BRIEFING

Budget 2011: A case of tunnel vision

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March 2011

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This paper was first published in March 2011.

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The deficit reduction path

Once the Office for National Statistics (ONS) said that the economy had shrunk by 0.5 per cent in the final quarter of 2010[1] – an estimate that was subsequently revised further downwards to 0.6 per cent – it was clear that George Osborne would have to aim for a 'budget for growth' today.

However, it was also clear that there was little he could do by way of tax cuts or public spending increases to boost aggregate spending in the economy. Constrained by the aggressive deficit reduction plan that he set out last June, and his stubborn refusal to consider any deviation from that plan – never mind a full-blown 'Plan B' – the Chancellor found he had painted himself into a corner.

ippr has argued that there is a viable 'Plan B', one that is centred on the idea of averaging deficit reduction over a number of years, offering greater flexibility to respond to economic developments while sticking to a firm long-term deficit elimination target.[2] If he had adopted such a plan, the Chancellor would have been able to offer more support to the economy now, and possibly to mitigate the increase in unemployment forecast by the Office for Budget Responsibility (OBR)(see below).

Changes to taxes and duties

As a consequence of his refusal to shift the path of deficit reduction, Osborne was compelled to produce a fiscally neutral budget. This meant he had to fall back on three favourite stand-bys of the last Labour government in order to finance his giveaways: a clamp-down on tax avoidance, a windfall tax, and a stealth tax.

By reducing tax avoidance, Osborne hopes to raise an additional £1 billion. Increasing the supplementary charge on North Sea oil and gas production raises a further £2 billion. And the shift to indexing tax allowances by consumer price inflation rather than (the usually higher) retail price inflation – the stealth tax – raises another £1 billion by 2015/16.

Together with £630 million extra from the bank levy, these moves allowed the Chancellor to announce a few giveaways – most of which had already been well trailed in the press (another habit this government seems to have picked up from Labour).

The £600 rise in the personal tax allowance from April 2012 and measures to reduce fuel duty – including the cancellation for the rest of this parliament of the 'fuel duty escalator', which adds 1p per litre above the rate of inflation – will help hard-pressed families a little (although not those that find themselves out of work or earning less than £7,500, or which do not own a car). But these baubles fade into insignificance relative to the effects of higher inflation. A family with a post-tax income of £20,000 is around £400 a year worse off compared with last year, because inflation is about 2 percentage points higher than expected. By comparison, the higher tax allowance is worth just £45 a year. So there's little change here: ordinary families – Nick Clegg's 'alarm clock Britons' – will continue to see their living standards squeezed in 2011.

Helping the unemployed

The Chancellor has responded to the political pressures created by youth unemployment's relentless rise to its highest level in 18 years by funding 40,000 additional apprenticeships and 80,000 new work experience places.

1 ONS (2011) *Gross domestic product preliminary estimate 4th Quarter 2010*. http://www.statistics.gov.uk/pdfdir/gdp0111.pdf

2 See 'Plan B for the Budget', press release, 17 March 2011. http://www.ippr.org/pressreleases/?id=4394

However, the funding for these measures falls well short of what the Future Jobs Fund would have provided and – unless the OBR is wrong and the private sector suddenly starts to create jobs in greater-than-expected numbers – youth unemployment will remain a serious problem for the next few years.

To compound the pressure, figures released today to accompany the budget statement show that the OBR has increased its own unemployment forecasts.[3] It now expects an additional 130,000 people to be claiming Jobseekers Allowance in 2012 and 2013. Meanwhile, the ILO measure of unemployment will be 0.5 percentage points higher than previously forecast – hardly the sign of a budget for growth and jobs.

The Green Investment Bank

The outcome on the Green Investment Bank looks like a classic compromise between HM Treasury and the Department of Energy and Climate Change (DECC). The bank will be operational a year earlier than planned and given an additional £2 billion in up-front capital. But there's a catch: it won't be able to borrow until 2015/16. Conveniently, no extra debt will be placed on the government's balance sheet until after the next election.

Boosting the economy's long-term growth potential

In the absence of any capacity to boost demand in the economy, a Chancellor wishing to present a 'budget for growth' needs to come up with a comprehensive plan for supply-side policies – policies that would boost the UK economy's long-term potential growth rate.

On this score, the Chancellor failed. His approach – cut government spending, cut corporate tax rates, cut regulation and re-introduce enterprise zones – harks back to the 1980s. There is little evidence to suggest that these measures led to an increase in sustained growth in jobs in the private sector then, and no reason to believe they will fare any better now.

Osborne trumpeted his announcement of 21 new 'enterprise zones' – but this is an old idea. Six of the 10 zones identified today are located in the North, and this is a welcome recognition of the need to boost growth in the area. But enterprise zones have been tried in the past and found wanting – they are more successful at encouraging businesses from neighbouring areas to relocate than they are at creating new jobs, which is what the North, and Britain, really needs. Indeed, a recent Work Foundation report warned that while enterprise zones do stimulate rapid investment in the short term this tends not to be sustained beyond the first three years.[4]

The measures announced today were, in style, reminiscent of Gordon Brown's as Chancellor, sounding less like a coherent plan for the economy's future than a shopping list of ideas producing by a trawl through the Treasury. Lots of small ideas – though many of them, such as the extra £100 million for the science budget, are welcome – do not amount to an adequate response to the big problems facing the economy.

Cutting the deficit involves making tough political choices – increasing VAT, slashing the budgets of local councils and so on – but mechanically at least it is relatively straightforward: ask the OBR for an estimate of how much needs to be cut, ask Treasury

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3 See OBR (2011) *Economic and fiscal outlook*, Annex C: Selected tables. http://cdn.hm-treasury.gov.uk/2011budget_annexc.pdf

4 See Sissons A with Brown C (2011) *Do Enterprise Zones Work?* London: Work Foundation. http://www.theworkfoundation.com/research/publications/publicationdetail.aspx?oItemId=283

officials how much money would be raised by various tax increases or saved by various spending cuts, and then pick out enough fiscal options to add up to the OBR's number.

Promoting long-term growth in the economy is a lot harder. It involves fostering the right combination of free markets and private enterprise alongside supportive state institutions.[5] What the country needs now is a modern industrial strategy centred on innovation, state-led investment in infrastructure that will generate income further down the line, support from the banking sector for small and medium-sized businesses, and new employer-focused ways of thinking about skills.

Nothing the Chancellor said today suggests that he recognises the need for such a broad-based approach. Instead, he hopes to take a short-cut to private sector growth, a decision that is likely to end in disappointment, for the government and for the British people.

In summary

The key lesson from today's budget announcement is that the Chancellor's stubbornness is not confined to his approach to deficit reduction: it also extends to his refusal to countenance an industrial strategy. Just as there will be no 'Plan B' for the deficit, there will not be even a 'Plan A' for supply-side economic policy.

The Chancellor is hoping that cuts in public spending, cuts in corporation tax and cuts in regulation will be sufficient to generate strong growth in private sector job creation. History suggests he is wrong. Without a different approach, the result is likely to be economic growth that disappoints over the next few years and sustained high levels of unemployment.

5 For more, see Chappell L (2011) *Five ideas for a budget for growth* London: ippr. http://www.ippr.org/publicationsandreports/publication.asp?id=811