasionally over the last few years: in 1967-68 (the motion was presented on 21 May 1968); in 1974-75 (4 March 1975); in 1991-92 (13 March 1992); in 1993-94 (1 February 1994); and in 1997-98 (14 July 1997). The guillotine procedure has always been controversial, and, given the central importance of taxation, it is

[46] Library Standard Note, The Budget and the annual Finance Bill (SN/BT/813)

not surprising that it has been used very rarely in these circumstances. It seems likely that in future the Government will have far less need to use guillotine motions, with the introduction of programme orders, which have been used with most Bills since the start of the 2000-2001 session.[47]

[47] Further detail on the implications for the Finance Bill of the Budget being held shortly before a General Election are in section 3 of Library Standard Note, The Budget and the annual Finance Bill (SN/BT/813).

# 5 Appendix 1: Economic and public finance data

**Economic data**

| | Real GDP growth (%) | Inflation CPI (%) (a) | Inflation RPI (%) | Unemployment (b) 000s | % |
|---|---|---|---|---|---|
| 1979 | 2.7 | .. | 13.4 | 1,063.7 | 3.7 |
| 1980 | -2.1 | .. | 18.0 | 1,351.0 | 6.3 |
| 1981 | -1.3 | .. | 11.9 | 2,152.4 | 8.4 |
| 1982 | 2.1 | .. | 8.6 | 2,521.9 | 9.5 |
| 1983 | 3.6 | .. | 4.6 | 2,761.9 | 10.1 |
| 1984 | 2.7 | .. | 5.0 | 2,887.8 | 10.3 |
| 1985 | 3.6 | .. | 6.1 | 2,997.2 | 10.4 |
| 1986 | 4.0 | .. | 3.4 | 3,066.6 | 10.3 |
| 1987 | 4.6 | .. | 4.2 | 2,779.6 | 8.6 |
| 1988 | 5.0 | .. | 4.9 | 2,253.1 | 6.7 |
| 1989 | 2.3 | 5.2 | 7.8 | 1,768.0 | 5.4 |
| 1990 | 0.8 | 7.0 | 9.5 | 1,648.1 | 6.1 |
| 1991 | -1.4 | 7.5 | 5.9 | 2,267.8 | 8.5 |
| 1992 | 0.1 | 4.3 | 3.7 | 2,741.6 | 9.9 |
| 1993 | 2.2 | 2.5 | 1.6 | 2,876.6 | 9.4 |
| 1994 | 4.3 | 2.0 | 2.4 | 2,598.6 | 8.2 |
| 1995 | 3.1 | 2.6 | 3.5 | 2,289.7 | 7.4 |
| 1996 | 2.9 | 2.5 | 2.4 | 2,087.5 | 6.2 |
| 1997 | 3.3 | 1.8 | 3.1 | 1,584.5 | 4.7 |
| 1998 | 3.6 | 1.6 | 3.4 | 1,347.8 | 4.4 |
| 1999 | 3.5 | 1.3 | 1.5 | 1,248.1 | 3.8 |
| 2000 | 3.9 | 0.8 | 3.0 | 1,088.4 | 3.4 |
| 2001 | 2.5 | 1.2 | 1.8 | 969.9 | 3.1 |
| 2002 | 2.1 | 1.3 | 1.7 | 946.7 | 3.0 |
| 2003 | 2.8 | 1.4 | 2.9 | 933.1 | 2.9 |
| 2004 | 3.0 | 1.3 | 3.0 | 853.3 | 2.6 |
| 2005 | 2.2 | 2.1 | 2.8 | 861.8 | 2.9 |
| 2006 | 2.9 | 2.3 | 3.2 | 945.0 | 2.9 |
| 2007 | 2.6 | 2.3 | 4.3 | 863.7 | 2.5 |
| 2008 | 0.5 | 3.6 | 4.0 | 905.1 | 3.6 |
| 2009 | -5.0 | 2.2 | -0.5 | 1,531.8 | 5.0 |
| Latest (c) | -3.3 | 3.5 | 3.7 | 1,585.1 | 4.9 |

Source: ONS

Notes: (a) CPI estimated before 1997

(b) claimant count

(c) GDP: 2009 Q4 compared with 2008 Q4; inflation: January 2010; unemployment: February 2010

