

Post-Budget Briefing 2007: Opening Remarks

Good afternoon everyone. My name is Robert Chote, Director of the IFS.

Welcome to our traditional post-Budget briefing; a particularly historic occasion as we wave goodbye to the Clunking Fist.

I will make a few opening remarks. We then have four presentations:

- Chris Frayne on the public finances;
- Carl Emmerson on public spending;
- Mike Brewer on personal taxes and child poverty, and;
- Mike Devereux on corporate taxes.

The slides will be available on the website at the end of the day.

Gordon Brown certainly cannot be accused of ending his tenure at the Treasury with a damp squib. He laid out spending plans and tax reforms that span the next three years, doing much of his successor's job for him and defining the ground on which he hopes to fight his first general election as Labour leader. Mr Brown may have disavowed any Gladstonian ambition to serve formally as Chancellor and Prime Minister simultaneously, but it may not feel that way.

On the fiscal position, Mr Brown had to concede for the sixth Budget running that the outlook for the public finances is weaker than he had previously thought – thanks on this occasion to lower expected North Sea oil revenues. But, as usual, he confidently predicted that the current budget balance would be back in comfortable surplus in five years time.

One consequence of his overoptimistic fiscal forecasting is that the huge margin by which he expected to meet the famous “golden rule” (to borrow only to invest) early in Labour's second term has all but disappeared. Yesterday's forecasts suggest that the rule would be met over the 10 year cycle drawing to a close this year with almost £11 billion to spare. But the rule would have been missed by almost £4 billion without the conveniently timed decision in summer 2005 to add two years to the beginning of the cycle. Whether the rule is met by £11 billion over 10 years or missed by £4 billion over eight years is of no direct economic significance when you consider that this is the difference between total revenue and total current spending, which have both exceeded £5,000 billion in today's terms over the past 10 years.

But the perception that the Chancellor has moved the goalposts and that he delayed the tax raising measures and cuts in spending plans that we and other independent commentators had been saying would be necessary until after the 2005 election has undermined the credibility of the fiscal framework. The Chancellor did not address this problem yesterday, but there is a window of opportunity for his successor to make improvements without needing to disown everything that has gone before.

On public spending, the Chancellor confirmed yesterday that we are in for the tightest squeeze since Labour's earliest years in office, when it was helped by falling unemployment and debt interest costs. Spending is planned to rise by 2 percent a year over the three years of the Comprehensive Spending Review, half the rate during Labour's years of plenty but still more than the Conservatives delivered between 1979 and 1997. Despite deriding the Conservative pledge to cut public spending as a share of national income over the economic cycle, Mr Brown seems to be doing his level best to adhere to it.

One symptom of the squeeze is that education spending is set to grow only half as quickly as it did in the years of plenty and will stop rising as a share of national income. At this rate, it would be 2020 before Mr Brown meets his objective to raise spending per pupil in the public sector to the level seen in the private sector in 2005-06. Bear in mind that public spending per pupil in 2005-06 was the same as private spending in 1996-97, so this would actually lengthen the time lag between spending per pupil in the public and private sector from 9 years to 15 years.

All talk of spending has of course been swept from the headlines by yesterday's blizzard of tax changes. Mr Brown has developed a zeal for tax reform rather late in the day, but better late than never.

The Chancellor announced a £2½ billion package of income tax cuts and tax credit increases, offset by high national insurance. This was paid for with higher green taxes, lower relief from business rates for empty properties and anti-avoidance measures.

The income tax and national insurance changes are a welcome simplification of the untidy way in which the rates of these two taxes interact. My predecessor criticised Mr Brown's decision to introduce the 10p lower rate in the first place as an unnecessary complication that would do less to help the poor than the Government claimed at the time; so it would be churlish not to welcome its abolition now.

The new rate structure is not quite as simple as it looks because the lower rate remains for savings income, a decision for which there is no obvious logical explanation. And differences in the definitions of income subject to tax in the two systems may be more important sources of complexity than a higgledy-piggledy rate structure.

But this is a useful and significant step in the right direction, bringing us closer to the day when a bold Chancellor may have the nerve to abolish national insurance altogether and fold it into income tax – a change that would certainly create further distributional challenges, but which would deliver real gains in transparency and reduced administrative and compliance costs.

With regards distribution, it is somewhat unfair to criticise the Chancellor for having given with one hand and taken with another in this Budget. He said clearly and with good reason that the public finances required him to deliver a neutral Budget and we often complain that Chancellors fight shy of revenue neutral tax reforms because of the fear of creating losers.

The income tax and NI package has been cleverly designed to limit the number of losers to one-household-in-five at a modest overall cost to the Exchequer that has been recouped elsewhere without much difficulty.

It is not one of Mr Brown's Robin Hood Budgets, deliberately taking from the rich to give to the poor. Most losers are in the middle of the income distribution, but lose only small amounts. This is a genuinely simplifying Budget, with the losers necessarily determined by where the complexities are that have to be removed. To reform the system in a useful way within tight financial constraints and with only modest gains and losses should be a cause for congratulation rather than criticism.

The corporate tax reforms also involve winners and losers within a broadly neutral package. The Chancellor is financing a cut in the corporation tax rate for big companies by increasing the amount of profit subject to tax, a combination of base broadening and rate reducing. Ironically, he is doing the opposite for smaller firms, narrowing their base and increasing their rate. This is a further attempt to reduce the artificial incentive for self-employed people to make themselves companies to reduce their tax bills that was at its worst during Mr Brown's doomed experiment with a zero percent corporation tax rate for small firms.

Let me now hand you over to my colleagues, who will take you through these issues in greater detail. Starting with Chris on the public finances...