HM TREASURY

Budget 2009

Building Britain's future

Economic and Fiscal Strategy Report and Financial Statement and Budget Report

April 2009

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Stephen Timms
Her Majesty's Treasury
22 April 2009

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HM Treasury contacts

This report can be found on the Treasury website at:

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For general enquiries about HM Treasury and its work contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558
Fax: 020 7270 4861
E-mail: public.enquiries@hm-treasury.gov.uk

This and other government documents can be found at:

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The Economic and Fiscal Strategy Report and the Financial Statement and Budget Report contain the Government's assessment of the medium-term economic and budgetary position. They set out the Government's tax and spending plans, including those for public investment, in the context of its overall approach to social, economic and environmental objectives. After approval for the purposes of Section 5 of the European Communities (Amendment) Act 1993, these reports will form the basis of submissions to the European Commission under Article 99 (ex Article 103) and Article 104 (ex Article 104c) of the Treaty establishing the European Community.

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Economic and Fiscal Strategy Report

1 OVERVIEW

The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all. Budget 2009, *Building's Britain's Future*, presents updated assessments and forecasts of the economy and public finances and reports on how in the face of a steep and synchronised global downturn, the Government is delivering a comprehensive and coherent package of targeted support to continue to help households and businesses, while implementing a strategy to support a strong and sustainable recovery.

Building on the strategy set out at the 2008 Pre-Budget Report, the Budget announces targeted discretionary support for the economy through these difficult times, while continuing sustained fiscal consolidation from 2010-11 when the economy is expected to be recovering and able to support a reduction in borrowing:

- **support for employment, including for Jobcentre Plus and the Flexible New Deal, and the offer a guaranteed job, training or work placement for all 18-24 year olds who reach 12 months unemployed;**
- **support for business, including by extending the enhanced loss relief for an additional year and expanding HMRC's Business Payment Support Service, increasing capital allowances for new investment to 40 per cent for one year, and establishing a £750 million Strategic Investment Fund to support advanced industrial projects of strategic importance;**
- **support for individuals, including through an increase in the annual investment limit for Individual Savings Accounts (ISAs) to £10,200, up to £5,100 of which can be saved in cash; an additional payment alongside the Winter Fuel Payment worth £100 for households with someone aged over 80 and £50 for households with someone aged over 60;**
- **support for homeowners and homebuyers, including with a £600 million funding package of measures to build more homes through unlocking sites currently sitting as dormant, and an extension of the stamp duty holiday for all houses costing up to £175,000 until the end of the year; and**
- **support for the environment, including setting the world's first carbon budgets and measures to encourage energy efficiency and low-carbon growth.**

The Budget also announces:

- **from April 2010, an additional rate of income tax of 50 per cent will apply to income over £150,000, and the income tax personal allowance will be restricted for those with income over £100,000;**
- **from April 2011, tax relief on pensions contributions will be restricted for those with incomes of £150,000 and over, and tapered down until it is 20 per cent;**
- **fuel duty will increase by 2 pence per litre on 1 September 2009, and by 1 penny per litre in real terms each year from 2010 to 2013; and**
- **£5 billion recoverable value for money savings in 2011-11 raising the 2007 Comprehensive Spending Review target from £30 billion to £35 billion, and in the next Spending Review period additional efficiencies to help support the economy and front-line services rising to £9 billion by 2013-14. The Budget sets assumptions for spending growth from 2011-12 onwards, with current spending growing by on average 0.7 per cent in real terms and public sector net investment moving to 1¼ per cent of GDP by 2013-14.**

1.1 The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all.

Global economic downturn

1.2 The world economy faced exceptional challenges through 2007 and 2008, with the financial crisis of late 2008 precipitating a steep and synchronised global downturn. The UK, like other advanced economies, has seen a large fall in output, with GDP down 1.6 per cent in the final quarter of 2008 and industrial production down 4.5 per cent. In the euro area, GDP contracted 1.6 per cent, while industrial production fell more than 18 per cent in the year to February. In the US, GDP also fell 1.6 per cent and industrial production was down 5.4 per cent in the first quarter of 2009. In Japan, GDP fell by 3.2 per cent and exports were down by an unprecedented 45½ per cent in the year to February 2009.

UK and global policy response

1.3 There are worldwide economic difficulties with international causes and consequences for every country, so global solutions are needed. The UK Government, as Chair of the G20 in 2009, forged agreement between G20 Leaders on a comprehensive *Global Plan for Recovery and Reform* at the London Summit in April 2009.

1.4 Reinforcing the international response the Government is delivering a coherent and comprehensive package of support to stabilise the financial system, provide support to the economy and to those who need it most, and set a clear and fair plan for ensuring sound public finances over the medium term.

Prospects for the UK economy

1.5 In 2009, the world economy is forecast to contract for the first time in the post-war period, with UK GDP forecast to drop 3½ per cent. As support from macroeconomic policy takes hold and credit conditions ease, the world and UK economies are forecast to recover. Recovery in the UK is forecast to begin in late 2009, with growth picking up through 2010 and the economy is forecast to grow strongly in 2011.

Budget 2009

1.6 This Budget sets out the action the Government is taking to support individuals and businesses through the current downturn, while ensuring the economy is able to make a strong and sustainable recovery. Budget 2009 describes the next steps that the Government is taking to make further progress in:

- **maintaining macroeconomic stability**, through supporting the economic recovery and building a strong economy for the future, while ensuring sound public finances;
- **ensuring financial stability**, by introducing the Government's view of the longer-term action required to renew financial markets for the future;
- **supporting business**, with targeted measures that will help business' short-term cashflow, and improve competitiveness;
- **helping people fairly**, with further Government action to support employment, to help savers and families with childcare, to support pensioners, and help homeowners;
- **improving public services**, with continued investment in front-line public services alongside a stronger drive on value for money; and
- **building a low-carbon recovery**, with action to address the global challenge of climate change.

MAINTAINING MACROECONOMIC STABILITY

I.7 The Government's long-term economic goal is to maintain macroeconomic stability in order to achieve its objective of a fair society where there is security and opportunity for all. Chapter 2 sets out prospects for the UK economy and public finances, details of which are set out in Chapters B and C of the *Financial Statement and Budget Report (FSBR)*.

Policy response

I.8 To promote economic recovery while ensuring sound public finances, Budget 2009 focuses on further targeted support for those most affected by the downturn and to ensure a sustained and sustainable recovery, including support for employment and investment.

I.9 In the UK, the Government has undertaken a set of measures to improve the flow of credit to creditworthy borrowers, and significant macroeconomic policy support is in place. The Bank of England has cut Bank Rate to ½ per cent, a £75 billion programme of asset purchases is under way, and the Government is delivering fiscal support worth 4 per cent of GDP in 2009-10 through discretionary action announced in this Budget and the 2008 Pre-Budget Report and the automatic stabilisers.

Ensuring sustainability

I.10 Over the medium-term the Government's fiscal policy objective is to ensure sound public finances and that spending and taxation impact fairly within and between generations. Building on the significant fiscal consolidation announced in the 2008 Pre-Budget Report, this Budget sets out tax and spending measures that reduce borrowing by £26½ billion by 2013-14:

- **from April 2010, an additional rate of income tax of 50 per cent will apply to income over £150,000 and the income tax personal allowance will be restricted for those with incomes over £100,000. From April 2011, tax relief on pensions contributions will be restricted for those with incomes of £150,000 and over, and tapered down until it is 20 per cent. Fuel duty will increase by 2 pence per litre on 1 September 2009, and by 1 penny per litre in real terms each year from 2010 to 2013; and**

- **the Government will continue to improve and invest in public services while delivering the additional savings identified by the Operational Efficiency Programme over the next Spending Review period, rising to £9 billion a year by 2013-14. Current spending will grow by an average of 0.7 per cent a year in real terms between 2011-12 and 2013-14 and public sector net investment will move to 1¼ per cent of GDP by 2013-14.**

Economic prospects

I.11 It will take time for policy support to take hold fully. With a sharp recession taking place in the world's economies, global forecasts are marked by very significant uncertainties and risks. World GDP is forecast to fall by 1¼ per cent in 2009, marking the first full-year contraction in the post-war period. Advanced economies are expected to contract most sharply, with G7 GDP forecast to fall by 4 per cent. As the global policy response takes hold and credit conditions ease, the world economy is forecast to begin to recover towards the end of 2009, with growth picking up through 2010 and 2011. In the UK, prospects for 2009 have been revised down substantially since the 2008 Pre-Budget Report. Like many advanced economies the UK will experience a sharp recession in 2009 with a forecast contraction of 3½ per cent. GDP is forecast to contract sharply in the first half of 2009, to stabilise in the second half of the year, and to pick up progressively through 2010 and 2011.

The public finances

I.12 Global economic developments will have a profound effect on the fiscal positions of most countries, with debt likely to rise significantly in all advanced economies. The Budget 2009 projections show that:

- Public sector net borrowing (PSNB) is projected to peak at 12.4 per cent of GDP in 2009-10, as the economic downturn significantly reduces tax receipts, particularly from the financial sector. PSNB then declines to 5.5 per cent of GDP by 2013-14 as the economy recovers and the Government takes action to ensure the sustainability of the public finances; and
- Public sector net debt (PSND), including unrealised losses from financial sector interventions, increases over the period to 2013-14. It then stabilises at around 79 per cent of GDP by the end of the forecast period.

1.13 Reflecting the principle of transparency, the fiscal forecasts include a provisional estimate for the high end of a range for the net impact of unrealised losses on financial sector interventions, equal to 3½ per cent of GDP.

Table 1.1: Summary of fiscal projections

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Public sector net borrowing (PSNB)	2.4	6.3	12.4	11.9	9.1	7.2	5.5
Total change since 2008 Pre-Budget Report	*-0.1*	*0.9*	*4.4*	*5.1*	*3.8*	*3.1*	*2.6*
Impact of discretionary measures on PSNB [1]	*0.0*	*0.0*	*0.5*	*0.0*	*-0.5*	*-1.1*	*-1.5*
Surplus on current budget	-0.4	-3.6	-9.3	-9.4	-7.2	-5.6	-4.3
Cyclically-adjusted surplus on current budget	-0.7	-3.1	-6.7	-6.4	-4.9	-3.9	-3.2
Public sector net investment	2.1	2.6	3.1	2.5	1.9	1.6	1.3
Public sector net debt[2]	36.5	43.0	55.4	65.0	70.9	74.5	76.2
Public sector net debt including unrealised losses [3]	36.5	46.5	59.0	68.4	74.0	77.5	79.0

Note: Figures on a National Accounts basis unless otherwise indicated.

[1] *Including changes in forecasting assumptions on spending growth in 2011-12, 2012-13 and 2013-14.*

[2] *Debt at end March; GDP centred on end March; excluding financial sector interventions.*

[3] *Debt at end March; GDP centred on end March; including unrealised losses on financial sector interventions.*

FINANCIAL STABILITY

1.14 The world economy was hit by a global credit shock in mid-2007. Since then, global financial markets have suffered a sustained period of stress and instability. The intensification of the financial market stress into the worst global financial crisis for generations delivered a severe blow to an already weakened world economy, precipitating a steep and synchronised global downturn. The world economy is forecast to contract in 2009 for the first time in the post-war period.

1.15 Financial markets are critical to the well-being of all citizens and the success of all businesses in this country. They also strongly influence economic growth and development across the world. They are the core mechanism for allocating resources efficiently in an economy and a key driver of productivity, growth and opportunities. Financial instability, to the extent that it disrupts the functioning of financial markets, can therefore affect everybody.

1.16 Governments around the world have provided significant support to strengthen their financial systems. At the London Summit, G20 Leaders committed to take all necessary action to restore the flow of credit and ensure the soundness of systemically important institutions.

1.17 The Government has taken decisive action to support the stability of the financial system and wider economy. Tackling a downturn of this nature and dealing with its consequences requires a comprehensive policy response to support the economy: fiscal and monetary policy, financial sector interventions, and targeted support for individuals and businesses.

I.18 The action taken by the Government since October 2008 has been successful in preventing the collapse of the financial system and ensuring that no retail depositors in UK banks or building societies lost money. These interventions have supported the wider economy, and they are helping individuals and businesses. The Government will continue to do whatever it takes to maintain financial stability through its objectives to ensure stability and restore confidence in the financial system, protect retail depositors' money and safeguard the interests of taxpayers.

