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Time for Another People's Budget

by Tony Dolphin

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Executive summary

This year's budget on 22 April will be the most important for many years. The UK economy is deep in recession; unemployment is widely expected to increase to 3 million; and independent forecasts suggest the Government's budget deficit will be around 10 per cent of GDP in 2009–10, even before any measures contained in the 2009 Budget. Chancellor of the Exchequer Alistair Darling faces the unenviable task of having to produce a package of measures that supports the economy in the short term, while providing reassurance that the deficit will be reduced in the medium term.

In this paper, we urge Darling to look to the great reforming Chancellor David Lloyd George for inspiration. Almost 100 years to the day before this year's budget, on 29 April 1909, Lloyd George presented arguably the most famous, the most radical and the greatest UK budget. He made the moral case for taxation to finance welfare spending and established the principle of a progressive tax system. The budget was such a success that it was given a soubriquet and is now known as the 'People's Budget'.

Alistair Darling should be as bold as Lloyd George was 100 years ago. To counter the recessionary forces in the economy, he should propose a package of measures that includes:

- A substantial increase in personal tax allowances
- Extra spending to achieve the Government's child poverty reduction target
- Extra spending on low-carbon technology
- An immediate restoration of the link between pensions and earnings.

When looking to the medium term, the Chancellor should reaffirm the moral case, made by Lloyd George 100 years ago, for progressive taxation to fund welfare spending. He should announce:

- Tough limits on the growth of overall government spending, in real terms, while emphasising:
  - Those on lower incomes will be protected
  - Education and health spending will continue to rise in real terms
  - A willingness to cut spending in other areas, such as defence
- The extra revenues needed to reduce the budget deficit will be sought through a combination of:
  - Green taxes
  - Aggressive action to reduce tax avoidance
  - Increased taxes for those that can afford them – high earners and the wealthy.

This will not be easy politically and there will be accusations of a return to 'old Labour' values. But the unavoidable fact is that higher tax revenues will be required over the medium term. The three principles that should guide the Chancellor in his search for these revenues are:

- Environmental sustainability
- Fairness
- A more progressive tax system.

The 1909 Budget helped solve the economic problems of the day and revived the political fortunes of the Liberal Party, showing that boldness can deliver economic results and votes. Alistair Darling would do well to heed the lessons of history.

Time for another 'People's Budget'

> *'This is a war budget. It is for raising money to wage implacable warfare against poverty and squalidness. I cannot help hoping and believing that before this generation has passed away we shall have advanced a great step towards that good time when poverty, and the wretchedness and human degradation which always follow in its camp, will be as remote to the people of this country as the wolves which once infested its forests.'* David Lloyd George, 29 April 1909

Introduction

On 29 April 1909 the Liberal Government's Chancellor of the Exchequer, David Lloyd George, presented his budget to Parliament. The circumstances were not favourable. A string of by-election losses had shown support for the Government was in serious decline. Output had fallen in the previous year, causing unemployment to rise sharply, a large budget deficit was projected, and there were calls for tariff reform.

Lloyd George's response was a bold package of measures which included the introduction of a 'super tax' and the taxation of land. The budget was rejected by the House of Lords, triggering a constitutional crisis and a General Election and it was not until 28 April 1910 that the budget finally became law.

Now seen as a crucial turning point in Britain's economic history, making the moral case for taxation to finance welfare spending and establishing the principle of a progressive tax system, that budget has come to be known as the 'People's Budget'.

There are some similarities between the situation in 1909 and that facing current Chancellor Alistair Darling in the presentation of his 2009 Budget, to take place on 22 April, one week short of the one hundredth anniversary of the 'People's Budget'. In particular, the projected budget deficit has soared as a result of the current recession. Darling may be tempted to be timid, arguing that he has been left with little room for manoeuvre. However, to do so would risk a further drop in household and business confidence. It would be far better for him to follow the example of Lloyd George and delivered a bold budget, supporting the economy in the short term and setting out proposals for reducing the budget deficit in the medium term, while also restating the moral case for taxation and a progressive tax system.

The 1909 'People's Budget'

> *'These problems of the sick, of the infirm, of the men who cannot find the means of earning a livelihood … are problems with which it is the business of the state to deal.'* David Lloyd George

In 1909, Lloyd George wanted to do nothing less than transform the social and economic landscape of Britain by abolishing the Victorian distinction between the deserving and the undeserving poor. He believed the state should help all those who could not help themselves.

