

the unavoidable Budget:

a smaller state, a bigger
society?

Chris Wales



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This timely analysis of the coalition government's 2010 Budget strategy forms part of the Smith Institute's on going work on policies for a fairer society. It complements the research we are undertaking on the forthcoming spending review and the monograph of essays on fair tax, which was edited by Dr Chris Wales. We hope this report offers a fresh and enlightening perspective on the Budget and fosters further discussion and debate. We are grateful to Chris and would like to thank the Oxford University Centre for Business Taxation for supporting the project.

The unavoidable Budget: a smaller state, a bigger society?

The coalition government's June Budget was introduced to deal with the declared emergency of "the largest budget deficit of any economy in Europe with the single exception of Ireland". It was a Budget that set a new political tone and mapped out a new course for the government's role in the economy and in society.

In this paper, I examine three issues:

- Was this an unavoidable Budget in any economic sense, or was its purpose primarily political?
- Has the chancellor been bold enough in pursuing the budgetary strategy that he has set to achieve its fundamental purpose?
- In the unique circumstances that have led to this coalition, is there a need to seek a clear mandate for the scale of change that the government now proposes?

I conclude that:

- For the right, rather than being an economic necessity, the Budget was a political opportunity, created by the financial crisis, to redefine the nature and the role of government, to give life to the Conservative desire for a smaller state, enabling rather than providing, drawing in the private sector and looking to civil society to fill the gaps left by the withdrawal of government provision.
- There is a significant gamble in the Budget strategy. As government shrinks, it needs the private sector to take up the slack, and that dependency may prove to be the acid test of George Osborne's chancellorship. Among the consequences of a rapid withdrawal of government spending, there are likely to be substantial public-sector job losses. So, if the private sector fails to meet the challenge to create new jobs in equivalent numbers, there is a risk that the budgetary strategy will fail with it. The coalition's philosophy is that government needs to "get out of the way of business". But that may not be enough. There is a significant risk that the deregulation and tax changes that the government has announced in the Budget will fail to generate the surge in private-sector investment and job creation on which the chancellor's strategy depends. As business secretary Vince Cable said on 3 June, "fiscal stabilisation will only be successful if it leads to growth".

- And, finally, to legitimise the fundamental choices that the coalition is making on our behalf about the role of government, it should seek to hold a much broader, better-informed debate with the electorate around the budgetary strategy and the spending review. There is a place for asking the public which items of expenditure can be saved. But there is a more important, prior question that has not been asked or answered satisfactorily about achieving the right balance between tax changes and expenditure cuts to deal with the deficit on the public finances.

The economic background

The Budget has taken place against a background in which the signals from the economy are very mixed. There has been a return to growth after the recession, but that growth has been relatively weak, and the first-quarter figures were not helped by the difficult and snowy start to the year.

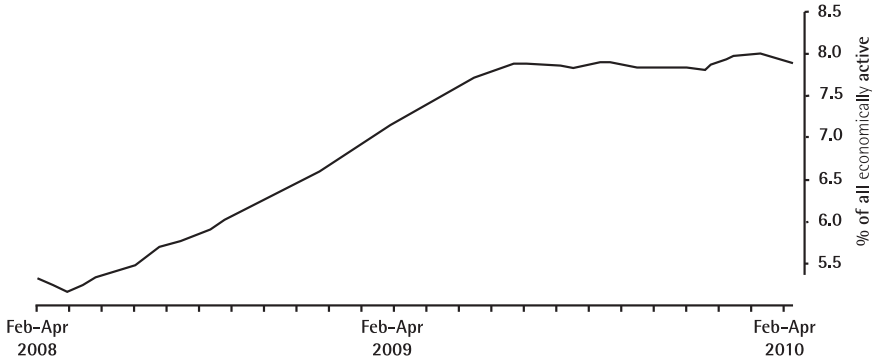
Interest rates continue to be low, protecting both commercial and private borrowers. The Bank of England's Financial Stability Report for June 2010 shows that household debt in the UK is still above 100% of GDP, but UK households' capital gearing has dropped almost 10% since 2009. Gross interest as a proportion of household income has fallen dramatically since 2007, to just over 7%. Arrears and possessions in the mortgage market are under half the level that they were in the early 1990s. Possessions stand at just 0.1% and arrears at 1.5%, compared with a peak of around 0.2% and 3.5% respectively in the early 1990s, when interest rates were around 14%.

Unemployment has risen significantly since the lows of the middle of the decade, with the sharpest rise occurring between the first quarter of 2008 and the same period in 2009. Since then, it has, perhaps temporarily, stabilised at around 8.0% of the economically active. This is well below the levels reached elsewhere in Europe and in the US, in spite of the dependence of the UK economy on the badly hit financial services sector.

Long-term unemployment is, however, a cause for concern. The figures from the Office for National Statistics (ONS), published on 16 June 2010, show that the number of people unemployed for more than 12 months increased by 85,000 over the first quarter of this year. At the period end, the total stood at 772,000, the highest figure since the first quarter of 1997. Although there was a small rise in job vacancies, the ratio of unemployed to job vacancies rose to just over 5:1. Earnings growth has slowed, responding to the easing of employment demand.

Figure 1: Unemployment rate

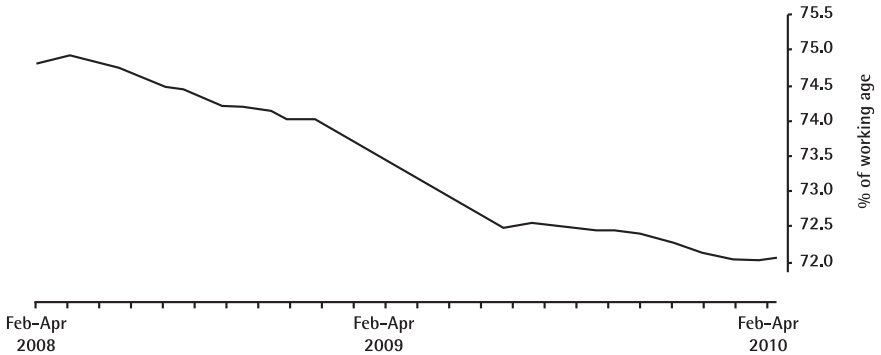
Seasonally adjusted; sampling variability $\pm 0.2\%$



Source: Office for National Statistics, 2010

Figure 2: Working-age employment rate

Seasonally adjusted; sampling variability $\pm 0.4\%$



Source: Office for National Statistics, 2010

Youth unemployment (for those aged 18-24) is also high. The Centre for Economic & Social Inclusion, in its June Labour Market Analysis, notes that the youth unemployment rate (including students) is 17.3%, compared with 6.4% for those aged 25-49 and 4.5% for those aged 50 and over. Since the start of the recession the youth unemployment rate has risen 5.1%, compared with 2.5% for those aged 25-49 and 1.7% for the over-50s. It remains to be seen whether there will be a bigger than usual cyclical movement in youth

unemployment this summer, as a number of those who entered or stayed on in higher education to avoid the immediate impact of the recession come on to the jobs market.

Another potentially disturbing trend is the shift towards self-employment and part-time work. While there is reason to celebrate the flexibility in the UK labour market that this seems to demonstrate, it is also cause for concern that there are now 1.08 million people who are in self-employment or part-time work specifically because they have been unable to find full-time employment. This is the highest figure since records were first kept in 1992. And the number of people in such work for this specific reason rose by 45,000 in the first quarter of 2010, while the number of people in full-time employment fell by 56,000 in the same period.