I.19 Chapter 3 sets out the Government's response to financial market disruption in two areas. First, it describes the Government's immediate response aimed at ensuring the stability of the financial system, involving:

- targeted action for individual financial institutions; and
- a comprehensive system-wide response, including action to ensure liquidity, strengthen bank capital, guarantee certain wholesale funding, deal with impaired assets, and increase lending in the economy.

I.20 Second, Chapter 3 sets out the Government's view of the longer-term action required to renew financial markets for the future. It introduces a forthcoming paper by the Government, covering:

- key elements of the Government's approach to the future of financial markets;
- steps already taken to achieve this approach, including the Turner Review, leading work in the G20, and the Banking Act 2009; and
- further important action, including renewing financial regulation, reducing the impact of bank failure, protecting and supporting consumers, improving efficiency and competition in capital markets, and strengthening regulators and the international regulatory framework.

SUPPORTING BUSINESS

I.21 The financial crisis has caused a steep and synchronised global downturn. Government support, alongside action to restore the flow of credit in the financial system, is helping businesses across the UK. Budget 2009 builds on this support with targeted measures that will help businesses' short-term cashflow, including:

- **further support to loss-making businesses, by extending the enhanced loss relief announced in the 2008 Pre-Budget Report for an additional year and expanding HMRC's Business Payment Support Service;**
- **enabling businesses to spread payment of this year's inflation up-rating to business rates over three years, as announced on 31 March 2009;**
- **a 'top-up' trade credit insurance scheme to help businesses maintain their finances, in which Government will offer to match private sector trade credit insurance provision, for a temporary period, if insurers reduce cover to any UK business;** and
- **for a temporary period, a vehicle scrappage scheme, co-funded with industry, that will enable consumers who scrap vehicles older than ten years to replace them with new vehicles at a discount of £2,000.**

1.22 Over the last decade the UK has built up key strengths that provide a platform for growth as the UK emerges from the recession. Consistent with the strategic vision set out in *Building Britain's Future: New Industry, New Jobs* published 20 April 2009, Budget 2009 announces a package of measures that will support the adjustment towards renewed economic growth and improve the UK's competitiveness, offering:

- **an increase in capital allowances for new investment to 40 per cent for one year, with effect from April 2009, to allow a higher proportion of private investment to be offset in that year against taxable profits;**
- **a £750 million Strategic Investment Fund to support advanced industrial projects of strategic importance, of which a third of the funding will be earmarked specifically for low-carbon projects; and**
- **the implementation of a package of reforms to the taxation of foreign profits, including the introduction of an exemption for foreign dividends, supported by a limited restriction to the interest deduction rules.**

HELPING PEOPLE FAIRLY

Budget 2009 policy decisions

1.23 Low inflation and interest rates mean many households will have higher real incomes in 2009. In addition, households have benefited from action that the Government has taken to support economic recovery, including an increase in the personal allowance and a temporary cut in VAT. However, the Government recognises that many households have been hit by the downturn, including those affected by rising unemployment or by falling hours or wages.

1.24 Budget 2009 announces further Government action to support employment, to help savers and families with children, to support pensioners and to help people manage their finances, including:

- **an additional £1.7 billion set aside for the Department for Work and Pensions** to sustain the high numbers of individuals currently moving off Jobseeker's Allowance in the early months of each claim and provide support for the minority who remain unemployed for longer periods;
- **a guaranteed job, training or work placement for all 18-24 year olds who reach 12 months unemployed** to ensure no young people are left behind due to long-term unemployment;
- **an additional payment alongside this year's Winter Fuel Payment, worth £100 for households with someone aged over 80 and £50 for households with someone aged over 60;**
- **an increase in the annual investment limit for Individual Saving Accounts to £10,200, up to £5,100 of which can be saved in cash.** These higher limits will be available to people aged 50 and over from 6 October 2009 and available to all from 6 April 2010, directly benefiting over 5 million people who currently use their full ISA allowance;
- **an increase to the child element of the Child Tax Credit of an additional £20 a year above indexation from April 2010,** providing valuable support to families with children;
- **an additional £125 million in 2009-10 and £145 million in 2010-11 allocated to the Social Fund;** and

- **an increase in the level of statutory redundancy pay, making the weekly rate £380.**

1.25 Budget 2009 also announces a package of measures to help homeowners, homebuyers and the housing market:

- **a £600 million funding package of measures to build more homes through unlocking sites currently sitting dormant;** and
- **an extension of the stamp duty holiday for all houses costing up to £175,000 until 31 December 2009.**

1.26 In addition, Budget 2009 announces:

- **from April 2010 an additional rate of income tax of 50 per cent will apply to income over £150,000, and the income tax personal allowance will be restricted for those with incomes over £100,000;**
- **from April 2011 tax relief on pensions conributions will be restricted for those with incomes of £150,000 and over, and tapered down until it is 20 per cent; and**
- **changes to alcohol and tobacco duties, and a package of measures protecting £3 billion of tax receipts from erosion due to tax evasion and avoidance by 2011-12.**

IMPROVING PUBLIC SERVICES

1.27 Since 1997, record levels of investment matched by reform have enabled the Government to deliver real and lasting improvements in Britain's public services.

1.28 The Government's short-term focus is on supporting employment and jobs through the recession. Budget 2009 **announces new spending measures, including additional funding for Jobcentre Plus to avoid the problems associated with long-term unemployment that took hold in previous recessions; and that the September guarantee of a place in education and training to every 16 and 17 year old who wants one will be met in full, an extra 54,000 student places in the next academic year.**

1.29 At the same time, the Government is determined to do more to prepare Britain for the economic recovery, building the wealth and jobs of the future. Budget 2009 **announces:**

- **a new £750 million Strategic Investment Fund to support advanced industrial projects of strategic importance,** £250 million of this will be earmarked for low-carbon investment;
- **£500 million of additional spending as part of an overall £1.4 billion package of targeted support to boost Britain's low-carbon sectors;** and
- **a further £600 million to increase housing supply,** including through an extension to the shared equity scheme Homebuy Direct and additional social housing investment.

1.30 The Government will continue to invest in front-line public services alongside a stronger drive on value for money. Budget 2009 announces:

- **£5 billion recoverable value for money savings in 2010-11, raising the 2007 Comprehensive Spending Review (CSR) target from £30 billion to £35 billion,** while maintaining in full the allocations planned for key front-line services;

- **plans to increase the Government's target on relocating posts out of London to 24,000** by 2010;
- **in the next Spending Review period, additional efficiencies to help support the economy and front-line services drawn from procurement, back office and IT, and property running costs,** rising to £9 billion of additional efficiency savings by 2013-14; and
- **new incentives and mechanisms with the aim of realising up to £16 billion of property and other asset sales** in the three years from 2011-12 with proceeds used to supplement capital budgets.

1.31 Building on these reforms, **Budget 2009 sets assumptions for spending growth from 2011-12 to 2013-14, which allow continued investment in public services while ensuring sustainable public finances:** with current spending growing by an average 0.7 per cent in real terms; and public sector net investment moving to 1¼ per cent of GDP by 2013-14.

BUILDING A LOW-CARBON RECOVERY

Budget 2009 policy decisions

1.32 The UK has led the world in taking a strategic and long-term approach to the problem of climate change. Existing policies are already enabling £50 billion of low-carbon investment over the three years to 2011, and helping to support 900,000 jobs. Budget 2009 builds on these foundations and provides over £1.4 billion of extra targeted support in the low-carbon sector. Together with announcements made since last autumn, measures announced today will enable an additional £10.4 billion of low-carbon sector and energy investment over three years, securing new jobs and new business, and placing the UK at the forefront of a worldwide low-carbon recovery.

1.33 To strengthen the long-term policy framework and give UK industry the confidence to invest in low-carbon technologies, Budget 2009 **sets the world's first carbon budgets,** as required by the new Climate Change Act. These set a legally binding 34 per cent reduction in emissions by 2020, a new level of ambition for UK climate policy.

1.34 Saving energy is the easiest way to cut carbon emissions, saving households and businesses money on bills. Building on the one million homes insulated last year, Budget 2009 announces an additional **£375 million to support energy and resource efficiency in businesses, public buildings and households over the next two years, and £70 million for decentralised small-scale and community low-carbon energy.** Together, these measures will support employment, and save 380,000 tCO_2 and around £60 million in energy bills each year.

1.35 Meeting carbon budgets will require a transformation of the way the UK meets its energy needs. The Government's existing framework will enable a ten-fold increase in renewable investment by 2020. To protect investment and jobs in low-carbon energy, and to strengthen the long-term framework for a low-carbon energy future, Budget 2009 announces:

- **£405 million to support low-carbon industries and advanced green manufacturing,** to help make the UK a worldwide leader;
- **that UK renewable and energy projects stand to benefit from up to £4 billion of new capital from the European Investment Bank,** removing blockages in project financing;
- **an uplift in support for offshore wind investments that reach financial close between now and 2011 through the Renewables Obligation.** This is expected to support £9 billion of investment and power up to 2.8 million homes;

- **extending support for combined heat and power through climate change levy exemptions,** helping bring forward £2.5 billion of investment and 3 GW of capacity by 2015, and supporting employment; and
- **a new funding mechanism to support up to four carbon capture and storage demonstration projects, and £90 million to fund detailed preparatory studies.**

1.36 To support the public finances, while also driving the move to a low-carbon and resource-efficient economy, Budget 2009 announces:

- **an increase in fuel duty of 2 pence per litre on 1 September 2009, and of 1 penny per litre in real terms each year from 2010 to 2013.** This will contribute to medium-term fiscal consolidation, and save 2 MtCO_2 per year by 2013-14; and
- **a continued increase in the standard rate of landfill tax by £8 per tonne on 1 April each year from 2011 to 2013,** to reduce landfill in a sustainable way by encouraging further investment into alternative waste management options.

BUDGET MEASURES AND THE IMPACT ON HOUSEHOLDS

1.37 The measures introduced in this and previous Budgets and Pre-Budget Reports support the Government's objectives of promoting work and tackling child and pensioner poverty. The 2008 Pre-Budget Report announced the bringing forward of Child Benefit uprating to January 2009 and future year increases to Child Tax Credit to help families with children. Working-age taxpayers also gain from personal tax measures announced in the Pre-Budget Report. This Budget announces measures to support pensioner households including an additional payment of £50 (£100 if someone is aged 80 or over) paid alongside the Winter Fuel Payment in 2009-10 and an increase to the amount of savings that pensioners are allowed to hold without it affecting their benefit payments.

1.38 This Budget also announces measures on individuals that contribute towards the consolidation of the public finances in the medium term. These measures largely impact on those who can afford to pay – people with the top 2 per cent of taxable incomes.

1.39 As a result of measures announced in this and previous Budgets and Pre-Budget reports in 2009-10, compared with 2008-09:

- households will be better off by £10, on average;
- households in the poorest fifth are better off by £25, on average; and
- families with children are better off by £90, with those in the poorest fifth of the population better off by £175 on average.

1.40 As a result of personal tax and benefit measures introduced since 1997 by April 2011:

- households will be £1,550 per year better off, on average; and
- households with children will be £2,350 per year better off, on average, and those in the poorest fifth of the population £4,750 per year better off, on average.

1.41 Consistent with the requirements of the *Code for fiscal stability*, the updated public finance projections in Budget 2009 take into account the fiscal effects of all firm decisions announced in the Budget. The fiscal impact of Budget policy decisions is set out in Table 1.2. Full details are provided in Chapter A of the FSBR.

