

Analysis of the Budget 2007

Brown's final Budget by Robert Chote

Gordon Brown has certainly dashed fears that his swansong Budget would be a damp squib. He has confirmed that the next few years will see the tightest squeeze on public spending for a decade, but combined this with an eye-catching package of personal and corporate tax reforms. He has already stamped his mark on the machinery of monetary policy and planning the public finances – with a welcome simplification of income tax and national insurance he is staking his claim to be a tax reformer too.

Winners and losers by Mike Brewer (IFS)

The Budget contained a series of changes to personal taxes and tax credits, which together will cost the Treasury £2.4bn in 2009–10. This net cost represents the difference between a set of measures which give away £13.2bn, and a set of measures which raise £10.7bn. As a result, the majority of families will find that some measures make them better off and other measures make them worse off. The changes to personal taxes seem to have been carefully designed to ensure that this Budget is not a tax raid on the rich: those earning over around £42,000 a year will find their disposable income almost unaffected by the personal tax changes. However, almost 1 in 5 families in the UK will lose from, and, unusually for a Brown Budget, the losers come from across the income distribution, and include some families with children."

Child Poverty by Mike Brewer (IFS)

Pre-Budget speculation was that the Budget would be one for children, not least because the Government has challenging targets for child poverty in 2010 which will not be met on current spending plans. Increases in the child element of the child tax credit gives the most help to the poorest children, and extra spending on working tax credit will help encourage lone parents to work. Along with the changes to income tax and NI, the Treasury estimate today's changes will take 200,000 children out of poverty. Although helpful, much more needs to be done in the next three years if the Government is serious about meeting its target.

Simplification by Stuart Adam (IFS)

The wholesale removal of an income tax band - at least for earned income – and the further alignment of income tax and National Insurance thresholds are welcome simplifications. But they raise the question of whether a much greater simplification could be achieved by fully integrating income tax and National Insurance.

Corporation Tax by Helen Simpson (IFS)

The Chancellor announced a cut in the main rate of corporation tax from 30% to 28% in 2008–09. At the same time he announced a reduction in the generosity of capital allowances for investment. Taken together these imply a cut in the tax rate but a broadening of the tax base (the lower rate being applied to a larger fraction of profits). Companies investing heavily in buildings and in plant and machinery seem the least likely to benefit. The most profitable companies (where the value of tax allowances is small relative to income) are those most likely to gain, and the rate cut may make the UK a more attractive location for such firms.

The Chancellor also announced a gradual increase in the small companies' rate of corporation tax from 19% to 22%. This almost takes us full circle – in his first budget the Chancellor cut the rate from 23% to 21%; further cuts followed, plus the introduction and subsequent abolition of the 10% and 0% starting rates of corporation tax. The current increase is aimed at reducing incentives to incorporate (and take income in the form of dividends rather than wages) created by the tax system. These incentives were previously greatly enhanced by the ill-fated 0% starting rate.

He also introduced a new Annual Investment Allowance (AIA) which allows all firms an immediate deduction of up to £50,000 for investment in plant and machinery. For some small companies this should lessen the effect on their tax bills of the increase in the small companies' rate.

While the reforms for large firms lower the tax rate and broaden the tax base, for companies paying at the small companies' rate, the reforms increase the tax rate, but for those benefiting from the AIA, narrow the tax base.

Public finances by Carl Emmerson and Christine Frayne (IFS)

Today's Budget revealed that yet again the outlook for the public finances is slightly weaker than the Chancellor had expected. Borrowing forecasts over the next few years have been raised by about £2bn in each year. This was largely due to a downwards revision to the expected output of North Sea Oil companies which reduces their tax bills. While the Budget measures were individually substantial in terms of their giveaway and takeaway from both the corporate and the personal sector the net impact on the public finances was negligible as the exchequer gains and loses largely offset each other. The Chancellor remains on course to meet both his fiscal rules over the current economic cycle and, more importantly, over the next economic cycle.

Public spending by Robert Chote (IFS)

Mr Brown confirmed that, after economy-wide inflation, total public spending will rise by just 2 percent a year on average over the three years of the Comprehensive Spending Review: 2008–09, 2009–10 and 2010–11. This is half the 4 percent annual increase Labour has delivered during its “years of plenty” since 2000. On the other hand, it is nowhere near as tight as the squeeze in Labour’s early years in office and more generous than the 1.5% a year delivered by the Conservatives from 1979.

At this rate spending will not keep pace with growth in the economy. You could argue that this is enough in itself to imply a “cut”, for example if public sector wage increases need to keep up with private sector ones and if social security payments need to keep pace with the improving living standards of those in paid work.

When the Conservatives proposed increasing spending in real terms but reducing it by 2 percent of national income over six years in the 2005 election, Mr Brown and his colleagues described it as a £35 billion cut. On the same basis, Mr Brown’s plans to reduce public spending by 0.6 percent of national income over the CSR would be a £8 billion cut, rising to £10 billion if you include his tentative projection for 2011–12. Whether this is a cut or slowdown is a matter of opinion. Politicians inevitably describe these things in the way that best suits them at the time. But of one thing we can be sure: Labour’s years of plenty are at an end.

Education spending by Alissa Goodman and Luke Sibieta (IFS)

Today’s Budget announced the CSR settlement for total education spending. Education spending in the UK is set to grow from £77.4 billion in 2007–08 to reach £90 billion in 2010–11, in cash terms. This equates to an annualised average real terms increase of 2.4% per year. This means that total UK education spending will remain broadly constant as a share of national income between 2007–08 and 2010–11, at 5.6%. When looking at education spending in England over the same period, we see that this will grow in real-terms by 2.5% per year on an annualised average basis.

This Chancellor also spelled out how much his education plans will help him in his aspiration to increase state schools spending per pupil to £8,000 in 2005–06 prices (that spent in the private sector in 2005–06). State school spending per head is set to increase from a planned value of £5,263 in 2007–08 to reach £5,800 in 2010–11, all in 2005–06 prices. Some of this increase comes from the new capital spending that was already announced before today’s Budget. Some of the increase is also due to an expected fall in pupil numbers, which allows existing funding to go further. Today’s announcements imply an additional £300 per pupil on top of these. What does this mean for when his aspiration might be met? If the average real growth seen in per pupil spending over the CSR period is maintained after 2010–11, then the aspiration

will not be met until 2020–21. It could be met in 2016–17 if instead per pupil spending were to grow at the same rate seen between 1997–98 and 2007–08 (5.7%).

ENDS

Notes to editors:

1. The IFS will be presenting a more detailed analysis of the Budget at a briefing on Thursday 22nd March, from 1pm – 2.30pm at the Institute for Fiscal Studies. Please contact Bonnie Brimstone (bonnie_b@ifs.org.uk) if you would like to attend.