Elsewhere, there are more mixed signs for the economy. UK corporate debt remains high against historic benchmarks, but the number of liquidations has been lower than some commentators expected. The Bank of England attributes this partly to low interest rates, partly to forbearance by the banks and partly to some help from HMRC through the Business Payment Support Service.

In its recent Financial Stability Report, the Bank of England recognises the importance of banks continuing to lend and the mutuality of interest between the banks and their business customers:

Banks have a collective interest in supporting economic recovery through their lending activities ... There is a risk that banks alleviate their own funding pressures by further constraining credit conditions for their customers. That would dent economic recovery and so raise credit risks for all banks.

Preparing the way for the 'unavoidable Budget'

So where does the main threat to the economy come from? The coalition, and the Conservative Party before the election, have emphasised the risk that the financial markets might take fright at the absolute level of UK public debt. They have been very open about their fears of a downgrading of the UK's credit rating from its current AAA status and the consequential risk of higher interest rates.

They have sought to craft a populist message around that set of concerns. For example, on 7 June, prime minister David Cameron said:

I have been in office for a month and I have spent much of that time discussing with the chancellor and with government officials the most urgent issue facing Britain

today, and that is our massive deficit and our growing debt. How we deal with these things will affect our economy and our society, indeed our whole way of life. The decisions we make will affect every single person in the country and the effects of those decisions will stay with us for years, perhaps even decades, to come.

There are three simple reasons why we have to deal with the country's debts. One: the more the government borrows, the more it has to repay; the more it has to repay, the more lenders worry about getting their money back; and the more lenders start to worry, the less confidence there is in our economy.

Two: investors – people lending us this money – they do not have to put their money in Britain. They will only do so if they are confident the economy is being run properly; and if confidence in our economy is hit, we run the risk of higher interest rates.

Three: the real, human, everyday reason this is the most urgent problem facing Britain is that higher interest rates hurt every family and every business in our land. They mean higher mortgage rates and lower employment. They mean that instead of your taxes going to pay for the things we all want, like schools and hospitals and police, your money, the money you work so hard for, is going on paying the interest on our national debt. That is why we have to do something about this.

By international standards, the UK had a good record on public debt for more than a decade under Labour, and this provided a buffer at the start of the financial crisis. Eurostat figures published on 22 April 2010 showed that the stock of UK government debt at the end of 2007 was 44.7% of GDP on a Maastricht basis, and 52.0% at the end of 2008. At each of these dates, it was significantly lower than the stock of German (65.0% and 66.0%) and French (63.8% and 67.5%) government debt, let alone Greek government debt, which stood at 95.7% and 99.2% of GDP respectively for those years.

Concerns about the level of public-sector debt coming out of the financial crisis were and remain real – a point acknowledged by all the main parties during the recent election campaign – but the markets have not reflected a view of the UK as an economy in crisis and have put relatively little pressure on interest rates. In fact, the markets have been relatively calm throughout the political events of the past six months.

- Since the end of 2009, UK government CDS (credit default swap) spreads have widened a little but not as much as for other governments, including governments that have introduced significant austerity packages. Not all of this can be put down

to the anticipation of a Conservative victory or a Conservative-style budgetary policy.

- UK 10-year gilt yields have moved broadly in line with German bunds through the period 2008-10. The spread over German bunds has stayed largely within the range of 0-100 basis points, generally higher than the spread for French government bonds, but relatively stable.

Table 1: Selected sovereign credit default swap premiums

Senior five-year credit default swap premiums (in basis points)

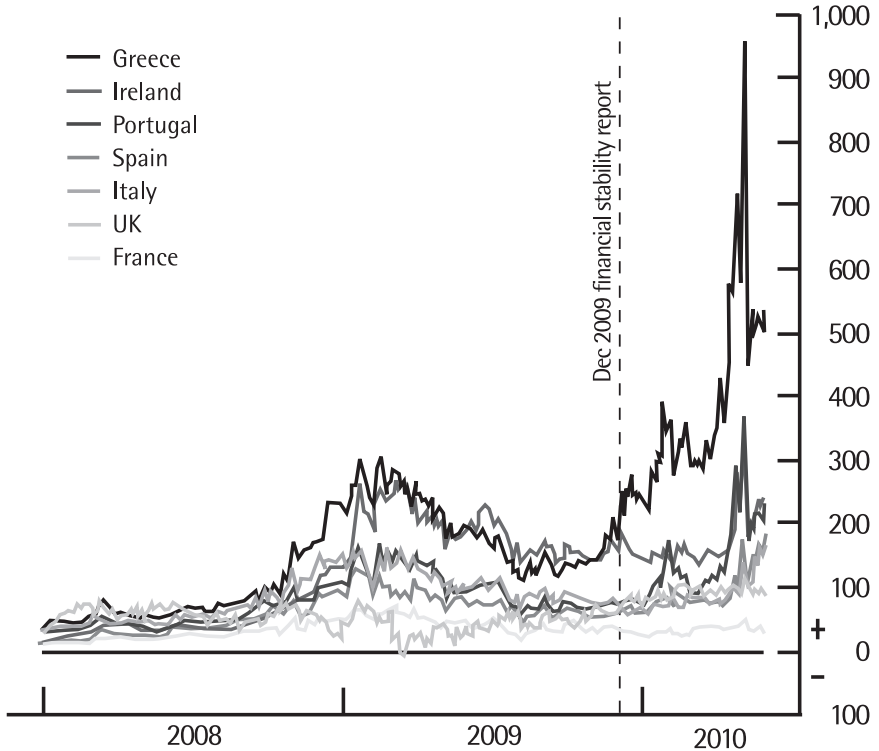
	Jan 2008	Jun 2009	Dec 2009	Jun 2010
UK	9	87	70	93
US	8	45	32	43
France	10	38	24	95
Germany	7	34	23	50
Greece	22	155	182	762
Ireland	13	220	150	285
Italy	20	105	85	245
Portugal	18	77	70	358
Spain	18	98	86	269

Source: Thomson Reuters Datastream; Bank of England *Financial Stability Report*

It is of course helpful in this context, and in the context of currency movements during the financial crisis, that the UK government bond market is less dominated by foreign investors than are many others. With external ownership of UK gilts at around 20% of GDP, the UK is closer to the bottom end of the scale than the top. Together with the weighting towards longer maturities, this has made the UK much less exposed to refinancing risk. External ownership of US debt is higher. External holdings of German bunds are almost twice as high as those of UK gilts, while external ownership of French and Italian government bonds is almost three times as high. The risk of contagion from troubled Eurozone issuers undeniably exists for the UK but, arguably, at a much lower level than that painted into the public mind. The UK is not Greece, and although the UK deficit in 2010 was expected to be high by EU standards, the ability of the UK to absorb the shock is much greater.

Figure 3: European sovereign spreads

Spread of 10-year government bond yields over German bunds for selected countries, from data to close of business on 10 June (in basis points)



Sources: Thomson Reuters Datastream; Bank of England calculations

When calculating the impact of the Budget measures on the likely course of interest rates, the Office for Budget Responsibility concluded that "bond yields could have been around 30 basis points higher over the next three years without the measures in this Budget", adding: "These calculations are illustrative, highly uncertain and depend on a range of assumptions." Even if the full 30 basis points were to be added today to UK gilt yields, they would not warrant any serious comparison with Greek or Irish government bond yields. But the chancellor nevertheless put interest rates first on his list of June Budget concerns.

In his Budget speech, George Osborne referred to his emergency Budget as "the unavoidable Budget". In the world of political theatre, it was clearly unavoidable and a necessary step in the articulation of the government's economic strategy. But, beyond that, it has done little but pave the way for action later.