Table 1.2: Budget 2009 policy decisions

		(+ve is an Exchequer yield)			£ million
		2009-10 indexed	2010-11 indexed	2011-12 indexed	2009-10 non-indexed
Supporting Business					
1	Business rates: deferral of payments	-700	+335	+320	600
2	First-year capital allowances: one year increase to 40%	-1,640	-190	+380	-1,640
3	Loss carry back: further temporary extension	-55	-195	-45	-55
4	Car scrappage	-300	0	0	-300
5	Strategic Investment Fund	-400	-350	0	-400
6	Lloyd's UK dividend exemption	-10	-10	-10	-10
7	Loan relationships: late paid interest to connected companies	-5	-15	-5	-5
8	North Sea fiscal regime: incentives for investment	0	-5	-10	0
9	Residence and domicile: consequential changes	-5	-5	-5	-5
10	VAT Package: refund scheme	*	-5	-5	*
11	Agricultural property and woodlands relief: extension	-5	-5	-5	-5
12	Building Colleges for the Future	-200	0	0	-200
Helping People Fairly					
13	DWP additional employment funding	-590	-1,080	0	-590
14	Employment: guarantee for young people [1]	-300	-900	-	-300
15	Increase in Statutory Redundancy Pay	-15	-25	-	-15
16	Age related payments to pensioner households	-600	0	0	-600
17	Increase ISA limits	-5	-20	-60	-5
18	Increase Pension Credit capital disregards	-60	-130	-	-60
19	Working Tax Credit run-ons: extension	-5	-10	-	-5
20	Child Trust Fund: extra payments for disabled children	0	-15	-	0
21	Increase Child Element of Child Tax Credit	0	-140	-	0
22	Housing Benefit/Council Tax Benefit overpayments: remove double subsidy provision	0	+10	-	0
23	Housing Benefit/Council Tax Benefit: earnings disregard	0	-5	-	0
24	Housing Benefit: managing gains from Local Housing Allowance	0	+145	-	0
25	Increase Social Fund	-125	-145	0	-125
26	Support for Mortgage Interest	-135	0	0	-135
27	SDLT holiday for residential homes: extension to 31 December 2009	-90	0	0	-90
28	Support for housing supply	-420	-180	0	-420
29	Local Authority guideline rent increases in 2009-10	-10	-10	0	-10
30	Repeal furnished holiday lettings rules	0	-15	+20	0
31	Reduced VAT rate for children's car seat bases	*	-5	-5	*
32	Financial assistance for charities	-20	0	0	-20
33	Armed forces accommodation	-50	+25	-	-50
Preparing for a green recovery					
34	Support for low carbon technologies	-160	-65	0	-160
35	Support for energy and resource efficiency	-220	-55	0	-220
36	Landfill tax reform	+30	+70	+70	+30
37	Landfill tax rates	-5	-25	+80	-5
38	Enhanced capital allowances	+10	+15	+15	+10
39	Company car tax rates	0	0	+85	0
40	Vehicle excise duty	0	-5	-5	0
41	VAT: Revalorisation of fuel scale charges	0	0	0	-10

Table 1.2: Budget 2009 policy decisions (continued)

		(+ve is an Exchequer yield)			£ million
		2009-10 indexed	2010-11 indexed	2011-12 indexed	2009-10 non-indexed
Ensuring sustainability of the public finances					
42	Fuel duty: increases	+600	+1,250	+1,750	+1,575
43	Income Tax: full withdrawal of personal allowance from £100,000 [2]	0	+100	+180	0
44	Income Tax: increase additional rate to 50% from £150,000 and increase trust rate to 50% from 2010-11 [3]	0	+1,130	+1,810	0
45	Pensions Tax: restrict tax relief to 20% above £150,000 [4]	0	0	+200	0
46	Tobacco: 2% increase in specific duty	+60	+60	+60	+60
47	Gambling participation fees: removal of VAT	-50	-55	-60	-50
48	Gaming duty on casino card rooms	+5	+5	+5	+5
49	Bingo duty: increase rate to 22%	+35	+35	+35	+35
50	Amusement machine licence duty: increase rates	+20	+15	+15	+20
Protecting Revenue					
51	Foreign exchange: targeted anti-avoidance rule	+20	+20	+20	+20
52	Corporate intangible assets regime: countering abuse	+70	+130	+110	+70
53	Review of Alcohol Fraud Strategy	+20	+10	+10	+70
54	Manufactured overseas dividends: avoidance	0	0	+50	0
55	Double tax relief: avoidance	+100	+100	+200	+100
56	Living accommodation benefit charge: avoidance	+45	+45	+55	+45
57	Publishing names of serious tax defaulters	0	+20	+60	0
58	Accountability of senior accounting officers	0	+40	+50	0
59	Review of powers: debt management	+5	+5	-135	+5
TOTAL POLICY DECISIONS:		-5,160	-100	+5,230	-2,845
ADDITIONAL ITEMS					
60	Reserve: support for military operations	-1,900	0	0	-1,900
61	Reprofile addition to 2008-09 DEL reserve	-500	-500	0	-500
Memo: reset AME margin		-1,000	-2,000	-	

- Included within the current spending growth assumption for 2011-12 onwards.

** Negligible*

[1] Gross costs are £1.4 billion over 2009-10 and 2010-11. The figures in the table are net of associated savings.

[2] This modifies the yield published at PBR 2008 for the staged restriction of the personal allowance. The total yield in 2012-13 from the removal of the personal allowance will be £1.5 billion.

[3] This measure is in addition to the yield published at PBR 2008 for the 45% additional rate commencing from 2011-12. The total yield in 2012-13 from the 50% additional rate will be £2.4 billion.

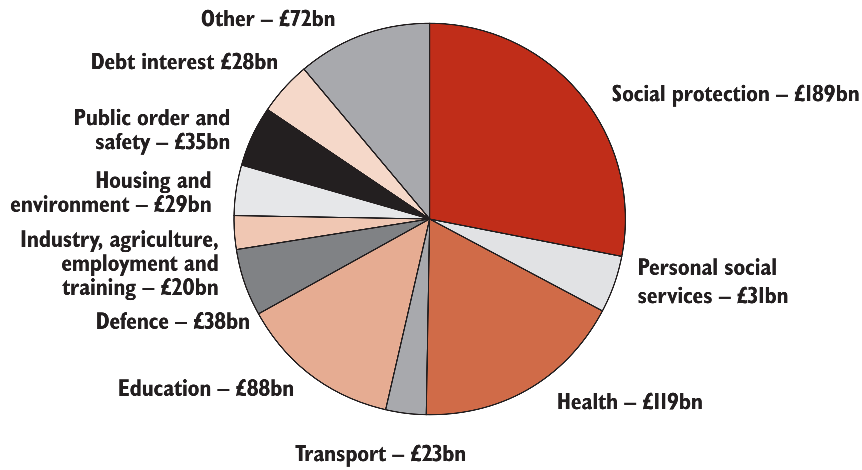
[4] Yield increases due to lagged effect of self-assessment. For 2012-13, the yield is £3.1 billion.

GOVERNMENT SPENDING AND REVENUE

1.42 Chart 1.1 presents public spending by main function. Total Managed Expenditure (TME) in 2009-10 is expected to be around £671 billion. TME is divided into Departmental Expenditure Limits (DEL), shown in table C11 of the FSBR, and Annually Managed Expenditure (AME), shown in table C9 of the FSBR.

Chart 1.1: Government spending by function

Total managed expenditure: £671 billion

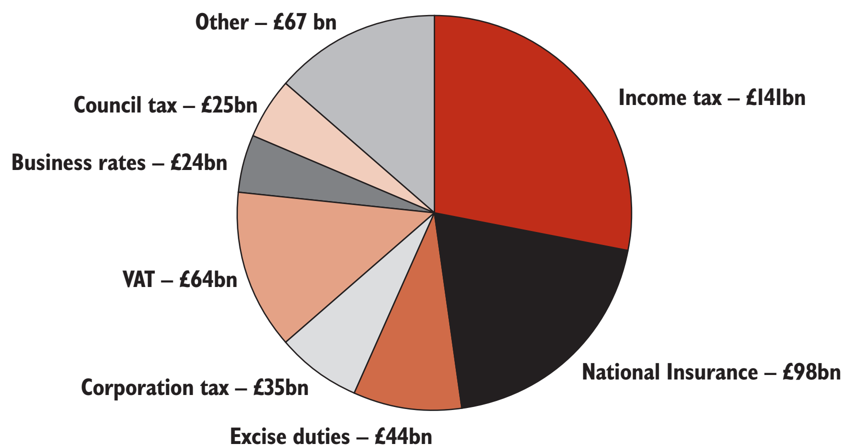


Source: HM Treasury 2009-10 near-cash projections. Spending re-classified to functions compared to previous presentations and is now using methods specified in international standards. Other expenditure includes spending on general public services: recreation, culture, media and sport; international cooperation and development; public service pensions; plus spending yet to be allocated and some accounting adjustments. Social protection includes tax credit payments in excess of an individual's tax liability, which are now counted on AME, in line with OECD guidelines. Figures may not sum to total due to rounding.

1.43 Chart 1.2 shows the different sources of government revenue. Public sector current receipts are expected to be around £496 billion in 2009-10. Table C6 of the FSBR provides a more detailed breakdown of receipts consistent with this chart.

Chart 1.2: Government receipts

Total receipts: £496 billion



Source: HM Treasury, 2009-10 projections. Other receipts include capital taxes, stamp duties, vehicle excise duties and some other tax and non-tax receipts – for example, interest and dividends. Figures may not sum to total due to rounding.

2 Maintaining macroeconomic stability

The financial crisis has caused a steep and synchronised global downturn. Recessions are being experienced in all the world's major advanced economies and the world economy is set to contract by 1¼ per cent in 2009, the first fall in the post-war period. The UK Government, as Chair of the G20 in 2009, forged agreement between G20 Leaders on a comprehensive *Global plan for recovery and reform* at the London Summit in April 2009.

The Government is delivering a coherent and comprehensive package of support to restore the flow of credit, support economic recovery in the UK and build a strong economy for the future, while ensuring sound public finances.

The Government is delivering fiscal support worth 4 per cent of GDP in 2009-10 from the measures announced in this Budget, the 2008 Pre-Budget Report and the operation of the automatic stabilisers. The Bank of England has cut Bank Rate to ½ a per cent and annouced a £75 billion programme of asset purchases. With substantial macroeconomic stimulus already in the system, this Budget focuses on further targeted support for those most affected by the downturn, and on ensuring a sustained and sustainable recovery, including support for employment and investment.

It will take time for this support to take hold fully. Like most advanced economies, the UK will experience a sharp recession in 2009, with GDP falling by -3½ per cent in 2009, before substantial macroeconomic stimulus drives recovery, with growth of 1¼ per cent forecast in 2010.

Global economic developments will have a profound effect on the fiscal positions of most countries, with debt likely to rise significantly in all advanced economies. In the UK, borrowing is forecast to peak at 12.4 per cent of GDP in 2009-10, before falling as the economy recovers and the Government takes further action to ensure sustainability. Building on the significant fiscal consolidation announced in the 2008 Pre-Budget Report, this Budget sets out tax and spending measures that reduce borrowing by £26½ billion by 2013-14:

- **from April 2010, an additional rate of income tax of 50 per cent will apply to income over £150,000 and the income tax personal allowance will be restricted for those with incomes over £100,000. From April 2011, tax relief on pensions contributions will be restricted for those with incomes of £150,000 and over, and tapered down until it is 20 per cent. Fuel duty will increase by 2 pence per litre on 1 September 2009, and by 1 penny per litre in real terms each year from 2010 to 2013; and**
- **the Government will continue to improve and invest in public services while delivering the additional savings identified by the Operational Efficiency Programme over the next Spending Review period, rising to £9 billion a year by 2013-14. Current spending will grow by an average of 0.7 per cent a year in real terms between 2011-12 and 2013-14 and public sector net investment will move to 1¼ per cent of GDP by 2013-14.**

Reflecting the principle of transparency, the fiscal forecasts include a provisional estimate for the high end of a range for the net impact of unrealised losses on financial sector interventions, equal to 3½ per cent of GDP.

Budget measures contribute to an average reduction in the cyclically-adjusted current budget of over 0.8 per cent a year from 2010-11 to 2013-14. Based on cautious fiscal forecasting assumptions, borrowing declines to 5.5 in 2013-14, and as a result net debt stabilises at 79 per cent of GDP, including potential losses on financial sector interventions, compared with 36 per cent at the end of 2006-07, when the economy was last on trend.

The Budget 2009 fiscal projections are consistent with the temporary fiscal operating rule introduced in the 2008 Pre-Budget Report, entailing a return to cyclically-adjusted current balance and debt falling as a share of the economy by 2017-18, when the global shocks will have worked their way through the economy in full.

OVERVIEW OF RECENT ECONOMIC DEVELOPMENTS AND THE GLOBAL AND UK POLICY RESPONSE

The global economy and international policy response

Global economic shocks and world downturn

2.1 The world economy was hit by a succession of shocks during 2007 and 2008. Initially, credit conditions tightened across advanced economies. Then the rise in global commodity prices squeezed real incomes. Together, these factors pushed many advanced economies into recession. Finally, the intensification of the credit shock into a global financial crisis delivered a severe blow to an already weakened world economy, precipitating a steep and synchronised global downturn.

2.2 Adjustments triggered by the global financial crisis, and exacerbated by the downturn in global trade, are having profound effects on people and businesses across the UK, and around the world:

- as world trade has fallen, manufacturers around the world have been hit hard. In 54 out of 57 countries for which data are available, industrial output fell in the final three months of last year;
- as the private sector has retrenched, economies have contracted. In the US and euro area, GDP fell by 1.6 per cent in the final quarter of 2008, the same rate as in the UK; and
- as economies have contracted, and companies have struggled with cashflow, jobs have been lost, with the unemployment rate rising to 6 per cent on average across the G7 economies.