However, his main priority when he began framing the 1909 budget was how to finance a projected deficit of around £16–17 million, while at the same time bolstering the Government's popularity. The introduction of an old age pension on 1 January 1909 (5s a week for those aged 70 and over, or 7s 6d for couples), at an estimated full year cost of £8 million, and increased naval expenditure of £3 million for four new Dreadnought battleships, meant that projected spending was well above projected revenues.

A second priority was to preserve the Liberal Party's free trade credentials and show that the revenue gap could be filled without resort to the general tariff (with preference for trade within the British Empire) that the opposition Conservative Party supported. Lloyd George, rightly, argued that higher tariffs on imported goods would hit the poor hardest. Foreigners and the poor were not going to pay more to close the gap between government spending and revenues, so the rich would have to.

Lloyd George met his challenge by proposing a range of measures which were projected to raise an additional £13.6 million (with a further £3 million coming in the form of a transfer from the Sinking Fund). The general rate of income tax was to be increased from 1s in the pound to 1s 2d (that is from 5 to 5.83 per cent) and a 'super tax' of 6d in the pound (2.5 per cent) was introduced for those with incomes over £5,000. Crucially, those with incomes of less than £2,000 were excluded from any increases in direct taxation.

Excise duties on tobacco and spirits and death duties on larger estates were also raised and a 3d levy on a gallon of petrol and licences for motor cars introduced. As car ownership in 1909 was limited to the wealthy, these charges on cars and petrol were progressive in nature as well as being – unwittingly – the UK's first 'green taxes'.

Most controversial were Lloyd George's land tax proposals: 20 per cent of any unearned increase in land value was to be paid in tax when land changed hands, whether through sale or as a gift or inheritance, there was to be a ½d in the pound tax on any added value that resulted from public expenditure, and a duty of 2s in the pound on the enhanced value of a property when it reverted at the end of a lease.

Although the land taxes were only projected to raise £500,000 in revenues in 1909–10, they were fiercely opposed in the House of Lords. It rejected the budget on 30 November, by 350 votes to 75. As a direct consequence, the Prime Minister, Herbert Asquith, asked the King to dissolve Parliament and a General Election was held in January 1910. Although the Liberal Party's majority over the Conservatives was reduced to just two seats, it retained power with the support of Irish Nationalist and Labour Party MPs. The House of Lords capitulated and Lloyd George's budget was finally passed into law on 28 April 1910.

The land taxes proved difficult to administer and failed to produce enough revenue to justify the effort, and were repealed in 1920. But Britain now had a nascent social welfare system, which in 1911 Lloyd George built on with the introduction of national health and unemployment insurance. This paved the way for Beveridge and the post-war welfare state in the UK.

To finance his war against 'poverty and squalidness', Lloyd George, the great innovator of his age, swept aside conventional wisdom and established the principle that 'taxation should be used for social regeneration'. As a result of the 1909 Budget, Britain had a progressive income tax system and its first green taxes. Lloyd George described his budget as 'a platform for social revolution'. It is a revolution that has endured for the last 100 years.

Background to the 2009 Budget

The financial and economic situation at the time of the 1909 budget was bad, but the current situation is far worse. The UK is experiencing its biggest financial crisis since the 1930s and the UK and world economies are in the midst of their deepest recessions since World War II. The International Monetary Fund expects the world economy to shrink by between 0.5 and 1 per cent this year – the first contraction in global economic activity since the Great Depression. The neo-liberal model of capitalism, which has dominated since the late 1970s, has proved to be unsustainable.

The recent G20 London Summit produced a series of measures designed to correct flaws in the capitalist model and to alleviate the effect of the economic downturn. Most notably, the G20 announced in an official communiqué 'an additional $1.1 trillion programme of support to restore credit, growth and jobs in the world economy'. It could not agree on how much further scope there was for easing fiscal policies in individual countries, but it did state: 'We are committed to deliver the scale of sustained fiscal effort necessary to restore growth.'

Meanwhile, the financial system in the UK no longer functions in a normal fashion. Northern Rock and part of Bradford and Bingley have been nationalised. The taxpayer owns substantial stakes in the Royal Bank of Scotland and Lloyds Banking Group (including HBOS) and large parts of the banking system may have to be nationalised yet. Hundreds of billions of pounds have been made available to shore up the banks' balance sheets but there is still a shortage of credit. Households and businesses that would, in normal times, be regarded as credit-worthy are finding it impossible to raise the finance they need. As a result, companies are failing and people are losing their jobs.