The Budget provided little detail on the spending cuts except in relation to welfare benefits. That will have to wait until the autumn. The expected VAT rise has been announced but will not be implemented until January 2011. Some detail has been given on the anticipated corporation tax changes, but little of it is to be legislated until after the recess and the implementation of most of it is deferred until well after 2011. The first Finance Bill is remarkable by its brevity and by its lack of immediate impact.

Surprisingly for a Budget responding to an emergency, it introduces almost nothing that brings in cash immediately: even the capital gains tax changes that came into force at midnight on Budget Day will raise no cash in the current year.

The political Budget: cuts, jobs, growth and fairness

So this was a political Budget. And the political strategy set out in George Osborne's Budget speech binds together, in a triple lock, the fate of the economy over the next decade, the success or failure of the coalition, and the course of his own political career. As the months and eventually the years go by, there will undoubtedly be questions and perhaps some answers about how much of the Budget – the scale of the expenditure cuts, the scope of the tax and benefit changes and the overall distributional impact – was truly unavoidable, and how much was choice, dictated by political rather than economic considerations.

Today, there are four fundamental questions to be asked about the coalition's June 2010 budgetary strategy:

- Are the cuts that have been outlined deliverable?
- Are they too deep for an economy in the early stages of recovery, when some key trading partners are still relatively weak?
- As the state withdraws quickly, will the proposed tax changes stimulate enough private-sector investment and job creation?
- Are the Budget measures fair enough in their incidence across society?

And, beyond that, there are some longer-term questions about what society will look like in 2015, what government will look like, what ground the general election of 7 May 2015 will be fought over and what the budgetary strategy will be at that point. This paper provides a necessarily brief and cursory look across these issues.

The June 2010 budgetary strategy is built around a particular balance of pain and encouragement. It is largely within the Treasury's power to deliver the pain: the spending cuts to which the coalition is committed. They will be painful and they will also be regressive, as would a Labour government's have been. But the coalition's cuts will be larger, at least in the first instance; and they will probably be more regressive, if one can take as a guide the early focus on disability living allowance, housing benefit and a shift from RPI-based up-rating of benefits to a CPI-linked system. To deliver these cuts, it is already clear that the Treasury and the prime minister will have to face down the protests of teachers, parents and students; of unions and civil servants; and maybe even of the disabled and the unemployed. But they can stand firm.

By contrast, the encouragement that the Budget can deliver is only encouragement. And the government is dependent on external agents to deliver its fruits.

There are some key propositions built into the Budget architecture:

- that spending cuts are more effective at tackling budget deficits than taxation increases;
- that the withdrawal of government spending will swiftly lead to the private sector filling the gap;
- that the government is spending too much on welfare and supporting worklessness among many who could be gainfully employed within the economy;
- that if prospects for growth were to weaken, the Bank of England would be willing and able to extend its programme of quantitative easing (assuming that inflation is under control);
- that the benefit of the prospective cuts in the rate of corporation tax that were announced in the Budget will outweigh the impact on investment of less generous capital allowances and stimulate a significant enterprise-led recovery;
- that the CPI "reflects everyday prices better" than other measures of inflation and is, therefore, a fair and more appropriate measure for the up-rating of benefits; and
- that the new approach to budgetary policy is fair across generations, genders and social groups.

(i) Cuts

The coalition programme of fiscal consolidation relies substantially more on spending cuts than on taxation increases. In doing so, it falls slightly short of George Osborne's target of an 80:20 split, reaching 77:23 by 2015/16. But it involves a higher burden of cuts than the Labour government envisaged. Both the Labour and coalition proposals represented a significant step away from the 50:50 approach of the 1990s. It remains to be seen whether this will be the optimal mix for the UK economy.

The Institute for Fiscal Studies' (IFS) post-Budget analysis commented:

The degree of reliance on spending cuts implies some very tough decisions. The government has identified welfare cuts worth £11 billion by 2014-15. More than half come from indexing benefits to an inflation rate that tends to be lower than the ones currently used. Mr Osborne implicitly assumes that recipients were overcompensated for increases in the cost of living in the past, an argument that is open to debate. The rest comes largely from the four biggest working-age benefits and tax credits, a mixed bag of reforms with no consistent objective beyond the desire to save money.

It added:

In total, the cut in central government public services spending as a share of national income now planned by the Coalition will more than reverse the entire increase we saw under Labour. We are looking at the longest, deepest sustained period of cuts to public services spending at least since World War II.

It is perhaps remarkable that this level of reduction could be not just proposed but put into action without a serious debate with the electorate about the right balance between spending cuts and taxation measures. Instead, the views of the OECD and the IMF have often been used to validate the effectiveness of spending cuts.

The Budget documentation references the IMF's *UK Article IV Consultation* of May 2009, the concluding statement of which contains the text: "The emphasis in current plans to weigh the adjustment toward expenditure reduction is appropriate in light of international experience that expenditure-based consolidations are more durable." This is a statement of IMF orthodoxy rather than a validation of a particular percentage split for the UK.

Interestingly, there is no reference in the Budget papers to the IMF's rather more recent *Public Information Notice No 10/27* of 23 February 2010, which emphasised

the dangers of unwinding government support for the economy "too early, which would jeopardize progress in securing economic recovery", noting: "For most advanced countries, some fiscal and monetary stimulus may need to be maintained well into 2010, and withdrawal could begin in 2011 if developments proceed as expected."

The Budget documentation refers instead to the OECD's June 2007 *Economic Outlook No 81*, which looks very broadly at the history of success and failure of fiscal consolidations around the world but provides no more than a summary of what has seemed to work better or worse in other situations. While there is no doubt that the OECD, like the IMF, believes that spending cuts are an important part of any fiscal consolidation, its most up-to-date analysis, published at the end of May 2010 in a working paper titled *The Political Economy of Fiscal Consolidation*, presents a much less black-and-white picture of its views than has typically been painted.

This paper identifies, as did the June 2007 paper, that it has tended to be government weakness rather than a fundamental flaw in tax-led consolidation strategies that has led to sub-optimal outcomes in some situations where heavy reliance has been placed on tax increases. The author, Robert Price, notes: "OECD analysis ... seems to confirm that substantial consolidation depends on cutting current expenditures." But the relative scale of the respective spending-cut and tax-raising components of those successful strategies is worth noting: "In non-euro area countries, where consolidation gains have been most persistent, on average half of the consolidation was due to expenditure cuts, half of which related to cuts in capital expenditures."

This seems to be a rather different balance from that proposed by the coalition or by its predecessor.

The Oxford Centre for Business Taxation notes that the cuts envisaged by the coalition are "extremely severe", going well beyond what the previous government had planned, even though the previous government "already intended to cut spending faster than the Thatcher government in the 1980s".

(ii) Jobs

There will be a significant impact on jobs. The government and the Office for Budget Responsibility (OBR) both acknowledge that there will be public-sector job losses. And both anticipate a substantial pick-up in private-sector employment to fill the gap. However, there have been some expressions of doubt about the forecasting by the newly constituted OBR of the scale of the public-sector job losses and the likelihood of those new jobs emerging.

Chris Giles and George Parker, writing in the Financial Times on 9 July, have highlighted and questioned the approach taken by the OBR in forecasting the likely trend of public-sector employment. They say that the coalition Budget will result in there being "far more public sector job losses than under Labour's plans" and, in unusually strong terms, note that "the OBR's fiddle of its modelling assumptions in the week before the Budget limited the apparent threat of redundancy to those in public service. The OBR did not tell anyone about this change ...". This looks like a row that will not go away quickly.