**Public finance data**

| | Public sector net borrowing | | Structural borrowing | Public sector net debt | |
|---|---|---|---|---|---|
| | £ billion | % GDP | % GDP | £ billion | % GDP |
| 1979-80 | 8.5 | 4.1 | 4.0 | 98.2 | 43.9 |
| 1980-81 | 11.5 | 4.8 | 3.4 | 113.8 | 46.0 |
| 1981-82 | 6.0 | 2.3 | -1.5 | 125.2 | 46.2 |
| 1982-83 | 8.5 | 3.0 | -1.4 | 132.5 | 44.8 |
| 1983-84 | 11.7 | 3.7 | 0.0 | 143.8 | 45.1 |
| 1984-85 | 12.3 | 3.6 | 0.6 | 157.2 | 45.3 |
| 1985-86 | 8.8 | 2.4 | 0.6 | 162.7 | 43.5 |
| 1986-87 | 8.1 | 2.0 | 1.9 | 167.8 | 41.0 |
| 1987-88 | 4.4 | 1.0 | 2.2 | 167.4 | 36.8 |
| 1988-89 | -6.3 | -1.3 | 1.3 | 153.9 | 30.5 |
| 1989-90 | -1.0 | -0.2 | 2.6 | 152.2 | 27.7 |
| 1990-91 | 5.8 | 1.0 | 2.6 | 151.3 | 26.2 |
| 1991-92 | 22.6 | 3.7 | 3.3 | 166.1 | 27.4 |
| 1992-93 | 46.7 | 7.4 | 5.5 | 201.9 | 31.4 |
| 1993-94 | 51.0 | 7.7 | 5.4 | 249.8 | 36.5 |
| 1994-95 | 43.3 | 6.2 | 4.7 | 290.0 | 40.1 |
| 1995-96 | 34.7 | 4.7 | 3.8 | 322.1 | 41.9 |
| 1996-97 | 27.1 | 3.4 | 2.8 | 347.2 | 42.5 |
| 1997-98 | 5.8 | 0.7 | 0.6 | 352.0 | 40.6 |
| 1998-99 | -4.5 | -0.5 | -0.2 | 350.7 | 38.4 |
| 1999-00 | -15.5 | -1.6 | -1.1 | 344.4 | 35.6 |
| 2000-01 | -18.3 | -1.9 | -1.1 | 311.1 | 30.7 |
| 2001-02 | -0.2 | 0.0 | 0.2 | 314.3 | 29.7 |
| 2002-03 | 25.1 | 2.3 | 1.9 | 346.0 | 30.8 |
| 2003-04 | 33.0 | 2.9 | 2.6 | 381.5 | 32.1 |
| 2004-05 | 39.8 | 3.3 | 3.1 | 422.1 | 34.0 |
| 2005-06 | 37.4 | 2.9 | 2.8 | 461.7 | 35.3 |
| 2006-07 | 30.8 | 2.3 | 2.3 | 497.8 | 36.0 |
| 2007-08 | 33.5 | 2.4 | 2.6 | 527.2 | 36.5 |
| 2008-09 | 96.1 | 6.7 | 5.7 | 617.1 | 43.8 |
| 2009-10 | 178 | 12.6 | 9.0 | 799 | 55.6 |
| 2010-11 | 176 | 12.0 | 8.0 | 986 | 65.4 |
| 2011-12 | 140 | 9.1 | 5.8 | 1,139 | 71.7 |
| 2012-13 | 117 | 7.1 | 4.5 | 1,270 | 75.4 |
| 2013-14 | 96 | 5.5 | 3.6 | 1,379 | 77.1 |
| 2014-15 | 82 | 4.4 | 3.1 | 1,473 | 77.7 |

Sources: ONS and HM Treasury

## 6 Appendix 2: Links to further information

**HM Treasury**

2009 Pre-Budget Report: http://www.hm-treasury.gov.uk/prebud_pbr09_index.htm

Public finance databank: http://www.hm-treasury.gov.uk/psf_statistics.htm

Forecasts for the UK economy: http://www.hm-treasury.gov.uk/data_forecasts_index.htm

**Office for National Statistics**

Public Sector Finance: http://www.statistics.gov.uk/cci/nugget.asp?id=206

GDP: http://www.statistics.gov.uk/cci/nugget.asp?id=192

Labour Market: http://www.statistics.gov.uk/StatBase/Product.asp?vlnk=1944

Inflation: http://www.statistics.gov.uk/cci/nugget.asp?id=19

**Institute for Fiscal Studies**

Green Budget 2010: http://www.ifs.org.uk/publications/4732

Briefings on public finances and expenditure:
http://www.ifs.org.uk/publications/browse?subject=15

**Treasury Select Committee**

http://www.parliament.uk/parliamentary_committees/treasury_committee.cfm

**House of Commons Library**

Economic Indicators Research Paper: http://hcl1.hclibrary.parliament.uk/wdw/subject/ei.asp