These factors are contributing to a steep drop in economic activity. Business and consumer confidence has collapsed and spending is being reined in. According to the IMF, real GDP – the output of the whole economy – will decline by 3.8 per cent in 2009 and by a further 0.2 per cent in 2010.

As a result of the drop in economic activity, unemployment is rising – by 369,000 during 2008 to end the year at 1.97 million. Surveys and anecdotal evidence suggest the pace of job losses picked up in the first few months of 2009 and it seems very likely that unemployment will reach 3 million at some point in 2010. All sectors of the economy are being affected, not just the financial industries. Latest figures show that the biggest proportionate drop in employment over the last year has been in manufacturing industry, where the workforce has fallen by 100,000, or 3.1 per cent.

The Chancellor will have to address the problems of slumping confidence, cutbacks in private sector spending and rising unemployment in his budget.

Slower growth and higher unemployment are affecting the Government's finances. Tax revenues fall when people lose their jobs and reduce their spending, and when companies' profits plummet. At the same time, spending on welfare benefits increases. In his Pre-Budget Report last November, the Chancellor forecast net government borrowing of £78 billion in 2008–09, rising to £118 billion in 2009–10. However, the economic forecasts underlying those numbers now look hopelessly optimistic. A more realistic assessment is that, before accounting for any actions in this year's budget, the 2009–10 deficit will rise to around £145 billion, or about 10 per cent of GDP – a larger percentage than borrowing reached in the recessions of the 1970s, early 1980s and early 1990s.

Like Lloyd George in 1909, Alistair Darling has to frame this year's budget in the context of a large projected fiscal deficit.

In another echo of 1909, protectionist sentiment has increased in the UK. Unlike one hundred years ago there is no clear party divide for and against protectionist measures, but there is evidence that the recession has helped to stir up protectionist sentiment. This is not something that can be tackled directly in the budget. However, if the Chancellor proposes a package of measures that increases confidence in the economic outlook, he will weaken the case of those arguing for protectionism.

The challenges facing Alistair Darling are, therefore, formidable. He could decide to duck them and use the poor state of the public finances to justify a modest set of proposals in the 2009 Budget – but ippr believes this would be the wrong thing to do. The Chancellor should match David Lloyd George's ambition and deliver a bold budget. It should contain measures to help alleviate the recession in the short term and to address concerns about the budget deficit in the medium term. It should also acknowledge the failures of the neo-liberal model of capitalism and deliver a vision of how the economy might develop over the next decade.

The principles that should underpin the 2009 budget

The Chancellor can no longer rely on buoyant tax revenues from the financial sector to fund public spending. In his budget he will have to set out the principles he will use when deciding how he is going to either replace those revenues or cut the spending they were financing. The debate over tax and spending has been remarkably technocratic in recent years, when there was plenty of money to spend. The new fiscal situation, in particular the need for restraint in the medium term, requires clear setting out of the moral principles about who should pay what and where money should be spent.

These principles should be underpinned by an assessment of what the capitalism of tomorrow will look like. For example, the Chancellor could say something about how progress in the UK will be monitored in future. The inadequacies of measures like real GDP are well understood, as is the need to take account of a range of factors, other than just standard of living, when assessing people's well-being or happiness. The Chancellor could set out proposals to develop measures of social well-being and assess its effect on government policies.

As a start, ippr believes this budget should be based on the following principles:

- Environmental sustainability
- Fairness
- Aiming for growth in the economy to be better balanced than in the past.

There is now a broad consensus that the pursuit of economic growth irrespective of its impact on the planet must be questioned. The budget should contain measures to help the battle to limit climate change.

At the same time, the budget should recognise the need for a better balance in the UK economy. In future, there should be less reliance on debt, capital flows and the City and more on creating sustainable, high value-added jobs in a broad range of service and manufacturing industries.

It is also likely that growth in the next economic cycle will have to be less oriented towards consumption and more towards exports. Household spending over the last decade has increased at an annual rate of 3.2 per cent in real terms, faster than the actual rate of GDP growth (2.6 per cent) and the trend rate (2.5 per cent). Meanwhile, imports increased by 4.9 per cent a year and exports by just 3.7 per cent. As a result the UK's trade deficit in 2008 ballooned to £44 billion.

No one believes this is sustainable. The present crisis is likely to be the event that leads to a reversal of these trends. As a start, it may be necessary for consumer spending to grow by roughly 0.5 per cent a year less than real GDP for several years – that is by around 2 per cent a year – to restore balance in the economy.