No less worrying than the revelations about the likely scale of job losses in the public sector is the concern that the growth in private-sector jobs will not be as strong as forecast. Dr John Philpott, chief economic adviser at the Chartered Institute of Personnel & Development, has said:

... a favourable outcome [to the Budget] depends on a return to health of the wider economy and increased demand for labour from the private sector. The conditions necessary for such a favourable outcome are at present far from self-evident and unlikely to emerge simply as a consequence of swifter and tougher action to reduce the deficit. On the contrary, historical precedent would suggest that the application of stronger fiscal discipline to an economy in too weak a state to bear it will both slow the rate of economic growth and stem the pace of job creation. Consequently, the employment outlook is likely to be far weaker than the OBR forecasts and the coalition government hopes, with a rise in unemployment toward 3 million in the next two years a distinct possibility.

In its 7 July Report on Jobs, accounting group KPMG notes:

Clearly, the proposed public sector cuts have not yet had an impact on the UK jobs market. However, it can now be only a matter of time before we will start to see the impact of the government's efficiency savings strategy which is likely to leave hundreds of thousands of public sector workers looking for employment. The big challenge will be to transfer as many of these jobs as possible to the private sector through outsourcing and divestment, otherwise the economy will be put under enormous pressure at all levels.

The political nature of the Budget makes it difficult for the coalition to have a Plan B. But the economy may need one. The IMF has already reacted to the Budget measures by reducing its growth forecast for the UK from the forecast it made only three months ago "by the largest amount for any of the leading economies" according to

the *Financial Times*, "reflecting the tighter path of fiscal consolidation outlined in the Budget".

While the ONS figures show that the manufacturing sector achieved its highest level of growth for 15 years in the year to May, economists are beginning to register concern that this is as good as it is likely to get. The National Institute of Economic & Social Research has said that the growth rate in the UK economy could slip back to lower levels in the second half of this year, with negative implications for employment. There are also signs that the housing market is falling back, reflecting a lack of confidence in the economy.

However, the coalition has sought and found political cover for its budgetary strategy in the actions taken by other EU member states and members of the G20. So, how does the scale of the cuts envisaged in UK public spending compare with those of other governments that have introduced austerity packages?

A brief summary of recent austerity packages introduced by other governments is provided in the appendix. Two countries that stand at opposite ends of the scale of fiscal rectitude are Germany and Greece. According to the *Financial Times* of 5 July, the German government proposes fiscal consolidation amounting in total to €80 billion. Of this, €11.2 billion will occur in 2011, more than half of which will come from spending cuts. The German government is anxious not to blow off course the industry-led recovery that is growing in strength. In an environment in which UK spending cuts seem likely to average 25% across all departments and may reach 33% in some, the German retrenchment looks relatively modest. Again according to the *Financial Times* of 5 July, overall government spending in Germany is to fall by 3.8% in 2011, with smaller reductions in subsequent years. The labour and social affairs ministry will see the highest cuts, at 8%, but spending on education and research will rise by more than 7%. The target is to reduce the structural deficit to 0.35% by 2016.

The spending cuts announced by the UK government also look tough when compared with those of the Greek government. According to analysis by the Oxford University Centre for Business Taxation, the UK cuts "exceed those identified by the Greek government, which faces a much greater fiscal crisis. (The Greek government aims to cut marginally deeper, but some of its cuts are still not identified or quantified.)"

Martin Wolf, writing in the *Financial Times* of 23 June, refers to the "gigantic gambles" in the Budget, and to the forecast "collapse" of government expenditure. "Massive fiscal tightening was ultimately inevitable. But perhaps only such a young government – in age and in time in office – would gamble so much on such a fast adjustment," he said, adding: "Mass public sector job losses lie ahead."

James Forsyth, writing in the *Spectator* of 23 June, summed up, in two sentences, the two sides of the budgetary strategy: "This Budget will certainly lead to a far smaller public sector. The corporation tax cuts should have created a far larger private sector by the time of the next election." And therein lies one of the Budget's greatest challenges. Will the coalition have provided enough encouragement to new investment? Or will a combination of inexperience, Treasury caution and the headwind of LibDem politics have doomed the experiment (and thus eventually the coalition itself) to failure?

(iii) Growth

The OBR's June forecast predicts that the corporation tax changes will deliver some growth. It expects the net impact of the rate cuts and the changes to capital allowances and to the annual investment allowance to have a positive effect on business investment. It says:

The cost of capital, which is the fundamental determinant of business investment in the long run, will be altered by the reforms to corporation tax. The cuts in the corporation tax rate more than offset the cuts in investment allowances so that the estimated cost of capital for new investment is lower for all non-financial companies, and the rate of return from the existing stock is higher. Our judgement is that this measure will promote a higher level of business investment throughout the forecast than would otherwise have been the case.

But the pick-up is relatively modest. It amounts to a 0.1% increase in 2011, 0.2% in 2012, 0.3% in 2013 and 0.4% in 2014, compared with the pre-Budget OBR forecast. Both the pre-Budget forecast and the June forecast show lower business investment for 2011 and 2012 than did the Treasury numbers in the March Budget.

The corporation tax changes are important, but they may prove not to be transformational. And the planned scale of withdrawal of government spending suggests that they need to be transformational if the private sector is to take up all the slack.

A number of factors contribute to doubts about whether this ambition will be realised. One of these is the uncertainty that the Budget itself creates around likely changes to business taxation in the future.

- One of the key factors that will determine whether new international investment is attracted to the UK will be whether returns from investment here are higher than those that can be obtained elsewhere. As the chancellor

noted in his Budget speech, "We live in a world where the competition for business is growing ever more intense ... Corporation tax rates are compared around the world, and low rates act as adverts for the countries that introduce them. Our current rate of 28p is looking less and less competitive." All of this is undoubtedly true. On its own, this set of programmed rate cuts will raise the return for international investors and, setting aside any effect from other corporation tax changes, will attract more investment than before. It is also true that the rate cuts "will give us the lowest rate of any major western economy, one of the lowest rates in the G20, and the lowest rate this country has ever known".

However, this will remain true only if none of the other governments responds. The Treasury and HMRC have always been cautious about the longevity of any rate advantage. In the dynamic environment of corporate tax competition, other governments are well aware that investment can be attracted or retained through lower rates, and it is unlikely that a UK rate advantage will endure for many years, as recent history has shown. This is particularly true for a long tail of prospective rate reductions. Investors will be wary of committing to long-term investment here when they know that more advantageous returns might well be found elsewhere in the near term, as other governments respond.

- Business confidence often hangs on small signals. The proposed cuts in the rate of corporation tax would undoubtedly generate more confidence if they were enshrined in legislation. However, only the initial cut to 27% is included in the current Finance Bill. It is difficult to be certain about the rationale behind leaving the other reductions to be legislated at a later point. Some commentators have suggested that the government may be attempting to avoid a situation in which the impact of the tax reductions is negative for large companies, including the banks, with significant deferred tax assets that would then have to be revalued down. However, if true, this might turn out to be a relatively poor trade-off against giving investors the certainty that the lower rates would come in automatically. The more substantial corporation tax rate cuts announced by Nigel Lawson in 1984 were legislated immediately in the 1984 Finance Act.
- The chancellor may also have damaged confidence in the business tax system by indicating that he intends to examine a number of aspects of corporation tax. These include: the controlled foreign company rules; the treatment of the profits of foreign branches; the taxation of intellectual property, including the system of research and development tax credits and the other issues covered

in the Dyson review, which touched on the royalty/patent box concept; and the North Sea oil and gas regime.