2.3 Contracting domestic demand in advanced economies is feeding directly through to emerging markets. Steep declines in exports, particularly in a number of Asian countries, highlight how closely aligned prospects in emerging and advanced economies have become in a world economy characterised by integrated global supply chains.

International policy response

2.4 Faced with these exceptional challenges, governments around the world have utilised all available policy levers to support their economies. Banking systems have been recapitalised and action taken to ensure that the presence of impaired assets on banks' balance sheets does not limit access to finance for creditworthy borrowers. To support demand, interest rates have been cut to historic lows, a number of central banks have introduced quantitative easing policies, and governments have adopted expansionary fiscal policies.

2.5 These are worldwide economic difficulties with international causes and consequences for every country, so global solutions are needed. The UK Government took a leading role in forging agreement on the appropriate policy response to these challenges at the London Summit, and will continue to do so through the G20 Presidency in 2009. Box 2.1 sets out the macroeconomic elements of *The global plan for recovery and reform* agreed at the London Summit.

Box 2.1: The global plan for recovery and reform

The Leaders of the Group of Twenty (G20) met at the London Summit in April 2009 and pledged to "*do whatever is necessary… to bring the world economy out of recession and prevent a crisis like the one currently affecting the global economy from recurring in the future*".[a] They reached agreement on a global plan for recovery and reform, including:

- to restore growth and jobs: a trebling of the resources available to the International Monetary Fund (IMF) to $750 billion, a new SDR[b] allocation of $250 billion and at least $100 billion of additional lending by the Multilateral Development Banks to ensure that capital continues to flow to emerging and developing countries, which have been the engine of recent world growth;
- to strengthen the international financial institutions (IFIs): reform of the mandates, scope and governance of the IFIs to strengthen their longer-term relevance, effectiveness and legitimacy. The G20 asked the Prime Minister, as Chairman in 2009, to consult and report back to the next meeting with proposals for further reforms to improve the responsiveness and adaptability of the IFIs;
- to promote global trade and investment: a commitment to reinvigorate world trade and investment, which has underpinned rising prosperity for half a century, to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions or implementing World Trade Organisation inconsistent measures to stimulate exports, and to ensure $250 billion of support for trade finance over the next two years; and
- to ensure a fair and sustainable recovery for all: using the additional resources from agreed IMF gold sales to provide $6 billion additional concessional and flexible finance for the poorest countries over the next 2 to 3 years.

This support builds on the unprecedented and concerted action being undertaken in G20 countries, including:

- fiscal expansion, which the IMF estimate will raise output by 4 per cent, supporting millions of jobs;
- expansionary monetary policies pursued by central banks, which have cut interest rates aggressively in most G20 countries; and
- comprehensive action taken to support the banking system, to provide liquidity, recapitalise institutions and address decisively the problem of impaired assets, implementing policies in line with the agreed G20 framework for restoring lending and repairing the financial sector.

Leaders stated their commitment to deliver the scale of sustained fiscal effort necessary to restore growth, while preserving long-term fiscal sustainability, and to take all necessary actions to restore the normal flow of credit through the financial system and to ensure the soundness of systemically important institutions. Central banks have pledged to maintain expansionary policies for as long as is needed and to use the full range of monetary policy instruments, including unconventional instruments, consistent with price stability. The G20 agreed to conduct all economic policies cooperatively and called on the IMF to assess regularly the actions taken and the actions required to restore growth.

[a] www.G20.org

[b] Special Drawing Rights. The SDR is the unit of account of the IMF. Its value is based on a basket of key international currencies. For information, see www.imf.org.

Global prospects

2.6 With a sharp recession taking place in the world's economies, global forecasts are subject to very significant uncertainties and risks. World GDP is forecast to fall by 1¼ per cent in 2009, marking the first year of contraction in the post-war period. Advanced economies are expected to contract most sharply, with G7 GDP forecast to fall by 4 per cent. Emerging economies are expected to continue growing, but at a greatly reduced pace, in part reflecting the sharp contraction in world trade. As the global policy response takes hold and credit conditions start to ease, the world economy is forecast to begin to recover towards the end of 2009, with growth picking up through 2010 and 2011. Further detail is provided in Chapter B.

Economic developments in the UK and the Government's policy response

Recent economic developments in the UK

2.7 UK GDP has fallen more sharply than forecast in the 2008 Pre-Budget Report, reflecting the cumulative impact of the succession of shocks that hit the global economy during 2007 and 2008. As credit conditions tightened and global commodity prices squeezed real incomes, growth slowed progressively, with the economy contracting by 0.7 per cent in the third quarter of 2008. In the final quarter of the year, the intensification of the global financial crisis caused a loss of confidence and a further reduction in the availability of credit that led to a sharp 1.6 per cent drop in GDP, in line with falls in activity across advanced economies. Overall, GDP growth slowed from 3 per cent in 2007 to ¾ per cent in 2008.

2.8 Consumer price inflation peaked at 5.2 per cent in September 2008. As commodity price pressures have reversed, inflation has eased in line with the Pre-Budget Report forecast. CPI inflation was 2.9 per cent in March, while RPI inflation was –0.4 per cent.

UK policy response

2.9 Reinforcing the international response, the Government is delivering a coherent and comprehensive package of support, focused on restoring the flow of credit, delivering broader support to the economy, providing targeted support to those most affected by the downturn and to prepare for recovery, and ensuring sustainability.

2.10 The Government has undertaken a series of interventions to support the economy, by focussing on addressing problems in the financial system. These interventions tackle problems at individual institutions, addressing system-wide instability, and getting credit flowing through the economy once more. These share the common purpose of protecting the customers of financial institutions – people and businesses – from the consequences of financial instability and restricted access to credit.

Restoring the flow of credit

2.11 With over £100 billion of funding guaranteed under the Credit Guarantee Scheme, £37 billion of capital injected into banks through the recapitalisation scheme, lending commitments amounting to around £40 billion, and agreement in principle for £585 billion of assets to be protected under the Asset Protection Scheme, the availability of credit to households and businesses should improve through 2009.

Government support for the economy

2.12 In addition to allowing the full operation of the automatic stabilisers, the Government is implementing a timely, targeted and temporary fiscal stimulus, and has authorised the use of a new instrument by the Bank of England to ensure the inflation target can be met. Together, these actions will support the economy during the downturn, helping to reduce the risk of a deeper or more prolonged recession.

Targeted support

2.13 The Government has introduced targeted measures to prepare for recovery and to provide additional support to those who need it most, including measures to provide temporary support through the downturn for employment, investment and mortgage holders.

2.14 Building on the extensive support already in the system, Budget 2009 focuses on further targeted support for employment and investment to ensure a sustained and sustainable recovery.

2.15 In total, significant macroeconomic policy support is in place in the UK, helping the economy, people and businesses: the Bank of England has cut Bank Rate to ½ per cent, a £75 billion programme of asset purchases is under way, and the Government is delivering fiscal support worth 4 per cent of GDP in 2009-10, through discretionary action announced in this Budget and the 2008 Pre-Budget Report and the automatic stabilisers, which the IMF has noted play an important role in supporting economic activity.

Ensuring sustainability

2.16 The Government has acted to protect fiscal sustainability by prioritising its actions carefully, to ensure that they will support recovery and future economic growth, and it remains committed to delivering a sustained fiscal consolidation over the medium term to ensure sound public finances, support orderly rebalancing and provide the platform for strong private-sector recovery.

2.17 Building on the consolidation announced in the 2008 Pre-Budget Report, the Budget sets out plans to deliver a sustained fiscal consolidation once the economy emerges from the downturn. The Budget includes tax and spending decisions that will reduce government borrowing by £26½ billion by 2013-14.

Prospects for the economy and public finances

UK growth prospects

2.18 The Budget 2009 economic forecast reflects the balance of key forecasting judgements relating to the negative effect of the global financial crisis and private sector retrenchment, and the positive effect of large-scale macroeconomic stimulus, both domestically and internationally, on growth. The forecast is underpinned by the assumption that G20 authorities deliver on policy commitments and that they are effective, so that the world economy is forecast to grow by 2½ per cent in 2010, picking up further to 4¼ per cent in 2011. The effects of lower commodity prices and the depreciation of sterling will also support demand.

2.19 In the near term, the negative effects of the steep downturn in global and domestic demand will dominate, with prospects for 2009 revised down substantially since the 2008 Pre-Budget Report. The forecast is based on the judgement that the effects of macroeconomic stimulus increasingly to take hold, driving recovery in demand and output in the UK and globally. The Budget 2009 economic forecast is for a contraction of 3½ per cent, worse than the 1 per cent contraction forecast in the Pre-Budget Report. GDP is forecast to contract sharply in the first half of 2009, to stabilise in the second half of the year, and to pick up progressively through 2010 and 2011 as credit conditions normalise and the effects of significant macroeconomic policy stimulus and the depreciation of sterling take hold.

2.20 The tightening of credit conditions facing households and companies, and the depreciation of sterling since mid-2007, provide the conditions for a rebalancing of demand in the UK economy. This macroeconomic adjustment is likely to entail increased saving by households, increased investment by companies as they respond to new opportunities, and a rebalancing of domestic and external demand.

UK inflation prospects

2.21 CPI inflation is forecast to continue to ease through 2009, moving well below target by the end of the year, and to remain below target during 2010, when the negative output gap is forecast to peak, though downward pressure on inflation is countered by monetary policy support further taking hold. CPI inflation is forecast to return to close to target during 2011 as the lagged effects of monetary policy easing are assumed to have their maximum impact.

2.22 As well as being subject to the same influences as CPI inflation, the RPI measure of inflation will be subject to additional downward pressures during 2009. Further declines in house prices and the lagged feed-through from Bank Rate to mortgage rates will put downward pressure on the measures of housing depreciation and mortgage interest payments included in the RPI. As a result, RPI inflation is forecast to fall further, to –3 per cent by September this year, but to move back above zero in 2010 as these additional downward pressures recede.

Table 2.1: Summary of UK forecast[1]

			Forecast		
	2007	2008	2009	2010	2011
GDP growth (per cent)					
Upper end of forecast range	–	–	–3¼	1½	3¾
Economic forecast	3	¾	–3½	1¼	3½
Forecasts underpinning public finance projections	–	–	–3¾	1	3¼
Inflation (per cent, Q4)					
CPI inflation	2	4	1	1	2¼
RPI inflation	4¼	2¾	–1¼	2½	4
GDP deflator	2½	2	¼	1¾	2¾

[1] *See footnote to Table B9 for explanation of forecast ranges.*

Risks and uncertainty

2.23 All economic forecasts remain subject to exceptional uncertainties across a broad range of factors, including the resolution of the global financial crisis and its impact on confidence and activity, and the implementation and effectiveness of the unprecedented global policy response to the economic downturn. A key uncertainty over near-term prospects in the UK and globally relates to the extent of inventory adjustment taking place in manufacturing and retail sectors, and the extent to which the sharp falls in production have been sufficient to offset the sharp drop in demand.

2.24 Prospects for recovery in advanced economies are closely linked to the delivery and effectiveness of global macroeconomic support. Monetary policy stimulus is largely in place already, but there are uncertainties over the effectiveness of historically low interest rates in encouraging spending when confidence has been severely affected by the global financial crisis. A significant proportion of planned fiscal support around the world is yet to be delivered. The Budget forecast is based on the assumption that it will be delivered as planned, so delays or reversals could represent a risk that the recovery will be weaker or later than forecast. As with monetary policy, there is uncertainty over the effectiveness of fiscal stimulus measures, relating to the degree to which they encourage private sector spending.

2.25 There is also considerable uncertainty over the effectiveness of macroeconomic support. The forecast for the UK is based on the judgement that the £75 billion programme of asset purchases will raise money GDP by approximately the same amount and bring inflation back up to target. It is possible that inflation could react sooner or by more than assumed, or that demand for and supply of credit remain weak, limiting the impact of asset purchases on nominal demand.

2.26 There is uncertainty over the degree to which households will further increase saving to rebuild their finances, and the speed with which any further adjustment will take place. This will be influenced by the degree of confidence they have about the future, especially jobs and repossessions. The Government has therefore targeted action at these areas. These uncertainties present risks to the consumer spending and residential investment forecasts. Businesses have reduced investment in the face of demand uncertainty so that, despite profits falling in the second half of the year, in aggregate the corporate sector continues to run a surplus. Investment is forecast to fall sharply in 2009, before recovering strongly. There are upside and downside risks to this forecast related to the availability of credit and restration of business confidence.

