

Immediate Budget Analysis

Public Finances

Like Gordon Brown so often before him, Alistair Darling today had to concede that Government borrowing is likely to be higher over the next few years than he had previously thought, but predicted that the problem would resolve itself without the need for big tax increases.

The Chancellor did announce some net tightening. By 2010-11 he expects to raise roughly £1.7 billion from environmental measures, £600 million from drinkers and the usual £500 million from anti-avoidance measures. He plans to give back a third of the proceeds to cut child poverty, leaving a net tightening of just under £2 billion – just 0.1% of national income.

This makes only a small dent in the extra borrowing that the Treasury now predicts over the next few years. Despite the extra revenue he plans to collect, Mr Darling said that borrowing would be £5 billion higher on average each year over the next four years than he thought last October. But by 2012-13 he returns to his previous borrowing forecast, partly by assuming that the squeeze on public spending over the next three years gets even tighter thereafter.

The extra borrowing means that public sector net debt is now expected to reach 39.8% of national income in 2010-11, just a whisker below the Government's self-imposed 40% ceiling (excluding the impact of Northern Rock). A succession of over-optimistic fiscal forecasts has now all but exhausted the Treasury's room for manoeuvre against this target.

The Chancellor has had to revise down his tax revenue forecasts largely because of the weakening housing market, lower share prices and weaker consumer spending (exacerbated by a shift within people's spending towards items like food and energy on which less VAT is paid). Revenues are also reduced because economic growth overall is expected to be weaker, although this is partially offset by higher expected inflation.

There is clearly a danger that tax revenues will turn out to be even weaker – for example if the slowdown in the economy is deeper or more persistent than the Treasury hopes. The Chancellor may also be overoptimistic about the medium-term path of corporation tax receipts.

There are also political pressures. Will the Chancellor be able to get away without repeating next winter's "one-off" £575 million giveaway to pensioner households? Will he be able to hold off pressure for further delays in planned

fuel duty increases? And presumably he will want to do more to bring the Government closer to its child poverty target: even if today's measures do take 250,000 children out of poverty as the Chancellor hopes, it will probably still be half a million short of the Government's target for 2010-11 if he finds nothing further.

So, on a number of counts, Mr Darling delivered today's Budget with fingers crossed. If the downturn is deeper than expected, if he is overoptimistic about the underlying strength of tax revenues, or if political pressure requires further giveaways, then Mr Darling or his successor may have to inflict more pain than he did yesterday.

Measures directly affecting households

The main Budget changes directly affecting households in 2008-9 are a one-year-only rise in winter payments for those aged 60 or more, a delay to October in the planned 2p rise in road fuel duties, and a 6% real rise in all alcohol duties, the first real rise since the early 1990s. Together, these changes cost the Treasury £0.7bn a year.

In subsequent years, families with children will benefit from small increases in child benefit and child tax credit, and a targeted change to housing benefit and council tax benefit that increase the gain to work for some families with children currently facing the weakest work incentives. However, the impact on the Exchequer of the extra £870m a year spending on families with children in 2010/11 is more than offset by further rises in alcohol duty, rises in the duty on main road fuels and biofuels, and a new system of vehicle excise duty, which together raise £2.2bn in 2010/11.

The changes announced today are dwarfed by those already announced by Gordon Brown in last year's Budget which will take effect in April: the abolition of the 10p income tax rate, the cut in the basic rate of income tax from 22p to 20p, the higher tax allowances for those aged 65 or over, more generous child and working tax credits, and the rise in the upper earnings limit for national insurance contributions.

ENDS

Notes to Editors:

1. IFS will present a full analysis at a lunchtime briefing, 1pm – 2.30pm on 13th March at the Building centre in London. Please contact Bonnie Brimstone (020 7291 4818 / bonnie_b@ifs.org.uk) if you wish to attend.