The Chancellor also needs to put fairness at the centre of his programme. The old-style capitalist model produced some very uneven outcomes, particularly in respect of the gains made by the very highest earners. Although, with the help of government policies, the gap between the lowest incomes and the median income has narrowed, the ratio of the income of the top 1 per cent of earners in Britain to the median income rose by over 15 per cent between 1996–97 and 2006–07 (Brewer *et al* 2008). New-style capitalism should be designed to produce more equal outcomes and the Chancellor can use the tax system to help bring this about.

There are also shorter-term considerations. The middle of the worst recession for the last sixty years, with consumer and business confidence fragile and private spending being cut sharply, is not the time to be announcing cuts in public spending or a net increase in taxation: quite the reverse. As Keynes argued in the 1930s, when households and businesses are too uncertain about the future to spend, then government has to step in to fill the breach. Barack Obama is following this advice. His budget could push the United States' fiscal deficit to $1.75 trillion, or over 12 per cent of GDP, in the fiscal year 2010. By this benchmark, Alistair Darling still has some room for manoeuvre. An equivalent budget deficit in the UK would be around £175 billion, £30 billion more than our current projection for 2009–10.

The recession means the Chancellor cannot emulate Lloyd George and present a package of measures to reduce the projected budget deficit. However, that does not mean that he should do very little. The original 'People's Budget' was progressive and green and it started a social revolution. The 2009 Budget should also be progressive and green and address the main social problems facing Britain today.

A progressive budget

In his 1909 budget speech Lloyd George made the moral case for increased taxation to finance the 'war against poverty and squalidness'. In so doing he established a set of principles for raising government revenues, based around the idea that the tax system should be progressive.

Alistair Darling finds himself in a similar position to Lloyd George. Higher public investment in education and the health service has been paid for, in part, by the buoyant tax revenues generated as a result of strong growth in the financial sector. Now that the financial sector is making big losses, revenues from that quarter will be much diminished in the short term and are unlikely to return to their previous levels for many years. In order to continue to invest in public services, therefore, alternative sources of revenue are required. In the 2009 Budget, the Chancellor needs to set out the principles that will guide him when looking for these alternative sources.

We will come to those principles shortly. First, though, we must emphasise that the short-term priority is to support the economy through the recession. The Chancellor therefore needs to maximise the additional spending generated by any tax cuts. This is best achieved by concentrating tax cuts on lower income households because they have a higher propensity to spend any additional income than higher income households.

Politicians like the headlines attracted by a cut in the basic rate of tax. This is not, however, the best way to boost the economy in the short term. The biggest gainers from a lower tax rate, in absolute terms and as a proportion of disposable income, are those with incomes close to the point at which the higher rate of tax becomes payable, because they have higher taxable incomes and a higher proportion of their income is taxable compared to those on lower incomes.

A bigger boost to the economy in the short term will result from increasing personal income tax allowances (and the entry threshold for national insurance contributions), incidentally taking many people out of the tax system altogether. Increasing personal allowances gives all basic rate taxpayers the same absolute tax reduction and so, crucially, it gives proportionately a bigger boost to the disposable income of those on low incomes – those who are most likely to spend any extra income.

At the cost of around £8 billion – less than the cost of a 2p reduction in the basic rate – all personal tax allowances could be raised by £1,000 and the employee entry threshold for national insurance could be increased by £20 a week[1]. This would save all basic rate taxpayers about £300 a year (the gains to higher rate taxpayers could be limited to this amount by adjusting the level of earnings at which tax is payable at the higher rate).

In the medium term, the Government will have to think about increasing taxes as part of its efforts to reduce its budget deficit. Last year's Pre-Budget Report contained the first measures to address this problem[2]. However, these are unlikely to be sufficient, particularly if fiscal policy is eased again in this budget. The Chancellor does not need to spell out exactly how he will reduce the gap between spending and revenues but he should set out the principles that will govern his future decisions.

There will have to be much tighter control over the aggregate level of public spending. Last November's Pre-Budget Report forecast current government expenditure equal to 40.1 per cent of GDP in 2009–10, rising to 40.6 per cent in 2010–11 and then falling back to 38.4 per cent by 2013–14. As a result of the depth of the recession, the figures for 2009–10 and 2010–11 will be higher in the 2009 Budget Report. However, the share of spending in GDP will still have to come down over the medium term.