2.27 The forecast is presented within ½ percentage point ranges, based on alternative assumptions about supply-side performance of the economy, with the public finance projections based on the lower end of the range, where GDP is forecast to contract by 3¾ per cent in 2009 before recovering to 1 per cent in 2010 and 3¼ per cent in 2011.

Implications for the public finances

2.28 The deterioration in the world and UK economies since the 2008 Pre-Budget Report and the policy action required to address it will have a profound effect on the public finances. Failure to act would have meant far greater risks to the economy and public finances in the future. Moreover, the Government has acted to protect fiscal sustainability by prioritising its actions carefully to ensure that they will support recovery and future economic growth, which will in turn support sound public finances over the medium and long term. **Reflecting the principle of transparency, the fiscal forecasts include a provisional estimate for the high end of a range for the net impact of unrealised losses on financial sector interventions, equal to 3½ per cent of GDP.**

2.29 Table 2.2 below provides a summary of the public finance projections. It shows that public sector net borrowing (PSNB) has increased significantly to provide support for the economy through discretionary fiscal action and the full operation of the automatic stabilisers. From 2.4 per cent of GDP in 2007-08, PSNB increased to 6.3 per cent of GDP in 2008-09, cushioning the economy from the impact of a similarly large downward adjustment to private sector borrowing. PSNB is projected to peak at 12.4 per cent of GDP in 2009-10, as the economic downturn significantly reduces tax receipts for all the main taxes, and in particular from the financial and property sectors.

2.30 Building on the significant consolidation announced in the 2008 Pre-Budget Report, this Budget sets out tax and spending measures that reduce borrowing by £26½ billion by 2013-14. As a result of this action, the cyclically-adjusted current balance improves by, on average, over 0.8 per cent a year from 2010-11 to 2013-14. Based on cautious fiscal forecasting assumptions, PSNB is projected to decline to 5.5 per cent of GDP by 2013-14. Public sector net debt (PSND) increases over the forecast period, before stabilising at 79 per cent of GDP in 2013-14 including unrealised losses on financial sector interventions, compared with 36 per cent at the end of 2006-07 when the economy was last on trend.

2.31 On the assumption that the Government delivers a further consolidation of 0.8 per cent of GDP a year in the cyclically-adjusted current budget beyond 2013-14, the fiscal projections set out in this Budget are consistent with the Government's temporary fiscal operating rule, returning to cyclically-adjusted current balance and debt falling as a proportion of GDP by 2017-18 when the global shocks will have worked their way through the economy in full.

2.32 This forecast represents a cautious projection of the public finances. It is based on the lower end of the GDP forecast range, incorporates a cautious judgement for unrealised losses on financial sector interventions, and uses assumptions on oil prices and equity prices and

the VAT gap that are audited by the National Audit Office and that build increased caution into the public finance projections during a period of recession in particular.

Table 2.2: Summary of fiscal projections

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Public sector net borrowing (PSNB)	2.4	6.3	12.4	11.9	9.1	7.2	5.5
Total change since 2008 Pre-Budget Report	*-0.1*	*0.9*	*4.4*	*5.1*	*3.8*	*3.1*	*2.6*
Impact of discretionary measures on PSNB [1]	*0.0*	*0.0*	*0.5*	*0.0*	*-0.5*	*-1.1*	*-1.5*
Surplus on current budget	-0.4	-3.6	-9.3	-9.4	-7.2	-5.6	-4.3
Cyclically-adjusted surplus on current budget	-0.7	-3.1	-6.7	-6.4	-4.9	-3.9	-3.2
Public sector net investment	2.1	2.6	3.1	2.5	1.9	1.6	1.3
Public sector net debt[2]	36.5	43.0	55.4	65.0	70.9	74.5	76.2
Public sector net debt including unrealised losses [3]	36.5	46.5	59.0	68.4	74.0	77.5	79.0

Note: Figures on a National Accounts basis unless otherwise indicated.

[1] Including changes in forecasting assumptions on spending growth in 2011-12, 2012-13 and 2013-14.

[2] Debt at end March; GDP centred on end March; excluding liabilities and unrealised losses from financial sector interventions.

[3] Debt at end March; GDP centred on end March; including unrealised losses on financial sector interventions.

SUPPORT THROUGH THE DOWNTURN AND PROMOTING RECOVERY

2.33 Reinforcing the international response, the Government is delivering a coherent and comprehensive package of support, focused on restoring the flow of credit, delivering broader support to the economy, providing targeted support to those most affected by the downturn and to prepare for recovery, and ensuring sustainability.

2.34 In addition to direct fiscal support, many of the Government's wider policy interventions, particularly those to support the financial system, will impact on the fiscal position.

Restoring the flow of credit

2.35 The financial system plays a crucial role in all modern economies, affecting the lives of every individual and business. It is the core mechanism by which resources are allocated through the economy, channelling funds from savers to creditworthy borrowers, and thereby supporting productivity, growth and jobs.

2.36 The Government has carried out a series of interventions in the financial system, tackling problems at individual institutions, addressing system-wide instability, and getting credit flowing through the economy once more. These interventions, described in Chapter 3, share the common purpose of protecting the customers of financial institutions – people and businesses – from the consequences of financial instability and restricted access to credit. In particular, by:

- dealing with specific institutions such as Northern Rock and Bradford & Bingley, the Government ensured that problems at one institution did not spread through the banking system, that no retail depositor in UK banks lost money and that borrowers were not unduly disrupted;
- acting decisively as the global financial crisis raised system-wide risks in October 2008 to prevent the collapse of the banking system, and the massive costs that would have entailed for businesses and individuals, and by

comprehensively addressing the needs for liquidity, capital and funding, the Government ensured that the banking system was in a position to support the economy through the provision of credit to creditworthy borrowers; and

- acting to limit the risks attached to banks' existing assets, through the Asset Protection Scheme, and agreeing quantified and legally-binding lending commitments with banks accessing Government support, the Government has enabled around £40 billion of additional lending to individuals and businesses in each of 2009 and 2010.

2.37 This action is in line with the approach agreed by G20 Finance Ministers and Central Bank Governors in March 2009, when they agreed a framework for financial repair and recovery, committing to taking decisive action, where needed, and to use all available tools to restore the full functioning of financial markets, on which further information is provided in Chapter 3.

Asset Protection Scheme

2.38 The Asset Protection Scheme will, in particular, play a key role. Uncertainty around the value of banks' previous investments mean they have an incentive to hoard capital rather than lend to businesses and households. In such circumstances it becomes necessary for governments to bear some of the risk attached to banks' existing assets by providing a manageable maximum loss on these assets to restore confidence in the financial system, and ultimately to increase lending to individuals and businesses.

2.39 Under the Asset Protection Scheme, on which further details are provided in Chapter 3, the Government provides protection against future credit losses on certain assets in exchange for a fee. A 'first loss' (similar to the excess in insurance policies) remains with the institution. The government protection will cover 90 per cent of the credit losses exceeding this amount, with the participating institution retaining the residual exposure. The scheme has been designed to draw a line under problems arising from impaired assets, by putting a floor to banks' exposure to losses associated with these assets, while protecting taxpayers' interests. This scheme has significant implications for the public finances, increasing exposure to financial sector losses. Failure to act would have meant far greater risks to the economy and public finances in the future.

Impact of the interventions

2.40 The Government's interventions in the financial system have therefore protected the economy from the worst costs of financial instability or bank failures, provided the resources and certainty necessary for credit growth, and agreed commitments that will get credit flowing to creditworthy borrowers, so supporting economic recovery.

2.41 The Bank of England's latest *Credit Conditions Survey*, published on 2 April, and its new *Trends in Lending* report, drawing on data collected on behalf of the lending panel and described in Chapter 3, suggest a slight easing in the availability of credit to companies during the first quarter of 2009, and expectations of further easing in the second quarter.[1] The availability of credit to households had continued to tighten, although it was expected to ease in the coming months. The latest Bank of England data show that while effective interest rates paid by households and companies have not fallen by the same amount as Bank Rate has been cut, they have declined significantly.

2.42 It will take time for the effective functioning of the financial system to be fully restored. In the meantime, the Government has taken action to support creditworthy businesses and individuals, including measures to provide temporary support through the downturn for employment, vulnerable industries and mortgage holders, as set out in Chapters 4 and 5.

[1] www.bankofengland.co.uk

2.43 The Government will continue to do whatever it takes to maintain financial stability and to take steps to protect people and businesses from the adverse effects of problems in the financial system. Chapter 3 introduces the Government's view of how the regulatory framework for the financial sector needs to be enhanced. In addition, the Government will, before the summer, publish a document describing its approach to the future of financial markets and setting out the actions necessary to achieve it.

Monetary policy action

The monetary policy framework

2.44 Price stability is a precondition for high and stable levels of growth and employment. Monetary policy remains the key tool for the management of demand in the economy and therefore inflation. The monetary policy framework is based on four key principles:

- clear and precise objectives. The primary objective of monetary policy is to deliver price stability. The adoption of a single, symmetrical inflation target ensures that outcomes below target are treated as seriously as those above, so that monetary policy also supports the Government's objective of high and stable levels of growth and employment;
- full operational independence for the Monetary Policy Committee (MPC). **The Government reaffirms in Budget 2009 the target of 2 per cent for the 12-month increase in the Consumer Prices Index (CPI)**, which applies at all times;
- openness, transparency and accountability. These are enhanced though publication of MPC members' voting records, minutes of MPC meetings and quarterly Inflation Reports; and
- credibility and flexibility to allow the MPC to decide how to react to events, within the constraints of the inflation target and the open letter system. If inflation deviates by more than one percentage point above or below target, the Governor of the Bank of England must explain in an open letter to the Chancellor the reasons for the deviation, the action the MPC proposes to take, the expected duration of the deviation and how the proposed action meets the remit of the MPC.

Creation of a new monetary policy instrument

2.45 Since the onset of the financial crisis, as economies have slowed sharply and commodity prices fallen, central banks around the world have cut policy rates to historically low levels to tackle the emerging risk of deflation.

2.46 On 19 January 2009, with Bank Rate at a very low level, the Government established the Asset Purchase Facility (APF), as a further step to help increase the availability of corporate credit and to provide a framework for the MPC to use asset purchases for monetary policy purposes.

Action taken by the Monetary Policy Committee

2.47 Since the 2008 Pre-Budget Report, the Governor of the Bank of England has written two open letters to the Chancellor, in December and March, as inflation remained more than 1 percentage point above target. However, the outlook for inflation in the medium term is now judged by the MPC to be weighed to the downside. In the February Inflation Report, the Bank of England's central projection was for CPI inflation to fall significantly below the 2 per cent target over the forecast period.[2]

2.48 The Monetary Policy Committee has therefore taken further action to loosen monetary policy. Bank Rate has been cut by a further 2½ percentage points since November, to ½ per

[2] All open letters are available at www.hm-treasury.gov.uk

cent. At its February meeting, the MPC judged that "*it seemed unlikely that the inflation target could be met solely by cutting Bank Rate*"[3] and voted unanimously that the Governor write to the Chancellor to request the use of the APF for monetary policy purposes. Box 2.2 provides further information on the Asset Purchase Facility and its role in the policy of quantitative easing. **The Government confirms that the Asset Purchase Facility will remain in place in financial year 2009-10, and that the Monetary Policy Committee will be able to use the APF for monetary policy purposes**, as set out in the Chancellor's letter to the Governor of 3 March 2009.[4]

Box 2.2: The Asset Purchase Facility

The Bank of England uses monetary policy to ensure it meets the inflation target. Normally, it does so by varying its target for the overnight interest rate, Bank Rate. When the financial system is functioning well, changes in Bank Rate are passed through the financial system, influencing interest rates faced by households and companies.

On 19 January 2009, the Government established the Asset Purchase Facility (APF) to enable the Bank of England to ease improved levels of liquidity in financial markets by making purchases of private sector assets.[a] Initially, these interventions were financed by Treasury bills, but on 3 March, with Bank Rate close to zero, the Chancellor agreed to the request from the MPC that purchases could be financed through the issuance of central bank reserves. This means that the MPC can use the APF for monetary policy purposes.

Using the APF, the MPC is able to ease policy further by injecting money into the economy. It does so through the purchase of securities issued by the private sector or the Government with central bank money. That raises the money holdings of the private sector. As investors buy other assets with those money holdings, that lowers the yield of those assets, and reduces the cost of finance. Over time, a lower cost of finance should encourage firms to raise capital to pursue profitable opportunities. In turn, this process should stimulate demand in the economy, ensuring that the inflation target can be met.