Most of the announcements are framed in positive language, but there will be uncertainty about whether the coalition will in fact be prepared to give up substantial revenues through reforms in these areas, however important they may be for long-term investment in the UK. In his speech, the chancellor said, "In the current climate, with the deficit the size it is, all these reductions in tax must be more than paid for by other changes to business taxation." It will be important to establish whether these comments reflect the coalition's overall stance on business tax policy. A broadly revenue-neutral set of measures may not provide much incentive for investment.

- Uncertainty over taxation, tighter regulation and a possible regulation-led restructuring of the banking sector will also cast a shadow over prospects for business investment. The outcome of discussions on both the proposed levy and the financial activities tax may affect the ability and willingness of the banking sector to support the UK economy through business and retail lending. The combined effect of tax and regulatory changes in this sector may reduce activity levels and profitability, leading to falls in corporate tax revenues in both the banking sector and the businesses it serves. Some of the banks that are most affected may even be tempted to look overseas for jurisdictions with less burdensome rules. The investment banks in particular rely extensively on very highly skilled migrant labour, much of which comes from outside the EU, and they may be adversely affected by a clumsy application of the cap on immigration. Other governments may benefit.
- Investors will also be wary of the direction of UK tax policy in relation to financing costs. Although the chancellor chose not to address the issue in this Budget, it is a poorly kept secret that he, if not yet the coalition, has it in mind to make substantial changes to the system of relief for the costs of debt finance. This is a major issue for inbound and domestic investors and for both large and small companies alike that rely on finance from banks and debt markets. The effective disallowance of interest expense, in whole or in part, has a great deal to commend it from a policy perspective, particularly if combined with a wider range of measures, but too hasty a move could cause waves rather than ripples through the markets, creating significant winners and losers. It could also push debt issuance offshore for multinational groups, perhaps adding to pressures on UK banking activity levels. And, of course, it could also have an impact on the overall level of business investment in the

UK economy.

In addition to these uncertainties, both domestic and international investors are likely to be concerned at the general economic climate in the UK.

- As the OBR's June forecast indicates, the Budget will reduce real household disposable incomes and consumption will be under significant pressure: "Consumption growth rises in the forecast to rates of over 2 per cent from 2013, but it remains below the rate of growth of GDP ... The level of real consumption is weaker than in the pre-Budget forecast, particularly in 2011 and 2012, as lower household incomes and the rise in VAT reduce household demand." This presents a difficult backdrop for those who are weighing up the pros and cons of investing in domestic businesses. Households will feel under pressure. There may be some short-term benefits to consumption before the VAT rise comes into effect in January 2011, but thereafter both consumption and savings will be adversely affected by the Budget measures. The June OBR forecast notes that most of the impact of the VAT rise will be passed on to households: "We judge that around two-thirds of the VAT increase will be passed on relatively quickly in prices, with further adjustment in the following year."
- There is also a persistent concern that bank lending may not be strong enough to support the level of growth in the private sector that the budgetary strategy requires. The Bank of England's Financial Stability Report for June 2010 reflects a worry that the banks may retrench, further reducing lending activity, in response to a new climate of risk aversion, new and uncertain forms of tax, and regulatory changes; and that this, in turn, may dent economic recovery. The Bank of England therefore urges that "the transition to the new regulatory regime [for banks] should take account of the economic environment. An extended transition would make it easier for banks to build resilience through profit retention, while sustaining lending." Most of the contraction in UK bank balance sheets has in fact come from a reduction in derivatives business, but alongside that there has been a reduction in new lending to businesses and households. This has assumed greater significance to the economic recovery in the UK because of the substantial withdrawal of foreign banks from these markets.

The Bank of England is clearly nervous of a downward spiral in which reduced bank lending is a key component. But there is arguably an inconsistency in its thinking. At the same time as it is urging the government to withdraw quickly its own direct support for the economy, it is arguing for the banks to be allowed time to adjust to new prudential rules so that they will continue to support it. There is an argument

that growth could be stronger and more certain if both the government and the banks remained active for longer in their interventions to support it.

- International investors will be influenced by broader conditions within the UK economy; by the level of investment in infrastructure, including transport links; by the flow of qualified school leavers and graduates; and also by softer factors such as amenities and quality of life. The coalition's policies impinge on all of these; and all may be more influential than the taxation changes on which the budgetary strategy is dependent.
- Investors will be uncertain about the government's intentions for capital spending in particular. The chancellor announced in his Budget speech his intention to protect capital spending, saying: "Well judged capital spending by government can help to provide the new infrastructure our economy needs to compete in the modern world ... I think an error was made in the early 1990s when the then government cut capital spending too much ... We have made many tough choices about the areas in which we should make additional savings, but I have decided that capital spending should not be one of them." However, since Budget Day, it has become clear that this should not have been interpreted to exclude the possibility of, for example, bringing to an end the Building Schools for the Future programme, which supports educational objectives as well as the badly hit construction sector and employment. The government will need to provide more certainty about which capital spending will actually survive the cuts.

In summary, the Budget measures leave some doubt as to whether the coalition will be able to achieve the transformation in private-sector investment necessary to compensate for the withdrawal of government spending. Although the proposed tax changes have generally been well-received by the business community, there remains a great deal of uncertainty in the UK economic environment, and international investors might well believe that there is a greater likelihood of achieving higher and more certain returns elsewhere.

Achieving a transformation in private-sector investment is so fundamental to the success of the budgetary strategy that there is a strong argument that government should have been bolder in the measures that it has taken to encourage it. As things stand, its actions look half-hearted and may therefore provoke only a half-hearted response from the business community.

In part, the fault lies in the *Coalition Agreement*, which has removed some of the flexibility that the chancellor might otherwise have had to apply resources where they could be most effective. In particular, he has allowed his budgetary planning to be blown off course by

the adoption of the LibDem election proposal for a significant rise in personal allowances. The first step towards this goal has cost the Exchequer revenues of almost £4 billion a year across the forecast period. This is largesse that the government could scarcely afford. According to the IFS, this single measure benefits primarily the seventh, eighth and ninth deciles of the population, and by only a few pounds per week, so it would be reasonable to assume that it is unlikely to add meaningfully to economic activity in the UK, although it may have averted a steeper decline in the savings ratio. It was a political act. A better alternative would have been to divert the resources to encouraging business investment in the UK or to reducing the scale of expenditure cuts, particularly in key areas where economic recovery is most at risk.

The regional measures that the chancellor unveiled in the Budget are little more than a token gesture and will fall well short of making up for the damage risked by closing the regional development agencies. Most of the measures are so small that they do not even require approval from the EU. The proposals on national insurance contributions fall under the *de minimis* provisions. According to the Treasury, only the Northern Ireland measures require clearance, and they may prove undeliverable. A fuller expression of localism will presumably have to wait for another year.

The chancellor talked in his Budget about building a "new, balanced economy where we save, invest and export". He has provided some modest encouragement to investment, but the OBR forecasts that savings will fall as a result of the measures announced in the Budget; and it projects only modest growth in exports of 0.1-0.2% above its pre-Budget forecasts – important but modest. Inevitably, it is the scale of the spending cuts that has caught media attention and dominated the headlines; and the way in which the Budget has approached the issue of burden sharing across society has raised some issues about the coalition's claim to fairness.