We believe the Chancellor should propose tough limits on growth in the real level of current expenditure over the course of the three years covered by the next Comprehensive Spending Review (2011–12 to 2013–14). This will not be easy to achieve, but it has been done in the past, most recently in the three years to 1998–99 (when real total managed expenditure actually fell by 0.8 per cent a year). However, even if this is achieved, current spending would still be higher, as a share of GDP, in 2013–14 than envisaged in the recent Pre-Budget Report.

With debt interest and benefit payments sure to be higher than previously planned, there will have to be cuts in spending in some areas. The details will be decided in the Comprehensive Spending Review, not in the Budget, but the Chancellor should make it clear that those on lower incomes will be protected and that spending on health, education and childcare will continue to rise. He should also say that major projects will probably have to be scrapped.

For example, after Barack Obama's recent comments on a non-nuclear future, the planned replacement of Trident missiles is one item of future spending that could be dispensed with. When this was approved by Parliament in 2007 the cost of the new submarines alone was put at £15–20 billion, spread over 30 years. However, it was widely reported at the time that running costs would add £1.5 billion a year, bringing the total cost to £65 billion. And this could rise even further if the nuclear missiles have to be replaced.

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1. These estimates come from ippr's new tax-benefit model, which is also able to assess the effect of changes in taxes and benefits on income distribution.
2. The rate of VAT will increase from 15 to 17.5 per cent on 1 January 2010, capital spending will fall between 2009–10 and 2010–11 because almost £3 billion of capital spending was brought forward from 2010–11, those with taxable incomes above £100,000 will pay more tax from 2010 because their personal allowances will be restricted, those with taxable incomes above £150,000 will face a marginal tax rate of 45 per cent from 2011 and national insurance contribution rates for all employees and employers will rise by 0.5 per cent, also from 2011. There will also be reductions of £5 billion in public spending in 2009–10 and 2010–11, compared to previous plans, thanks to 'additional value for money savings'.

Additional revenues will also have to be raised. When looking for these revenues the Chancellor should adhere to the following principles:

- Making the tax system more progressive so that those who can afford it pay
- Making the tax system fairer by attacking the use of the loopholes, offshore accounts and tax avoidance schemes that allow high earners to unfairly reduce their tax bills
- Making the tax system more environmentally friendly by taxing carbon emissions.

The rate of tax on incomes of £150,000 or more could rise to 50 per cent, not just to 45 per cent as is currently planned. According to the ippr tax-benefit model this would raise £3.5 billion relative to the current rate of 40 per cent (and £1.75 billion relative to the plan to increase the rate to 45 per cent). At the time of the Pre-Budget Report, when the 45 per cent tax band for incomes over £150,000 was announced, some commentators said it was a move that would raise little in the way of extra revenues because high earners were adept at avoiding income tax. If this is true, then the Chancellor should not abandon plans to raise tax rates for higher earners. Rather, he should take action to ensure high earners pay their fair share of taxes.

Tax reliefs that mainly benefit those on high incomes should be looked at and many abolished. For example, the anomaly that means higher rate taxpayers receive more relief for pension contributions than basic rate taxpayers should go and relief should be limited to the basic rate. There should also be a major push against tax avoidance and consideration given to the introduction of a minimum rate of tax for high earners.

The Chancellor should also look at the changes in inheritance tax that he announced in his 2007 Pre-Budget Report. Although it might be difficult, politically, to reverse them, the projected lost revenue of £1.4 billion in 2010–11 is money that could help, in a small way, to plug the gap between government spending and revenues. Remember, Lloyd George raised death duties in the People's Budget.

The Chancellor might also consider taxing wealth. Inequalities in wealth are even greater than inequalities in income. Wealth improves a family's wellbeing, for example by providing insurance against adverse shocks, and increases its ability to pay taxes. In the interest of fairness, it is justifiable to tax wealth as well as income. Admittedly, designing a system that is equitable, not over-complex and hard to avoid will be difficult and some European countries have abandoned their wealth taxes as administratively too expensive compared with the revenues raised.

But others continue to impose taxes on wealth, including Switzerland and Norway. The Swiss, for example, levy a wealth tax of around 1.5 per cent (varying from canton to canton) annually on the value of all assets located in Switzerland, above a certain threshold. In Norway there is a wealth tax at rates from 0 to 1.1 per cent and a land tax of 0.2 to 0.7 per cent.