The introduction of the APF as a monetary policy tool is consistent with the principles of full operational independence, openness, transparency and accountability. A published exchange of letters on 29 January 2009 established the APF and the operational framework for asset purchases, while in a subsequent exchange of letters on 3 March the Chancellor authorised up to £150 billion of purchases, of which up to £50 billion should be used to purchase private sector assets, in recognition of the importance of supporting the flow of corporate credit. In his letter, the Chancellor highlighted that the objectives of the monetary policy framework remained unchanged; the MPC should continue to maintain price stability and, subject to that, to support the Government's economic policy, in particular its objectives for growth and employment.

At its March meeting, the MPC decided to initiate the purchase of £75 billion of assets using central bank reserves. As of 16 April 2009, the Bank of England had purchased £2.4 billion of commercial paper, £0.5 billion of corporate bonds and £31.5 billion of gilts. These asset purchases have been predominantly financed by the issuance of central bank reserves. The Bank of England is considering how it might extend the APF to purchase a wider range of private sector assets, consistent with the objectives of the facility.

[a] The assets authorised for purchase are: paper issued under the Credit Guarantee Scheme (CGS), corporate bonds, commercial paper, syndicated loans, asset-backed securities created in viable securitisation structures, and Government debt for sale on the secondary market.

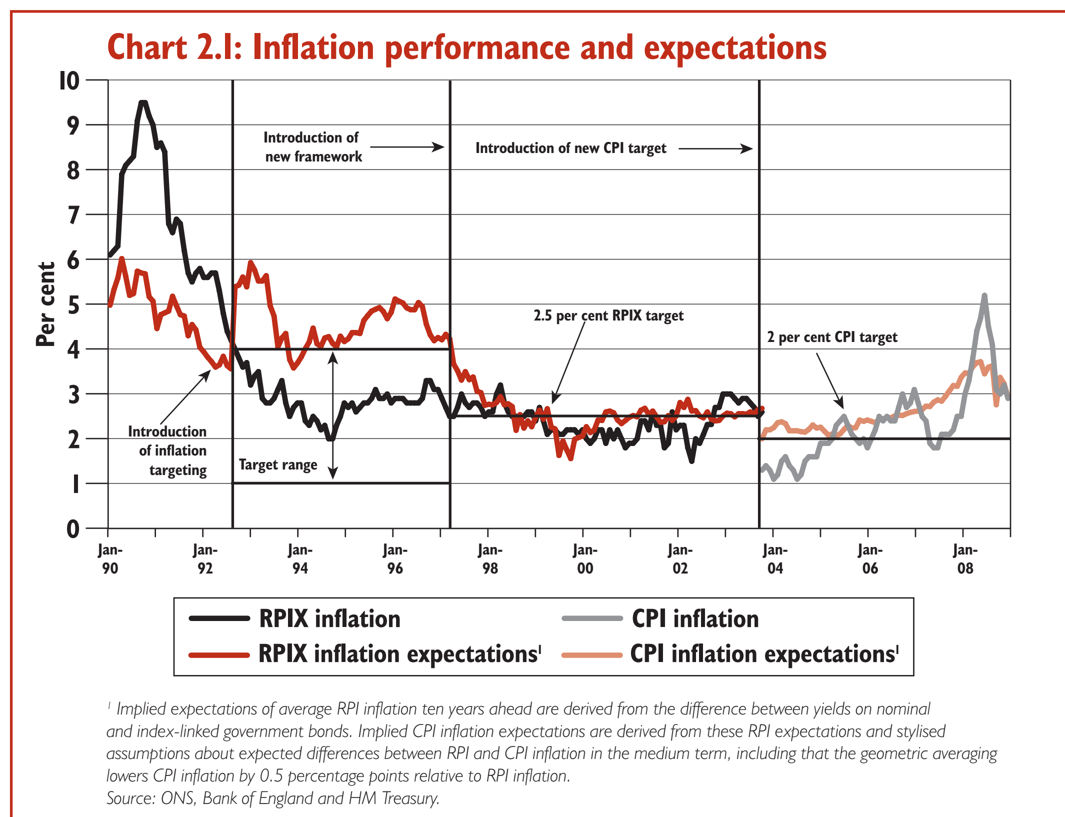
[3] www.bankofengland.co.uk
[4] www.hm-treasury.gov.uk

The impact of these actions

2.49 Initial evidence suggests that conditions for higher-grade corporate credits may have eased a little, although the extent to which this reflects the operation of the Asset Purchase Facility is unclear. Most notably, £15 billion of sterling-denominated non-financial corporate bonds were issued in the first quarter of this year, almost double the previous quarterly record. That said, there were also record levels of issuance in euro-denominated and dollar-denominated debt. Yields on 10-year gilts have declined by around 45 basis points since the end of January, with a sharp decline following the MPC's announcement in March. Furthermore, the difference between yields on 10-year gilts and German government bonds as fallen by around 40 basis points following the MPC's announcement. Yields on corporate bonds have declined by around 70 basis points since the end of January and there is evidence of commercial paper issuers being able to raise funds at a lower cost. However, movements in corporate sector and government bond yields reflect a variety of factors, making it difficult to isolate and measure the impact of the Bank of England's purchases.

2.50 Inflation expectations appear to have remained anchored, testament to the credibility that the monetary policy framework has built since 1997. As inflation has fallen from its recent peak, survey measures of inflation expectations have also moderated, but remain anchored. CPI inflation has moved within a range of 2.3 percentage points over the past year. However, the YouGov/Citigroup survey measure of household expectations for five to ten years ahead has moved within a narrow range of 1.1 percentage points over the same period. Financial market-derived measures of inflation expectations can be affected by other market developments, and have been more difficult to interpret given financial market volatility. However, these measures do not appear to point to a de-anchoring of expectations from the inflation target, and have moderated from recent peaks.

Chart 2.1: Inflation performance and expectations



[1] *Implied expectations of average RPI inflation ten years ahead are derived from the difference between yields on nominal and index-linked government bonds. Implied CPI inflation expectations are derived from these RPI expectations and stylised assumptions about expected differences between RPI and CPI inflation in the medium term, including that the geometric averaging lowers CPI inflation by 0.5 percentage points relative to RPI inflation.*
Source: ONS, Bank of England and HM Treasury.

Forward-looking approach

2.51 At the G20 meeting of Finance Ministers and Central Bank Governors on 14 March, it was agreed that "*G20 central banks will maintain expansionary policies as long as needed, using the full range of monetary policy instruments, including unconventional policy instruments, consistent with price stability.*" The Government will continue to support the Bank of England in the forward-looking decisions it takes to meet the inflation target.

Setting fiscal policy to support the economy and to ensure sustainability

2.52 The actions that the Government has taken since the onset of the crisis have been consistent with its fiscal policy objectives:

- over the medium term, to ensure sound public finances and that spending and taxation impact fairly within and between generations; and
- over the short term, to support monetary policy and, in particular, to allow the automatic stabilisers to help smooth the path of the economy.

2.53 In addition to direct fiscal support, many of the Government's wider policy interventions, particularly those to support the financial system, will impact on the fiscal position. The Government is committed to transparency and responsibility in its approach to fiscal policy, consistent with the *Code for fiscal stability*. Box 2.3 sets out the fiscal implications of measures to ensure financial stability and the approach that the Government has taken to the treatment of unrealised losses on its financial sector interventions within the fiscal projections.

Box 2.3: Fiscal implications of measures to ensure financial stability

The Government has made a series of interventions to ensure the stability of the financial system and restore the flow of credit, which is crucial to economic recovery. The long-term impact of these interventions on the sustainability of public finances will be determined not by the face value of the liabilities that the Government has incurred as a result but by any eventual profit or loss that accrues on them, taking account of fees received and the value of investments when they are sold.

Setting out estimates of these losses is inherently difficult in current market conditions. However, in setting plans to meet the Government's fiscal objectives in future it is prudent to make allowance for the potential for losses on these financial sector interventions. As set out in the *Code for fiscal stability*, the Government is committed to reporting as transparently as possible on the fiscal position to enhance public scrutiny of fiscal policy-making. Moreover, given the significant risks the public sector faces on these interventions, responsible management of the public finances requires planning on a cautious assumption of the range of potential outcomes.

The Government provisionally estimates that losses may lie within a potential range from £20 billion to £50 billion (1½ to 3½ per cent of GDP). The actual figure could be either larger or smaller than this range. The estimate is set out as a range because of the inherent uncertainty over potential outcomes from these interventions. In reaching an estimate of the scale of potential net losses, the Government's judgement has been informed by potential income from fees (for example, on the Special Liquidity Scheme and Credit Guarantee Scheme) and investments, data from stress-testing and due diligence exercises undertaken by the Treasury, Financial Services Authority (FSA) and the Bank of England in relation to the various schemes and our assessment of economic conditions. Publishing a range acknowledges the significant degree of uncertainty that remains about the performance of bank assets.

This provisional estimate is a cautious judgement, made for fiscal policy purposes. It is not an estimate of scheme-by-scheme losses over time, as it is impossible to set out accurate overall costs for certain at this point. Part of the problems currently faced by financial markets is uncertainty over the future value of assets, which makes valuing costs and benefits very challenging. Moreover, overall outcomes will depend on prospects for the economy, over which there is significant uncertainty.

The Budget sets out both its baseline fiscal projections, excluding liabilities and unrealised losses from financial sector interventions, and projections for borrowing and debt that include the high end of this range for the net impact of unrealised losses, equal to 3½ per cent of GDP. The Government will continue to develop estimates of losses as schemes are finalised, and as market conditions normalise. It will update its estimates of unrealised losses in subsequent Budgets and Pre-Budget Reports as new and better information becomes available. Box 2.7 sets out the Government's approach to making provision for losses on financial sector interventions in the fiscal forecast.

2.54 The Government has acted to protect fiscal sustainability by prioritising its actions carefully, to ensure that they will support recovery and future economic growth, and it remains committed to delivering a sustained fiscal consolidation over the medium term to ensure sound public finances.

2.55 The IMF has noted that the UK entered the crisis "*with greater space for supportive fiscal policy*" than some countries.[5] A starting point of low public debt and the action that the Government is taking to protect fiscal sustainability, by providing short-term support on a temporary basis and setting clear plans for consolidation over the medium term, mean borrowing and debt can be allowed some flexibility to rise in the short term to support the economy through the recession and enhance longer-term growth prospects.

2.56 Therefore, to promote economic recovery while protecting fiscal sustainability, Budget 2009:

- announces further targeted and cost-effective fiscal measures, to help those most affected by the downturn and support sustainable growth and employment, with a temporary cost, rather than a permanent impact on government borrowing; and
- sets out plans to deliver a sustained fiscal consolidation once the economy emerges from the downturn, including a combination of adjustments to tax and spending.

Fiscal policy framework

2.57 To underpin its commitment to sustained fiscal consolidation, the Government set a temporary fiscal operating rule in the 2008 Pre-Budget Report: to set policies to improve the cyclically-adjusted current budget each year, once the economy emerges from the downturn, so it reaches balance and debt is falling as a proportion of GDP once the global shocks have worked their way through the economy in full.

2.58 As there is considerable uncertainty over the path of the economy and the public finances in the short term, and over the persistence of the economic shocks, setting a rule focused on steady improvement in the public finances allows the Government flexibility to adjust to unanticipated developments in the economy, while constraining fiscal policy to deliver sound public finances over the medium term.

International fiscal policy

2.59 There is widespread international agreement on the need for governments to provide fiscal support in the short term, while ensuring the sustainability of fiscal positions over the medium term. The IMF recently noted: "*Macroeconomic policy stimulus will be critical to support demand while financial issues are addressed and to avoid a deep and prolonged recession… fiscal policy must play a central role in supporting demand, while remaining consistent with medium-term sustainability.*"[6] Box 2.4 summarises international agreements and actions on fiscal policy.

[5] *The case for global fiscal stimulus*, International Monetary Fund, March 2009.
[6] *Note to the Group of Twenty Deputies*, International Monetary Fund, February 2009.

