

Policy Briefing

Budget 2010

“The ambition to turn a record budget deficit into a surplus within five years is admirable”

This Budget sets out a five-year plan to re-build the British economy. For the first time, the Government's fiscal policy decisions have been based upon independent forecasts for the economy and public finances. The fiscal mandate that frames all policy decisions taken is an ambition to achieve a current balance by the end of this Parliament. This is supplemented by an ambition to see public sector net debt falling as a percentage of GDP by the end of this Parliament.

Budget Deficit

The enduring theme of this emergency budget has been the determination to restore Britain's fiscal credibility in the eyes of the World. The coalition's ambition to turn a record budget deficit into a budget surplus within five years is admirable. The two-year freeze in public sector pay is prudent; 35% of Doncaster businesses are still struggling to recruit skilled staff – it is important that the private sector can compete on even terms; many private sector employees have seen no inflationary increase in pay since 2007. However, the real -terms cuts to departmental budgets of a record 25% across the board are troubling. 59% of Doncaster businesses are deeply concerned by the impact this is likely to have on their efforts to grow in the coming years; a sizeable proportion of private sector turnover in Doncaster is, at present, still reliant on the public sector – we must remember that the economy is not long out of recession and has yet to see GDP growth of anything over 0.4% - the economic recovery is barely underway.

VAT

The widely expected 2.5% increase in value-added tax was the headline announcement of this budget. The Chamber has long argued against such a rise, in light of high inflation (3.4% in May) and falling disposable incomes which, along with high food and fuel costs, has left many families, particularly those on low incomes, struggling to survive. Worse still, there is a good chance that the increase in VAT will push inflation higher still, forcing the Bank of England to raise interest rates and thus, reduce economic growth. The Chamber has lobbied for a delay in the introduction of the rise, to allow excessive capacity in the economy to drag inflation lower, but does not feel that the proposed January introduction allows enough time for this to happen. This quarter's Doncaster Economic Review does, however,



reveal an increase in spare capacity in the economy (by some 18%) which, it is hoped, will blunt some of the effect of the VAT rise.

Capital Gains Tax

Capital Gains Tax will remain at 18% for low and middle-income earners, but taxpayers on higher income tax rates will now pay this at a rate of 28%. The Chamber strongly welcomes the extension of the 10% rate for entrepreneurs from the first £2m of qualifying gains to the first £5m.

Corporation Tax

This budget announces a reduction in the main rate of corporation tax from 28% to 24% over the course of four financial years from April 2011, a reduction in the small profits rate to 20% from April 2011 and a reduction in the main and special rate of capital allowances to 18% and 8% respectively in April 2012.

This will give the UK the lowest rate in the G7 and fifth lowest in the G20. The Chamber strongly believes that inward investment should be encouraged in this manner and is delighted that the coalition Government recognises the competitive advantage such a move offers.

The reduction in the annual investment allowance from £100,000 to £25,000 per year is, however, unwelcome, as despite the Government's insistence that 95% of businesses will still have their annual investment covered, we believe that such a move disadvantages the manufacturing sector. Concern must be raised over the nature of the businesses now excluded from this allowance – particularly in light of the coalition's intention to see economic growth led by high-end manufacturing and exporting – for whom £25,000+ of annual investment is not uncommon.

The Chamber also welcomes the intention to establish a business forum, chaired by the Exchequer Secretary to the Treasury, that will consult with multinational businesses on the UK's tax competitiveness, including the long-term aims of reform of the corporate tax system. We also awaits the autumn review on reform, particularly in light of the Government's belief that, in general, a broad tax base, a low rate and a more territorial approach will improve competitiveness and provide greater certainty for business.

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Regional Growth Fund

The Government will enable locally-elected leaders, working with business, to lead local economic development. As part of this change, Regional Development Agencies will be abolished.

Yorkshire Forward, as the region’s development agency, has been extremely successful at targeting support to those areas that need it. Yorkshire and Humber as a region has seen a lack of investment in many areas compared with other regions for decades – great steps have been taken by Yorkshire Forward towards reducing such funding disparities. The region also has a strong voice and strong brand in Whitehall thanks to Yorkshire Forward and business was keen to see this continue.

In this light, we await details of a scheme to help new businesses in targeted areas of the UK that need it most. During a three year qualifying period, new businesses which start up in these areas will get a substantial reduction in their employer National Insurance Contributions.

Opportunity Missed

Over-inflated house prices in the UK pose a strong underlying threat to long-term economic growth. The last decade has seen a housing shortfall develop, as the number of households created in any one year has far exceeded the levels of new homes completed. This gap has significantly worsened over the course of the recession, thus intensifying the risk to the economy, something that has still yet to dawn on key decision makers in Whitehall.

Ministers must recognise that house prices should become a key aspect of fiscal policy in the UK; if prices were to be stabilised at an affordable level, that protects long-term investment growth, while avoiding an inflationary ‘bubble’, this would go some way toward regulating the excessive levels of consumer debt that have become commonplace in the last decade and that fuelled the last recession.

To achieve this, the Chamber has lobbied the Government to commit to build significant numbers of new homes, in order to shield prices from supply pressures and then gradually reduce house prices, making homes more affordable for all. The coalition’s budget document fails to even recognise the matter as an area of concern.



Weaker Growth Forecasts

The independent Office of Budget Responsibility has forecast weaker growth prospects in light of the actions taken in the budget. This reflects measures which restrain Government spending and real household disposable income and will, as a result, hold back consumer demand.

In 2010, GDP is forecast to rise by 1.2 per cent followed by 2.3 per cent in 2011 (against 1.3 per cent and 2.6 per cent in the pre-Budget forecast). From 2012 onwards, GDP growth projections suggest a recovery, as prices and wages adjust and monetary policy continues to support demand. This assumption is troubling, as the Chamber feels that the VAT rise could force the Bank of England to raise interest rates – thus suppressing some of this expected growth.

When compared with the pre-Budget forecast, growth is stronger from 2013 onwards as the economy adjusts back towards potential output. By the end of the forecast, the adjustment is not yet complete, so that the output gap is slightly larger in 2014 than it was in the pre-Budget forecast.

Gamble

The growth forecasts from the independent Office of Budget Responsibility reveal the extent of the gamble taken by the coalition Government. Unless the significant spare capacity in the economy can suppress inflation sufficiently in the coming months, the 2.5% increase in VAT scheduled for January 2011 could see inflation pushed higher and force the Bank of England to raise interest rates – further damaging GDP growth prospects that have already been downgraded due to public sector spending cuts.

However, the Chamber must applaud the ambition of the coalition Government in pushing this budget through a House of Commons in which no single party has an overall majority. This parliamentary term will define prosperity for the next generation. Measures introduced now have the potential to restore growth and reduce debt within five years.

The Chamber remains cautious, however, over the timing of these measures, in light of the fragility of the economy in the short-term and its vulnerability to events in the EU.