The Chancellor should appoint a group of experts to look at the lessons from the European experience of wealth taxes and examine the feasibility of introducing a broad-based wealth tax in the UK as one means of increasing government revenues in the medium term.

Alternatively, if a broad wealth tax is judged to be unfeasible, the Chancellor should copy Lloyd George and introduce a land tax. The principal objection to a broad wealth tax – that it acts as a disincentive to wealth accumulation – does not apply to land (as the supply is fixed). A land tax would also be effective, as it would be very hard to avoid. And taxing land should increase the incentive to make more efficient use of it. The tax could be applied to the market rental value of land, irrespective of the use to which it is being put or of the development on it, and levied at a fixed rate.

For residential property, any land tax would replace, rather than be in addition to, council tax, not least because it would be inefficient administratively to raise revenues from housing in two forms. If set at the right level, it could also replace stamp duty on housing transactions. It would be more progressive than the existing system because the valuation bands used to calculate council tax impose a cap on tax levels.

Again, this is not something that can be implemented in the forthcoming budget. One would have to look into potential problems – for example, some way of helping the very property/land-rich and cash-poor. But the Chancellor could establish the principle of a wealth tax or a land tax as a potential future source of government revenues.

Increasing taxes and making major changes to the tax system are never popular. Losers make much more noise than winners. That did not stop Lloyd George in 1909 and it took a constitutional crisis and a general election before his 1909 Budget was passed.

A modern-day Chancellor does not face such high hurdles. Although he will risk accusations of a return to 'old Labour' values, Alistair Darling has to set out the principles that will guide his search for higher revenues in the medium term and these should be based on making the tax system fairer and more progressive and environmentally friendly.

A green budget

The 2009 budget should also be a 'green budget'. While grappling with the current financial and economic crises, the Chancellor must not forget the environmental crisis that has the potential to be bigger than both of them. The G20, at its London Summit, had disappointingly little to say about climate change. Alistair Darling should not make the same mistake. The Government's own *Stern Review on the Economics of Climate Change*, commissioned by Gordon Brown and published in 2006, concluded that the scientific evidence overwhelmingly suggests climate change is a huge risk and urged immediate measures to tackle the problem. Its author, Lord Stern, believes the need for action is even more urgent now than when he completed his report.

Given the huge projected budget deficit, the Chancellor might be tempted to increase carbon taxes. Options include increasing excise duties on mineral oils, particularly motor fuel; increasing the rate of VAT on domestic fuel use, which still stands at 5 per cent, compared with the current standard rate of 15 per cent; and introducing a broad-based carbon tax. There are, however, problems with all three.

Excise duties on mineral oils – particularly on motor fuel – are already the most important taxes on energy in the UK. Politically, it may not be feasible to increase them much further and environmentally it may be hard to justify when other forms of energy use are less heavily taxed.

There is a stronger economic case for increasing the rate of VAT on the use of domestic fuel because the existing rate is, in effect, subsidising spending on domestic fuel relative to spending on other items (though not those that attract a zero VAT rating). However, such a move would be highly regressive because poor households spend a higher proportion of their incomes on fuel than do rich households. The ippr tax-benefit model suggests that increasing the rate of VAT on domestic energy expenditure to 15 per cent would raise £1.8 billion in extra revenues. However, it would reduce disposable incomes by 0.9 per cent for households in the lowest income decile, but by only 0.1 per cent for those in the highest income decile. In theory, a scheme could be devised to compensate losers, but it might be complex. Politically, this also looks to be a non-starter for the present Government because it was Gordon Brown, as Chancellor, who cut the VAT rate on domestic fuel use from 8 to 5 per cent in 1997.

A broad-based carbon tax would also be regressive unless a compensation scheme was introduced alongside it. The ippr model suggests that a carbon tax of £25 per tonne of carbon dioxide would raise £3.5 billion in extra revenues. However, it would reduce disposable incomes by 1.7 per cent for households in the lowest income decile, but by only 0.3 per cent for those in the highest. Others have gone ahead, nonetheless. The Canadian province of British Columbia, for example, introduced a broad-based carbon tax, applied to nearly all fossil fuels, in 2008 and, at the same time a low-income climate action tax credit to counter the tax's regressive nature.

A broad-based carbon tax would be an important signal of the Government's intention to achieve a significant reduction in the UK's emissions. The Chancellor should announce plans to introduce such a tax, once a scheme has been devised that ensures the poorest household's are protected[3].