Box 2.4: International fiscal policy

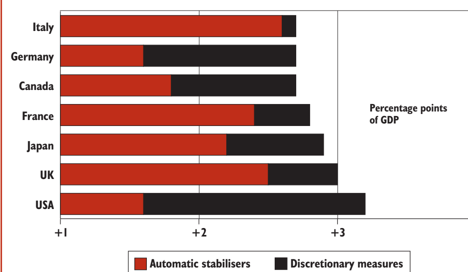
This is a global crisis and it requires a global response, including on fiscal policy. The European Council endorsed a European Economic Recovery Plan in December 2008[a] that called for a concerted fiscal stimulus equivalent to 1.5 per cent of EU GDP. In April 2009, the Leaders of the G20 also recognised the importance of concerted fiscal action and reasserted their commitment to "*deliver the scale of sustained fiscal effort necessary to restore growth*". Both the European Council and Leaders of the G20 have also stressed the importance of taking action to reduce borrowing and ensure the sustainability of fiscal positions, in a timeframe consistent with recovery.

In line with measures being taken internationally, in the UK the Government is delivering fiscal support worth 4 per cent of GDP in 2009-10, through the fiscal stimulus package announced in the 2008 Pre-Budget Report, further targeted support announced in this Budget and by allowing the automatic stabilisers to operate in full to support the economy.

As the IMF has noted, differences in the sizes of automatic stabilisers across countries means that "*in order to compare across countries the role fiscal policy is playing in supporting economic activity, it is better to focus not just on its discretionary component*".[b] Chart a shows IMF estimates, produced for the G20, of the average annual effect of discretionary measures and the automatic stabilisers on the fiscal balance of G7 countries over the period 2008 to 2010. It shows that total support being delivered to the UK economy through the automatic stabilisers and discretionary action is in line with the G7 average.

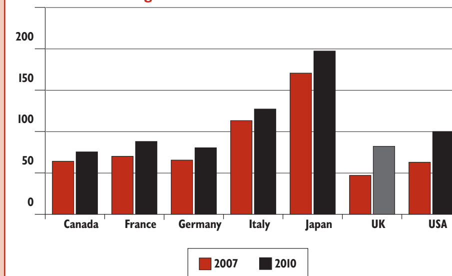
The IMF has observed that the on-going financial crisis has had a major impact on the fiscal balances and debt levels of most countries, and the UK is no exception, as shown by Chart b. This is not just the result of discretionary measures and the operation of the automatic stabilisers, but also from the need for governments to support the financial system and from lower revenues due to falls in asset and commodity prices.

Chart a: G7 average annual effect of discretionary measures and automatic stabilisers 2008-2010



Source: International Monetary Fund.

Chart b: OECD gross debt



Source: 2007 figures from OECD Economic Outlook 84, November 2008. 2010 forecasts from OECD Economic Outlook: Interim Report, 31 March 2009, except for the UK which is the Budget 2009 forecast for Treaty debt (general government gross debt on a Maastricht basis).

[a] www.consilium.europa.eu

[b] *Group of Twenty: global economic policies and prospects*, International Monetary Fund, March 2009

Delivering fiscal support

2.60 In addition to allowing the UK's relatively powerful automatic stabilisers to operate in full, the 2008 Pre-Budget Report announced a timely, targeted and temporary fiscal stimulus package worth around 1 per cent of GDP in 2009-10, including a temporary reduction in the rate of VAT to 15 per cent and bringing forward £3 billion of capital spending. Box 2.5 provides information on the implementation of this stimulus package.

Box 2.5 Implementation of the 2008 Pre-Budget Report fiscal stimulus package

A temporary reduction in the rate of VAT was chosen as the main lever for the fiscal stimulus as it could be implemented very quickly, coming into effect only one week after the announcement of the measure in the 2008 Pre-Budget Report, and, being temporary, could be expected to have a relatively powerful effect on demand by encouraging consumers to bring spending forward. Indeed, the Institute for Fiscal Studies has estimated that the VAT cut has a similar effect on the relative price of current consumption as a 1 per cent cut in interest rates, arguing, "this policy change is likely to be a reasonably effictive economic stimlant.".[a]

It is too early to make a full evaluation of the impact of the VAT reduction. But there have been some positive early signs of the reduced VAT rate having been passed through into lower prices, providing support to consumer spending. According to the Bank of England's February 2009 Inflation Report: "*prospects for consumer spending in the near term have been boosted by the temporary reduction in VAT*". This view is supported by stronger retail sales growth in December, January and February than many commentators had predicted, and significantly stronger than the equivalent point in the recession of the early 1990s. The VAT reduction will, in particular, provide support towards the end of the year when its imminent reversal should provide an incentive for consumers to bring forward spending.

In 2008-09, investment in energy efficiency, the social housing stock, and in further and higher education was brought forward to prepare the economy for a high-tech, low-carbon future. In 2009-10, spending that has been brought forward will help improve transport infrastructure, science research facilities, school buildings and primary healthcare facilities. New arrangements have been put in place to ensure that the additional spending advanced as part of the fiscal stimulus package is delivered in a timely manner. In addition, in March 2009, the Government announced a public sector infrastructure debt-financing unit to provide temporary support for PFI projects, ensuring that vital projects in areas such as schools, waste and housing can proceed as planned. Further details are set out in Chapter 6.

[a] IFS Green Budget, January 2009

Further action to support economy

2.61 This Budget announces further targeted support for those most affected by the downturn and to ensure a sustained and sustainable recovery:

- further support for businesses facing cash flow problems, consistent with rebalancing the economy by encouraging investment, and support for key growth industries of the future, set out in Chapter 4;
- further support for households hit hardest by the recession, including savers and pensioners, and additional measures to support employment, set out in Chapter 5;
- further investment in infrastructure and the housing sector, set out in Chapter 6;
- measures to support a move to a low carbon economy, set out in Chapter 7.

2.62 At a time of falling energy and mortgage costs, many households – in particular pensioners and families with children – are also benefiting from significant cash increases in tax credit and benefit rates. In January this year Child Benefit was increased by 6.4 per cent to £20 a week for the first child, and in April the child element of Child Tax Credit was increased by 7.2 per cent, the basic State Pension by 5 per cent, and Jobseeker's Allowance by 6.3 per cent. Furthermore, the Government will at least maintain the cash value of all benefits, tax credits and personal tax allowances and thresholds in April 2010, despite the expectation RPI inflation will be negative in September this year. This means that their real terms value will rise compared with standard indexation policy, increasing the impact of the automatic stabilisers and delivering a real boost to the purchasing power of many households.

Ensuring sustainability

2.63 The Government is committed to ensuring sound public finances and protecting fiscal sustainability. Sound public finances are essential for macroeconomic stability, which gives businesses and individuals the confidence to plan and invest for the long term. They also help to deliver low long-term interest rates, supporting businesses' access to new financing and resources for growth. At the London Summit G20 Leaders resolved to ensure long-term fiscal sustainability and price stability, and to put in place credible exit strategies from the measures that need to be taken now to support the financial sector and restore global demand.

2.64 During a period when demand is very weak and the operation of financial markets and monetary policy are impaired, it is appropriate for the Government to allow borrowing to rise to support the economy. But, in time, the demand for and supply of private sector credit will recover and the efficacy of monetary policy will be restored, enabling businesses to generate renewed economic growth and reducing the role for fiscal policy in stabilising the economy. Setting a credible plan to reduce borrowing over the medium term provides space for the Government to act flexibly in the short term to support the economy, while also promoting confidence in future growth and the private sector investment that will drive economic recovery.

2.65 Building on the significant consolidation announced in the 2008 Pre-Budget Report, this Budget sets out tax and spending measures, implemented at a time when the economy is forecast to be recovering and able to support fiscal consolidation, which reduce borrowing by £26½ billion by 2013-14. The plans presented here will deliver an average adjustment of over 0.8 per cent a year in the cyclically-adjusted current budget between 2010-11 and 2013-14.

Pace of consolidation

2.66 The Government has taken a judgement on the appropriate pace of consolidation of the public finances. This judgement recognises the uncertainty around prospects for the public finances given the exceptional nature and strength of the synchronised global downturn, the need to support the economy through the early stages of the recovery, and the need to deliver sustainable public finances.

2.67 On the assumption that the Government delivers a further consolidation of 0.8 a per cent of GDP a year in the cyclically-adjusted current budget beyond 2013-14, the fiscal projections set out in this Budget are consistent with the Government's temporary fiscal operating rule, returning to cyclically-adjusted current balance and debt falling as a proportion of GDP by 2017-18 when the global shocks will have worked their way through the economy in full. Box 2.6 sets out the Government's approach to ensuring the sustainability of the public finances.

Box 2.6: Ensuring sustainability of the public finances

Since 1997 the Government's medium term objective for fiscal policy has been to ensure sound public finances and that spending and taxation impact fairly within and between generations. Responsible management of the public finances is enshrined in the *Code for fiscal stability*, requiring the Government to ensure that "*the fiscal position is sustainable over the long term*."

There is no single measure of fiscal sustainability, with policy-makers and economists using a variety of measures to capture different aspects of this concept. One approach is to focus on the conditions required to stabilise public debt. Holding debt to a stable and prudent level in normal times allows space for debt to rise to absorb shocks when they come, while minimising risks to sustainability. However, there are many other factors that also contribute to delivering sustainable public finances. As set out in the OECD Journal on Budgeting in 2005, "*contemporary sustainability analysis focuses on fiscal conditions that may retard economic growth, cause tax burdens to rise, or transfer significant costs to future taxpayers*".[a] This implies that:

- governments should manage their public finances so as to support economic growth, as this ensures a robust economy and improvements in living standards. This is important to provide future revenues to finance public services and spending, thereby ensuring that future obligations can be met;
- governments should seek to deliver sustainability in the tax burden, to ensure that they can continue to meet their obligations in the future. This allows individuals and companies to plan ahead and make the appropriate investment decisions, supporting high and stable levels of long-term economic growth; and
- fairness between and within generations is important to support improvements in the standard of living for both current and future generations.

Reflecting the Government's commitment to ensuring sustainable public finances over the medium term, the temporary fiscal operating rule introduced in the 2008 Pre-Budget Report is designed to underpin a sustained fiscal consolidation once the economy is recovering. In particular, it requires debt to be falling as a proportion of GDP once the global shocks have worked their way through the economy in full, in order to prepare for future shocks and other long-term challenges.

[a] www.oecd.org

Tax measures

2.68 As set out in more detail in Chapter 5, the Government will make a number of reforms to support consolidation and reinforce the fairness of the tax system:

- **the income tax personal allowance will be restricted for those with incomes of over £100,000 from April 2010;**
- **an additional rate of income tax of 50 per cent will apply to income over £150,000 from April 2010; and**
- **tax relief on pensions contributions will be restricted for those with incomes of £150,000 and over from April 2011, and tapered down until it is 20 per cent.**

2.69 As set out in Chapter 7, to further support consolidation and to support the move towards a low-carbon and resource efficient economy, **the Government will increase fuel duty by 2 pence per litre on 1 September 2009 and by 1 penny per litre in real terms each year from 2010 to 2013.**

Public spending

2.70 Over the past ten years, public investment and reform of public service delivery have together generated real improvements in the quality of public services. Consistent with its fiscal objectives and the temporary fiscal operating rule, the Government is determined to continue delivering investment and improvements in public services, while ensuring sustainable public finances over the medium term.

2.71 Building on the successful delivery of the £5 billion of additional value for money savings in 2010-11, set out in Chapter 6, Budget 2009 announces a further step change in the Government's efficiency drive from 2011-12 onwards, including that:

- in the next Spending Review, the Operational Efficiency Programme (OEP) has identified scope for greater efficiencies across procurement, back office and IT, and property running costs in 2011-12 and beyond, rising to £9 billion of additional savings by 2013-14;
- the Public Value Programme will be expanded to ensure demanding Value for Money reviews are conducted right across departmental budgets. The expanded Programme will cover a minimum of 50 per cent of each Department's budget, with a particular focus on areas of spend that impact across departmental boundaries;
- building on the findings of the OEP, the Government will put in place new incentives and mechanisms with the aim of realising up to £16 billion of property and other asset sales in the three years from 2011-12, freeing up additional resources on top of capital budgets to fund investment priorities; and
- that the same rigour must also apply to the management of public spending, such as social security and tax credits, that is outside departmental budgets. So building on the reforms set out in the Welfare Reform White Paper in December 2008,[7] the Government will do more to ensure the working age benefits system is fair, affordable over the long term, and encourages people away from dependency and into work.

2.72 Building on all these reforms, Budget 2009 sets new assumptions for spending growth from 2011-12 onwards, which will ensure continued investment and improvements in front-line public service priorities, while ensuring sustainable public finances in the medium term:

- **current spending will grow by an average of 0.7 per cent a year between 2011-12 and 2013-14 in real terms; and**
- **public sector net investment will move to 1¼ per cent of GDP by 2013-14.**

2.73 By releasing additional efficiency savings through the Operational Efficiency Programme and expanded Public Value Programme, the Government will be able to continue to invest in and improve public services in the years ahead.