(iv) Fairness

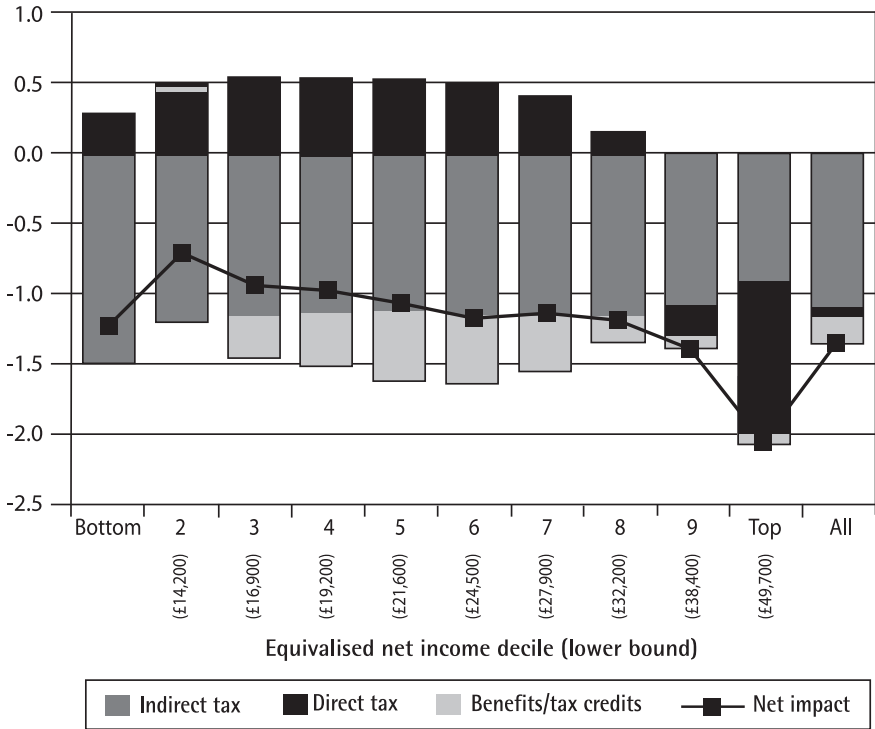
Many commentators have addressed the distributional impact of the Budget in the past few weeks. A number were surprised when the Treasury published, in the Financial Statement & Budget Report, only a distributional analysis of the Budget measures that showed the combined impact of the proposals from the Labour government and those of the coalition.

This might almost be justifiable on the basis that the coalition Budget should be read as simply the missing part of the Darling Budget. However, the Treasury has been at pains to remove from its website all the documentation issued by the previous government, including that relating to the March 2010 Budget. So it would probably be fair to suppose that there was a degree of obfuscation involved in the presentation of the data in figure 4 (taken from the Treasury's tax and benefit micro-simulation model) that is quite damaging

to the coalition's claims to transparency. This government is not the first to choose to illustrate the impact of its policies in the most favourable light, but it may be the first in modern times to draw on its predecessor's budget measures in quite this way to achieve that.

Figure 4: Impact of all measures as a percentage of net income, by income distribution, 2012/13

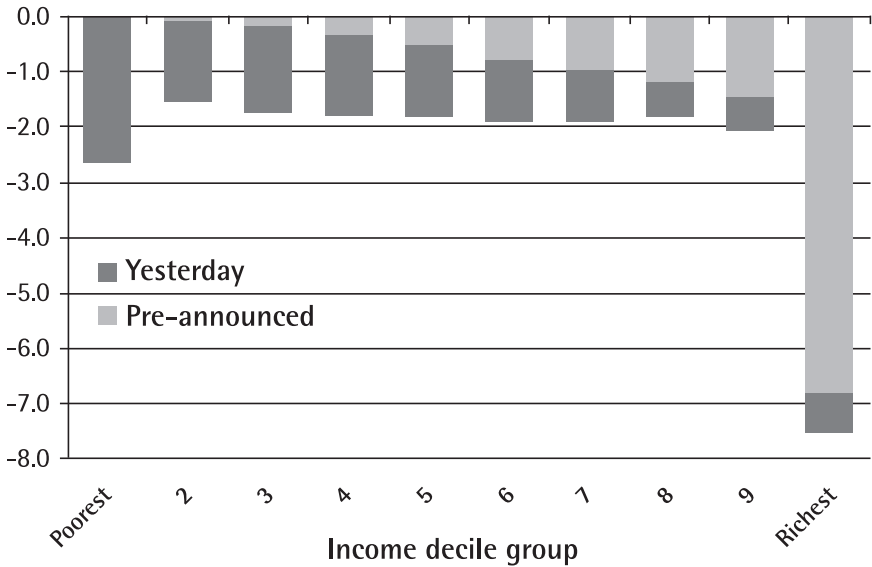
In percentage of net income (%)



Source: HM Treasury tax and benefit micro-simulation model

In any event, the IFS helpfully disaggregated the two sets of measures the following day, as the Treasury must have known it would, to show the impact of George Osborne's Budget alongside Alistair Darling's. Shown separately, they are dramatically different. The bias towards the lower income deciles that characterised the Labour years has more or less been inverted in this first coalition Budget.

Figure 5: Distributional impact in 2014/15 of tax and benefit measures since the crisis
Change in net income (%)



Source: Institute for Fiscal Studies

And it does not end there. Neither of these charts reflects the distributional impact of the proposed cuts in housing benefit or disability living allowance, both of which could be expected to have a greater impact on the lower income deciles. Nor is it possible to model the likely impact of the broader range of cuts in departmental spending that have been outlined.

The chancellor said, in his Budget speech:

My priority in putting together this Budget has been to make sure that the measures are fair. That all sections of society contribute, but that the richest pay more than the poorest. Not just in terms of cash, but as a proportion of income as well.

Robert Chote, director of the IFS, speaking the day after the Budget, made a number of comments about the distributional analysis that the institute had performed:

Mr Osborne and Mr Clegg have been keen to describe yesterday's measures as "progressive" in the sense that the rich will feel more pain than the poor. That's a debatable claim ... The Budget looks less progressive – indeed somewhat regressive – when you take out the effect of measures that were inherited from the previous government, when you look further into the future than 2012/13 and when you include some other measures that the Treasury has chosen not to model. ... The looming cuts to public services ... are likely to hit poorer households significantly harder than richer households.

Martin Wolf's analysis was broadly the same:

The chancellor stated, boldly, that: "We are a progressive alliance governing in the national interest." One has to admire his nerve, since the evidence provided in the Budget provides only partial support for this view: the adverse impact on the poorest 10% is harsher than on most richer groups even in 2012-13. This may worsen thereafter.

There are concerns about gender bias in the Budget measures, a number of which will have the biggest negative impact on women, and some questions about its effect on intergenerational fairness.

There are deep inconsistencies in the Budget architecture. The chancellor has won much praise for his commitment to the triple lock for the state pension, guaranteeing to up-rate it each year by reference to the highest of three measures: the rise in earnings, the rise in the CPI, or 2.5%. But people on welfare benefits live in the same world as pensioners, and often with higher demands placed on them and even less to live on. Unless the government believes that they are all scroungers, living off the state when they could be working, it would be logical to assume that, in the interests of fairness, they too should benefit from the same up-rating guarantees.

Deputy prime minister Nick Clegg, defending the Budget on the Today programme, rejected the IFS analysis and appeared to claim that fairness would be ensured through future Budgets, saying: "Nothing has included, of course, future changes which we will make, which we will show, as we have done in this Budget, that we're going to take very exceptional measures to ensure that fairness is instilled."

Claims and counter-claims about fairness and its interpretation in the context of the Budget will inevitably continue to be made. There is a clear lesson for the new government about transparency and how it deals in the future with Budget analysis in the documentation it publishes.

But the more important question is whether the impact on the poor and the most vulnerable in this Budget was unavoidable or not.

A budget contains many policy choices. The distributional impact is not predetermined. It is one of those choices.