If the 2009 Budget is to be a 'Green Budget', however, it will be mainly as the result of higher investment in green jobs, technology and infrastructure. If people cannot be persuaded, even through higher prices, to reduce significantly their energy consumption, then low-carbon technologies will have to be developed to limit the impact of energy use. This will only happen if governments invest heavily.

As a result of measures announced in last November's Pre-Budget Report, capital spending will be £2.9 billion lower in 2010–11 than previously planned (because the spending was brought forward) and current spending will be £5.0 billion lower as a result of 'value for money savings'. However, a lot has changed since November. The IMF now believes the UK economy will still be in recession in 2010. It would not, therefore, be sensible to cut planned public spending next year.

Instead, the Chancellor should earmark £7.9 billion for extra spending on innovation – developing genuinely new kinds of technology that will make low-carbon energy cheaper than existing energy – and on deployment of existing low-carbon technologies, such as offshore wind. These are currently funded through the Renewables Obligation, which requires electricity suppliers to source a minimum proportion of their electricity from renewable sources. To ensure policy continuity, and thus investor confidence, public spending should be made in a way that feeds into the Renewables Obligation, rather than replacing it.

It is clear that the financial crisis is affecting investment in energy generally, with scarcity adding significantly to the cost of capital even for large companies in established technologies. For many renewable energy projects, costs are even higher and in some cases loans are impossible to obtain. There is a real danger that despite the policies in place, the take-off of renewables will stall for several years. There is a strong case for the Chancellor considering the establishment of a 'Green Infrastructure Bank' to provide project finance to the sector, at least until finance is again available at rates that reflect a more realistic pricing of risk.

The budget should also contain measures that will support those sectors of the economy that the UK might have to rely on for growth in the future. It should be clear that the UK

3. It would be relatively easy to devise such a scheme in a broad-brush sense. As part of ippr's 'Red and Green Taxes' project, we have proposed a package of measures that combines a carbon tax, higher personal allowances, higher means-tested benefits, the abolition of the upper earnings limit for national insurance contributions and a 50 per cent tax rate for those earning over £250,000. This package increases net revenues by £500 million and is progressive in nature. However, even though low income families as a group gain, there would be losers within the lowest income deciles and a more complex compensation package might be needed.

will be less reliant on financial services in the future and that it will have to develop its comparative advantage in other areas if there is to be any chance of unemployment falling back over the medium term to the levels seen in 2007 and early 2008. These areas will include those creative industries in which the UK is already a world leader, and digital industries. Green jobs – ranging from the generation of energy from renewable sources to insulating homes – will be important too. This is not about picking 'winners'. The Government's role should be to encourage research and development, through tax credits, and to ensure that the necessary skills are available in the labour force.

A socially regenerative budget

The 2009 budget should also contain measures to help children living in poverty, the unemployed and others who rely on benefits.

The Government has admitted that it is slipping behind schedule if it is to achieve its goal of halving the number of children in relatively low-income households between 1998–99 and 2010–11 (on the way to eradicating child poverty by 2020). A recent report from the Joseph Rowntree Foundation, based on work at the Institute of Fiscal Studies, said that 'To meet its target for 2010, the Government would have to invest an estimated £4.2 billion a year in benefits and tax credits above its present plans' (Hirsch 2009). This figure is based on raising the per-child element of the Child Tax Credit by about 30 per cent on top of the uprating already planned and it could be lowered by taking away child tax credits from higher earners. Changes to other benefits would also reduce the cost. But this budget is the last chance the Government has to achieve its child poverty target, and it should make whatever extra commitment is needed.

More generally, the prospect of deflation presents the Government with an opportunity to help those in receipt of benefits. Normally, benefits are increased each year by the rise in the retail prices index over the year to September in the previous year. Thus, most benefits were increased by 5 per cent – the rate of inflation in September 2008 – this year. However, cuts in interest rates, lower prices for petrol and other fuel and the effects of the recession will cause inflation in September 2009 to be around -3 per cent. In last November's Pre-Budget Report, when the Treasury was projecting an inflation rate of -2.25 per cent for September 2009, the assumption was made that 'Unless a fall is specifically allowed for in statute, tax parameters and benefit levels depending on the negative RPI value for September 2009 are assumed to remain unchanged from their previous value'. In other words, there would be no cut in the nominal value of child benefit, unemployment benefit and so on, but also no increase (although pensions are guaranteed to rise by at least 2.5 per cent a year).

The Government should pledge to increase all benefits, other than the state pension, by 2 per cent next year, irrespective of the precise level of inflation in September.