Budgetary policy: is there consent?

The outlook for public spending was always likely to be bleak, whichever party won the May 2010 general election. All the main parties recognised the need for a period of fiscal consolidation; but all were unwilling to spell out the details of the scope and scale of the shift in budgetary policy that they envisaged. The election debate on this issue was uninformed, as the IFS noted, and the choices were blurred into a sterile and narrow discussion around the timing of government action that tended to emphasise the similarities rather than the differences in the parties' positions.

Detailed plans for dealing with the aftermath of the financial crisis were never published by the Labour government, but what was disclosed at the time of the March Budget was sufficient to show that they would have involved substantial cuts in government spending, starting mainly in 2011. These would have been deeper than the cuts of the Thatcher years, but they are likely now to be surpassed in severity by the coalition's plans as outlined in the Budget and to be published in full in October when the spending review has been completed.

And while there were similarities in the parties' spending cut proposals, what has emerged quite clearly since the election is that there are profound differences in political philosophy that underpin their respective budget strategies. The general election has marked a watershed for budgetary policy.

The last government saw the financial crisis as an economic aberration that would require a change of approach during the recovery period but not a fundamental change in the role of government, nor a shift in the boundary between the state and the private and charitable sectors. The coalition is working from an entirely different premise. That premise is that the state has become too big; that it is "crowding out" the private sector and taking too great a share of national income.

Conservative Party statements in the run-up to the general election emphasised both of these strands, and they are dominant in the new Budget's language as well. George Osborne, in his Budget speech, talked of "raising a new, balanced economy where we save, invest and export. An economy where the state does not take almost half of all our national income, crowding out private endeavour".

These are political words in a moment of political theatre, and perhaps they should not be examined too carefully. But a new chancellor, making his first Budget speech on behalf of a new government, has to recognise that others will look closely at the detail of what he says. In that context, some of his words look open to challenge:

- The aspiration to promote savings is, in the context of the Budget, only that – an aspiration – and the Budget measures are forecast by the OBR to reduce rather than increase the savings ratio.
- Improvements in investment and export performance are forecast to be modest, and there is considerable uncertainty about whether they will be achieved.
- Direct evidence to support the notion of “crowding out” by the UK public sector is rather difficult to find, and some researchers have argued that the opposite is the case. For example, in relation to employment, Working Paper No 75 of the Centre for Research on Socio-Cultural Change contends that publicly supported employment has been necessary “to cover the continuing failure of the private sector to generate and distribute welfare through job creation”.
- The chancellor does not, of course, claim that almost half of national income has been taken in tax under Labour, although the casual listener might be forgiven for thinking that he had. It is a matter of public record that, on the broadest of measures, according to Treasury figures, government receipts averaged 37.5% of national income during the period from 1997 to 2010, compared with the 40.2% average under the previous 18 years of Conservative government, and never exceeded 40%. The Treasury's forecasts in the March 2010 Budget and the OBR forecast in the June Budget both show government receipts relatively stable through the forecast period, at around 38% of GDP.

George Osborne said, in his Budget statement: “The country has overspent; it has not been under-taxed.” Here too there are arguments to be made on both sides, but what has been clear is that we have been under-taxed relative to our growing expectations from government. The 1990s and the early years of the 21st century have seen a rapid growth in what people expect from public services; and the higher standards of care and delivery that have been achieved have been treated as the norm. We have sought, as a country, to achieve a level of government provision that is out of line with our financial contribution as citizens. Citizens of other countries have been asked and been willing to pay for the higher level of provision that they enjoy.

The tax/GDP ratio in the UK has been consistently below those of countries such as France, Germany, Italy, the Netherlands, Finland, Denmark and Sweden.

There is and always has been a choice. The structural deficit in the UK has, in reality, come about because Labour, in opposition and in office, never asked the fundamental question: is the UK electorate willing to pay more for better and more widely available public services? In the world of media and party politics, it has never been an easy question to ask. But it is important. And it should have been asked. Answers to those sorts of questions are never the same over time, and the answers in 1997 – whatever they would have been – would have been different from those in 2001 and 2005; and they are different again in 2010. But finding out those answers is part of obtaining a mandate.

The OECD's recent working paper on the political economy of fiscal consolidation shows that there is no automatic or necessary correlation between high-spending and high-debt economies. Among the highest spenders, a number are also among the least indebted. And they are, of course, mostly the countries with the highest tax burden. But there does not seem to be any automatic trade-off either between taxation and growth. The German economy has shown better growth than the UK in the most recent years, in spite of its higher debt and spending; the Swedish government has, even in the last few days, upgraded its latest growth forecast from 2.5% to 3.3% for 2010, to 3.8% for 2011 and to 3.9% for 2012, against a backdrop of falling unemployment. It is in marked contrast to the IMF's downgrading of the UK forecasts.

But we do not need to adopt the Swedish model to tackle our budget deficit. The issue is not to impose on the UK the levels of taxation seen in some other countries. The issue is to determine what works best for the partnership that we should have in the UK between citizens, government and business; and beyond that, what works best for the outcome of that partnership, which should be a growing economy and living standards for all of us that are rising at the same pace as the best in Europe.

At the Smith Institute, we have, over the years, sought to engage government in a meaningful discussion about how the tax system should be restructured to meet the needs and aspirations of our society, which include the need for a strong and vibrant financial services sector and for a strategically focused and dynamic industrial base, as well as for a proper level of support, encouragement and social protection for the disadvantaged. We have also looked at how, within that framework, government spending can become better and more efficient. We have urged a much greater

engagement with the electorate on this important issue. Today, as the government prepares for the autumn spending review, there is a continuing and urgent need to have that discussion, and for it to be the informed discussion that we could not have at the time of the general election.

The question has yet to be properly asked, how far we are willing to pay collectively through taxation for the services we receive or how far we want the state to shrink so that, outside what remains in the diminished public sector, either we buy our services individually from the private sector or we go without. For the coalition, the answer to that question seems clear and unequivocal: the state should shrink, and shrink substantially and quickly. The aim is a "small state and a bigger society".

George Osborne's words "This country simply cannot afford it" frame the approach to the public sector and the provision of public services that the Budget seeks to deliver. What does that mean for the future? And what will society and the state look like at the end of this first parliament in modern times under a coalition government? It would be a brave man or woman who could answer plainly. But the coalition can surely sketch it out for us so we can have the debate. And then, better armed with the facts and more informed by the arguments, we can give our consent to the coalition proposals or withhold it.

Conclusion

As we emerge from the financial crisis, we have a genuine choice about the budgetary path that we follow and the opportunity to decide whether we want to pay more fully for public services or to shrink the state. To lead us along it, we have a form of government that is largely untested in British politics in modern times: a Westminster coalition whose policies are both radical and different from the individual parties' policy agendas that were put to the electorate at the time of the general election.

The Budget gives life to a political gamble around cuts, jobs, growth and fairness: that the new economic strategy that George Osborne has outlined will work and deliver the smaller state and bigger private and charitable sectors that have long been the aspiration of the Conservative Party. But as Martin Wolf has commented: "This gamble has now defined the government. If it is seen to have failed, it will be finished." It would be a wise strategy for the coalition to seek more explicit public consent to its plans through a broader debate with the electorate than has yet been allowed.

Appendix: Recently proposed austerity taxes in Europe

	Consumption		Personal income		Business		Notes
	Description	Value and timeline	Description	Value and timeline	Description	Value and timeline	
Germany	None	N/A	Cuts to welfare spending, particularly for the long-term unemployed Cuts in public-sector administration (up to 15,000 jobs) Cuts to the armed forces	€30 billion through 2014 €13.4 billion through 2014 €2 billion / year	Tax on the profits of nuclear power station operators Introduction of a tax on air travel levied on criteria such as price, noise and consumption Financial transaction tax	€2.3 billion / year €1 billion / year €2 billion / year from 2012	The proposed financial transaction tax is conditional on international agreement
Ireland	Decrease in excise duty for alcohol Decrease in VAT Carbon tax	-€0.09 billion / year -€0.167 billion / year €0.33 billion / year	Increase in the effective tax rate paid by high earners Cuts to welfare spending Reductions in public service salaries	€0.06 billion / year €0.43 billion / year €1 billion / year	None	N/A	
Italy	Fighting tax evasion	Not available	Increased tax on stock options Fighting tax evasion Three-year pay freeze for public employees Cuts in public-sector hiring (only one new employee will	Not available Not available Not available	Increased tax on private-sector bonuses Fighting tax evasion	Not available Not available	Cut in funds transferred from federal to regional and local governments of €4.5 billion / year may force local governments to

			be hired for every five who leave) Progressive pay cuts of up to 10% for high earners in the public sector, including ministers and parliamentarians	Not available			raise taxes
Greece	Increase in the sales tax on printed products from 4.5% to 5%, increase in the tax rate on items like food and medicine from 9% to 10% and an increase in the VAT up from 19% to 21% Further increase in sales taxes of 10%. Therefore, the sales tax on printed products rises to 5.5%, the tax on food and medicine to 11% and	€1.3bn/year Not available	Eliminate payments of the "13th and 14th month salaries" for public sector employees earning a gross minimum monthly salary of over €3,000 / month. Anyone earning below €3,000 / month will receive a modest bonus payment Freeze in public-sector salaries until 2014 Reduction in allowances by 8-20% and 3% in the wider public sector Eliminate payments of "13th and 14th month salaries" and allowances for all pensioners under 60 except in	Not available Not available Not available	Assess a one-time tax to companies showing a minimum profit of €100,000 Tax on all TV advertising of 20% Fighting tax evasion New gambling and gaming licences More green taxes	Not available Not available Not available Not available	Tax evasion alone is estimated to cost the Greek government €20 billion a year

	VAT to 23%		special circumstances	Not available			
	Tax on luxury cars (new and used) of 10-40% based on market value	Not available	Reinstate tax on pensions more than €1,400/month	Not available			
	Increase in tax levied on tobacco, alcohol and fuel (first increase, January 2010)	Not available	Additional 1% tax assessed to individuals claiming net income over €100,000	Not available			
	Increase in tax levied on tobacco, alcohol and fuel (second increase, March 2010)	Not available	Fighting tax evasion	Not available			
	Increase of 10% in tax levied on tobacco, alcohol and fuel (third increase, May 2010)	Not available					
	Additional property taxes	Not available					
	Fighting tax evasion	Not available					
Spain	Value added tax will rise to 18% from 16% and	€5.2bn through 2011	The salaries of civil servants will be cut by 5% and frozen for 2011	Not available			Also included in the austerity measures

	the reduced will increase to 8% from 7%		<p>Senior government officials' salaries will be cut by 15%</p> <p>€2,500 "baby cheques" will no longer be sent to new mothers</p> <p>€400 tax rebate will be cancelled</p> <p>Pensions will no longer rise with inflation</p> <p>13,000 public-sector jobs will be cut</p> <p>Tax on income from savings will increase to 19% on the first €6,000 and 21% above €6,000</p>	<p>Not available</p> <p>Not available</p> <p>€5.7 billion through 2011</p> <p>Not available</p> <p>Not available</p> <p>Not available</p>			was a €1.2 billion reduction of funding to the country's regions
France	Tax on home sales would rise	Not available	<p>Retirement age will be increased gradually from 60 to 62 by 2018</p> <p>The top income tax rate will increase to 41% from 40%</p> <p>A tax credit for dividends will be abolished</p> <p>Capital gains will now be taxed at the same rate as income</p>	<p>Not available</p> <p>€0.23 billion / year</p> <p>€0.645 billion / year</p> <p>€0.18 billion / year</p>	None	N/A	

			Public-sector wages will be decreased by 5%	Not available			
			Taxes on stocks options and supplemental pensions will be increased	Not available			
The Netherlands	Not available	N/A	The retirement age may be increased to 66 or 67 from 65	Not available	Not available	N/A	All measures listed here are only proposals. An election has recently taken place and budget cuts are expected to be the new government's first priority
			Housing subsidies may be curbed (i.e. limiting tax deductibility of mortgage payments or increasing social housing rent)	Not available			
			Reducing the military and firing civil servants	Not available			
Portugal	Raising VAT to 21% from 20%	0.3% of GDP for 2010 and 0.7% for 2011	Increases of income tax of 1% up to the third income bracket and 1.5% for the fourth income bracket and onwards	0.2% of GDP for 2010 and 0.4% for 2011	Raising corporate tax to 27.5% from 25% for profits above €2 million	0.1% of GDP for 2010 and 0.2% for 2011	
			The salaries of holders of political and public management offices will be cut by 5%	Not available			
			Introduction of capital gains tax of 20% on securities	Not available			

			The creation of new tax bracket for annual incomes above €150,000 which will be taxed at 45%	Not available			
			Hiring only one new public employee for every two that leave	Not available			
United Kingdom	Raise value added tax to 20% from 17.5%	€53.9 billion through to 2014/15 FY	Increase personal taxable allowance by €1,000	-€14.9 billion through 2014/15 FY	Corporation tax to be decreased 1% each year until it reaches 24% in 2014/15	-€6.4 billion through 2014/15 FY	
			Increase capital gains tax for higher-rate taxpayers to 28% from 18%	Not available	A bank levy will be introduced intended to encourage banks to move to less risky funding profiles	-€8.4 billion through 2014/15 FY	
			Public-sector pay will be frozen for two years for salaries above €21,000	Not available	Increase threshold for employer NICs	-€13.5 billion through 2014/15 FY	
					Increase Entrepreneurs' Relief to €5m	Not available	
					Small profits rate will be decreased to 20%	-€3.8 billion through 2014/15 FY	

Source: Analysis prepared by Keith Richards of FTI Consulting on 7 July 2010

Biography: Chris Wales

Chris Wales is a senior managing director in FTI's economic consulting practice and is based in London.

He joined the tax division of Arthur Andersen in 1979 and worked primarily in the financial services practice in the firm's London office. He became a partner in 1990 and was seconded to the Stockholm office from 1991 to 1995, where he was closely involved in the firm's work for the Swedish government on the restructuring of the banking industry following the financial crisis. In 1997 he was appointed as a member of the newly formed Council of Economic Advisers at HM Treasury and special adviser to the then chancellor of the Exchequer, Gordon Brown. He left the Treasury in 2004 and joined Goldman Sachs as a managing director in the financing group. In 2006 he co-founded Lucida plc, a life assurance company, and was managing director until 2009.

Chris has worked extensively with European governments and the European Commission. He led the work of the EU Code of Conduct group (business taxation) on behalf of its chair, and was closely involved in the negotiation of the EU Savings Directive. He is a member of the advisory board of the Oxford University Centre for Business Taxation, which he established in 2005 with the support of most of the UK FTSE 100 companies. Chris is also a member of the council of the Institute for Fiscal Studies. He has been a visiting fellow at the Faculty of Law at Cambridge University and is a research fellow at the Smith Institute. He has written widely on policy issues for both the national and the professional press. Chris studied at Cambridge University and has a doctorate in medieval history. He is also a chartered accountant (ICAEW).