The state pension should be treated differently. The Government has said that it will restore the link between the pension and earnings, which was removed in 1980, from 2012. It would be apt to celebrate the centenary of the introduction of the first state pension in 1909 by restoring that link in the 2009 budget. From next year, pensions should be increased by the rise in earnings, rather than the rise in prices. However, to avoid the possibility of a miserly increase in the pension in 2010, if earnings growth is dragged to very low levels this year by cuts in bonuses, there should be a guaranteed minimum increase of 4 per cent in 2010.

Helping the unemployed is not just about increasing benefits: it is also about getting them back into work. When unemployment rose above three million in the 1980s, it remained above that level for over four years and long-term unemployment became a serious problem. People lost touch with the labour market and found it very difficult to get back into work, even when the economy was growing strongly. The Government should, as part of its New Deal programme, aim to provide a job for everyone who has been unemployed for 12 months and is able to work. Work experience is far better than training in helping unemployed people to get back into the labour market. In his Pre-Budget Report, the Chancellor proposed bringing forward some public sector construction projects from 2010–11. He should go further and bring forward more, in particular 'shovel-ready' infrastructure projects.

At the same time, the Government should make clear that the Treasury has an overview of job creation, a role that is currently in danger of falling between the Department for Work and Pensions, the Department for Business, Enterprise and Regulatory Reform and the Department of Energy and Climate Change. It could then begin to assess the wide range of new projects that have been put forward as ways of reducing unemployment, including 'green jobs' in areas such as renewable energy, building a rail system fit for the twenty-first century, building new schools and hospitals, taking super-fast broadband into every community and rejuvenating Northern towns and cities.

The Chancellor should also use the budget to start rebuilding a savings culture in the UK. A better balanced economy will be one that is less reliant on debt and one in which a greater proportion of the population has some assets to fall back on in bad times. Savings empower people by giving them greater choice and control. They can also be used, for example, to help finance the establishment of a small business or, more simply, to help sustain consumption during a period of unemployment.

This Government has already made a start with Child Trust Funds and with the Saving Gateway accounts that will be launched next year. It may be hard to build on these at a time when public spending is likely to be constrained. But it should be thinking ahead about how it will eventually return the bank assets it has acquired to private ownership. One option that would certainly spread asset ownership would be to distribute free shares to every individual in the UK.

Conclusion and recommendations

In 1909, the Chancellor of the Exchequer, David Lloyd George, faced with financial difficulties and declining political support, chose to be bold. He took on sceptics, both within and outside his party with his progressive, socially regenerative and, unwittingly, green package of proposals. 2009's Chancellor, Alistair Darling, should now be bold too, remembering Tony Blair's maxim that: 'we're at our best when at our boldest'[4]. He should take on the modern-day sceptics, such as Mervyn King and David Cameron, and adopt a range of measures to support the economy in the short term, while setting out the principles that will underpin efforts to reduce the budget deficit in the medium term.

To tackle the immediate problems facing the economy, the Chancellor should propose a series of measures that are progressive, green and socially regenerative. These might include:

- A £1,000 increase in personal tax allowances for 2009–10
- £8 billion extra spending on innovation and deployment of low-carbon technology (in part financed by cuts to other spending plans)
- Extra spending to achieve the Government's child poverty reduction target and mark the centenary of the state pension by restoring the link between pensions and earnings.

4. Speaking to the 2002 Labour Party Conference

In setting out how the Government's budget deficit will be reduced over the medium term, the Chancellor should reaffirm the moral case, made by Lloyd George 100 years ago, for progressive taxation to fund welfare spending. Specifically, he should announce plans to:

- Set tough limits for growth in public spending in real terms over the three years of the next Comprehensive Spending Review, while protecting those on the lowest incomes and spending on health, education and childcare
- Increase taxes by eliminating anomalies and avoidance and raising tax rates for those who can afford it – high earners and the wealthy
- Examine the feasibility of introducing a wealth or land tax and a broad-based carbon tax.

This will not be easy politically. There will be accusations of a return to 'old Labour' values. But tax revenues will have to rise in the medium term and it is the Chancellor's job to explain how this will happen. He should be guided by three principles:

- Environmental sustainability
- Fairness
- The desirability of a progressive tax system.

If Alistair Darling lacks inspiration, he should look back to David Lloyd George and the most radical and greatest budget in the UK's history. This will show him that boldness can deliver votes as well as economic results.

References

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