[7] *Raising expectations and increasing support: reforming welfare for the future*, Department for Work and Pensions, December 2008

THE FISCAL OUTLOOK

Overview of the fiscal outlook

2.74 Table 2.3 compares the projections for net borrowing, the current balance, net investment and net debt with those published at Budget 2008 and the 2008 Pre-Budget Report. It shows that the global economic shocks and resulting downturn in the UK have had a profound effect on the public finances.

Table 2.3: Fiscal balances compared with Budget 2008 and the 2008 Pre-Budget Report

	Outturn[1]	Estimate[2]	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Net borrowing (£ billion)							
Budget 2008	**36.4**	**42.5**	**38**	**32**	**27**	**23**	
Changes to current budget	-1.2	31.6	74	77	65	56	
Changes to net investment	1.4	3.5	5 ½	-4	-5 ½	-8	
2008 Pre-Budget Report	**36.6**	**77.6**	**118**	**105**	**87**	**70**	**54**
Changes to current budget	-1.4	11.1	53 ½	64 ½	57	54	53 ½
Changes to net investment	-0.6	1.2	3 ½	3 ½	-3 ½	-6 ½	-10 ½
Budget 2009	**34.6**	**90.0**	**175**	**173**	**140**	**118**	**97**
Surplus on current budget (£ billion)							
Budget 2008	**-7.9**	**-9.6**	**-4**	**4**	**11**	**18**	
Effect of revisions and forecasting changes	1.2	-23.3	-61	-78	-75	-72	
Effect of discretionary changes[3]	0.0	-8.3	-13	1	10	16	
2008 Pre-Budget Report	**-6.7**	**-41.2**	**-78**	**-73**	**-54**	**-37**	**-21**
Effect of revisions and forecasting changes	1.3	-11.1	-48	-64 ½	-63 ½	-66 ½	-71
Effect of discretionary changes[3]	0.0	0.0	-5 ½	½	7	12 ½	17 ½
Budget 2009	**-5.3**	**-52.3**	**-132**	**-137**	**-111**	**-91**	**-74**
Net investment (£ billion)							
Budget 2008	**28.5**	**32.9**	**35**	**37**	**38**	**41**	
Effect of revisions and forecasting changes	1.4	2.5	2 ½	- ½	-2	-1 ½	
Effect of discretionary changes[3]	0.0	1.0	3 ½	-3 ½	-4	-6 ½	
2008 Pre-Budget Report	**29.9**	**36.5**	**40**	**33**	**33**	**33**	**33**
Effect of revisions and forecasting changes	-0.6	1.2	1 ½	2 ½	-2	-1 ½	-1 ½
Effect of discretionary changes[3]	0.0	0.0	1 ½	1	-1 ½	-5	-9
Budget 2009	**29.3**	**37.7**	**44**	**36**	**29**	**26**	**22**
Cyclically-adjusted surplus on current budget (per cent of GDP)							
Budget 2008	-0.7	-0.5	0.1	0.5	0.8	1.0	
2008 Pre-Budget Report	-0.8	-2.8	-4.4	-3.4	-2.3	-1.6	-1.0
Budget 2009	**-0.7**	**-3.1**	**-6.7**	**-6.4**	**-4.9**	**-3.9**	**-3.2**
Cyclically-adjusted net borrowing (per cent of GDP)							
Budget 2008	2.7	2.7	2.2	1.8	1.5	1.2	
2008 Pre-Budget Report	2.9	5.3	7.2	5.6	4.3	3.5	2.8
Budget 2009	**2.7**	**5.7**	**9.8**	**8.9**	**6.8**	**5.5**	**4.5**
Net debt (per cent of GDP)[4]							
Budget 2008	37.1	38.5	39.4	39.8	39.7	39.3	
2008 Pre-Budget Report	36.3	41.2	48.2	52.9	55.6	57.1	57.4
Budget 2009	**36.5**	**43.0**	**55.4**	**65.0**	**70.9**	**74.5**	**76.2**

Note: Figures on a National Accounts basis unless otherwise indicated.

Note: Totals may not sum due to rounding.

[1] *The 2007-08 figures were estimates in Budget 2008.*

[2] *The 2008-09 figures were projections in Budget 2008.*

[3] *Including changes to forecasting assumptions on spending growth in 2011-12, 2012-13 and 2013-14.*

[4] *Debt at end March; GDP centred on end March; excluding liabilities and unrealised losses from financial sector interventions.*

2.75 At the time of the 2008 Pre-Budget Report, the financial crisis was still at a relatively early stage. The Pre-Budget Report forecast that its impact on the public finances would be focused on the financial and housing sectors, projecting a significant deterioration in the structural position of the public finances as a result of lower receipts from those sectors, which previously were important sources of tax revenues, in addition to the cyclical impact from lower expected economic growth.

2.76 Since the 2008 Pre-Budget Report, the crisis has broadened out globally and in the UK to affect the whole of the economy, world trade has dropped and UK GDP has fallen more sharply than forecast in the 2008 Pre-Budget Report. The Budget 2009 public finance projections therefore incorporate a cyclical fall in receipts for all the main taxes and an increase in spending, as the Government allows the automatic stabilisers to operate in full. Large falls in VAT, income tax and onshore corporation tax have been experienced in 2008-09, and with overall nominal activity lower than in the 2008 Pre-Budget Report, these taxes remain significantly lower throughout the forecast. The fall in receipts is especially large because of the downwards revision to forecast inflation, compared with the 2008 Pre-Budget Report. In addition, the financial and housing sectors have weakened even further than expected in the 2008 Pre-Budget Report.

2.77 As a result, in the Budget 2009 projections, PSNB is projected to peak at 12.4 per cent of GDP in 2009-10, before declining to 5.5 per cent in 2013-14, as the economy recovers and the Government takes action to ensure the sustainability of the public finances through the discretionary tightening set out earlier in this chapter.

2.78 Table 2.4 shows that the automatic stabilisers account for a significant proportion of the increase in PSNB relative to the 2008 Pre-Budget Report projections throughout the forecast period. This reflects the deeper than expected downturn, which results in a larger than expected negative output gap throughout the forecast period. The table also shows that the discretionary fiscal tightening announced in this Budget reduces borrowing by £26½ billion by 2013-14.

2.79 PSNB in 2013-14 remains higher than forecast in the 2008 Pre-Budget Report because, the overall growth path of nominal activity across the forecast period is lower than forecast at the time of the 2008 Pre-Budget Report. In addition, the projected rebalancing of the economy will result in less tax-rich growth, with receipts from the financial sector in 2013-14 expected, in particular, to be lower than forecast in the Pre-Budget Report. Table 2.6 provides a full summary of the public sector finance projections.

Table 2.4: Public sector net borrowing compared with the 2008 Pre-Budget Report

	£ billion						
	Outturn	Estimate	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
2008 Pre-Budget Report	**36.6**	**77.6**	**118**	**105**	**87**	**70**	**54**
Changes since the 2008 Pre-Budget Report							
Automatic stabilisers[1]	-2.4	5.0	32	44	35	30 ½	28
Other tax and expenditure changes	0.5	7.3	17 ½	23	26 ½	34	41
Total before discretionary measures	**34.6**	**90.0**	**168**	**173**	**149**	**135**	**123**
Discretionary measures	0.0	0.0	7 ½	½	-8 ½	-17 ½	-26 ½
Budget 2009	**34.6**	**90.0**	**175**	**173**	**140**	**118**	**97**

Note: Figures on a National Accounts basis unless otherwise indicated.

[1] The cyclical component of PSNB, i.e. the difference between PSNB and cyclically-adjusted PSNB.

Making provision for financial sector losses

2.80 As explained in Box 2.3, the Budget sets out both its baseline fiscal projections, excluding liabilities and unrealised losses from financial sector interventions, and projections for borrowing and debt that include the high end of an estimated range for the net impact of unrealised losses. Including this provisional estimate means that fiscal policy takes into account the prospect of losses now, rather than waiting for firm estimates of total losses and their likely timings. Table 2.5 sets out the fiscal aggregates on both bases, and Box 2.7 sets out the Government's approach to making provision for these losses in the fiscal forecast.

Table 2.5: Fiscal implications of measures to ensure financial stability

	Per cent of GDP					
	Estimate	Projections				
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Fiscal projections excluding liabilities and unrealised losses on financial sector interventions						
Public sector net borrowing	6.3	12.4	11.9	9.1	7.2	5.5
Public sector net debt[1]	43.0	55.4	65.0	70.9	74.5	76.2
Fiscal projections including unrealised losses on financial sector interventions						
Provisional estimate of unrealised losses	+3.5					
Net borrowing[2]	9.7	12.4	11.9	9.1	7.2	5.5
Net debt[2]	46.5	59.0	68.4	74.0	77.5	79.0

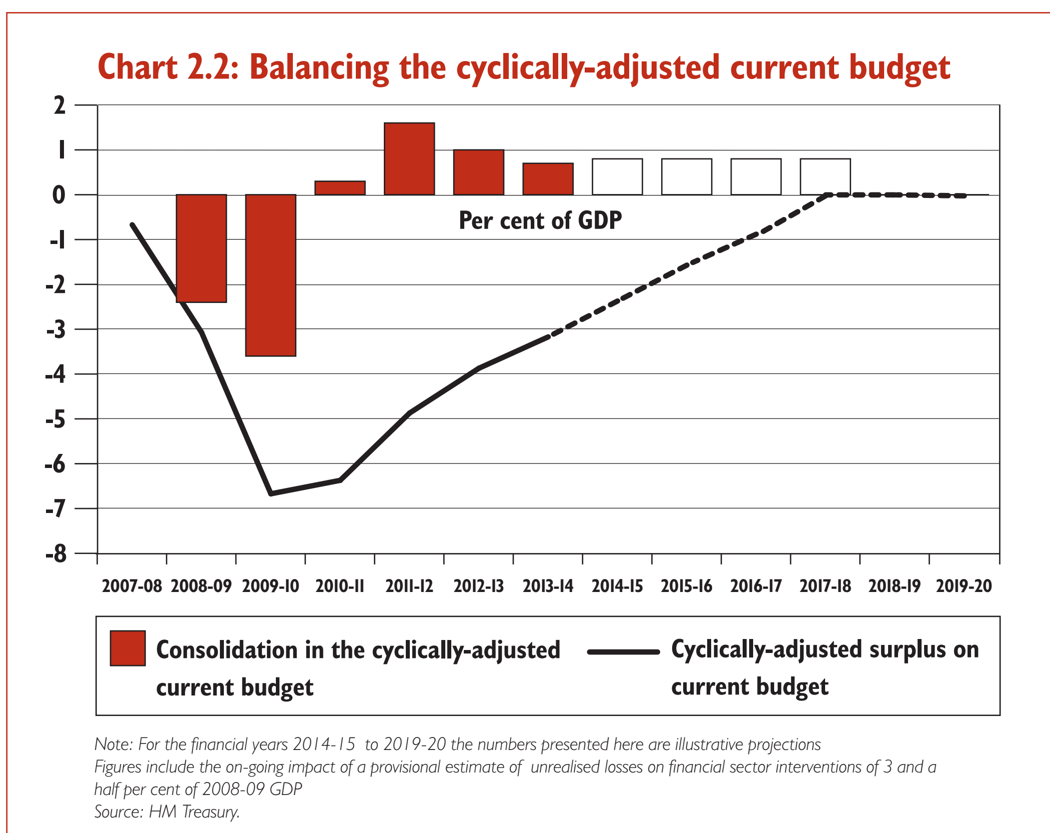
[1] *Debt at end March; GDP centred on end March; excluding liabilities and unrealised losses from financial sector interventions.*

[2] *Includes unrealised losses equal to £50 billion or 3½ per cent of GDP in 2008-09. This figure is smaller as a share of GDP in future years.*

Balancing the cyclically-adjusted current budget

2.81 This Budget puts the public finances on a path to achieve a cyclically-adjusted current balance in 2017-18. The cyclically-adjusted current deficit falls from 6.7 per cent in 2009-10 to 3.2 per cent of GDP in 2013-14, an average improvement of over 0.8 per cent a year. The bars on Chart 2.2 show the planned fiscal consolidation in each financial year of the projection period. A further adjustment of 0.8 per cent of GDP a year from 2014-15 would eliminate the deficit on the cyclically-adjusted current budget by 2017-18.

Chart 2.2: Balancing the cyclically-adjusted current budget



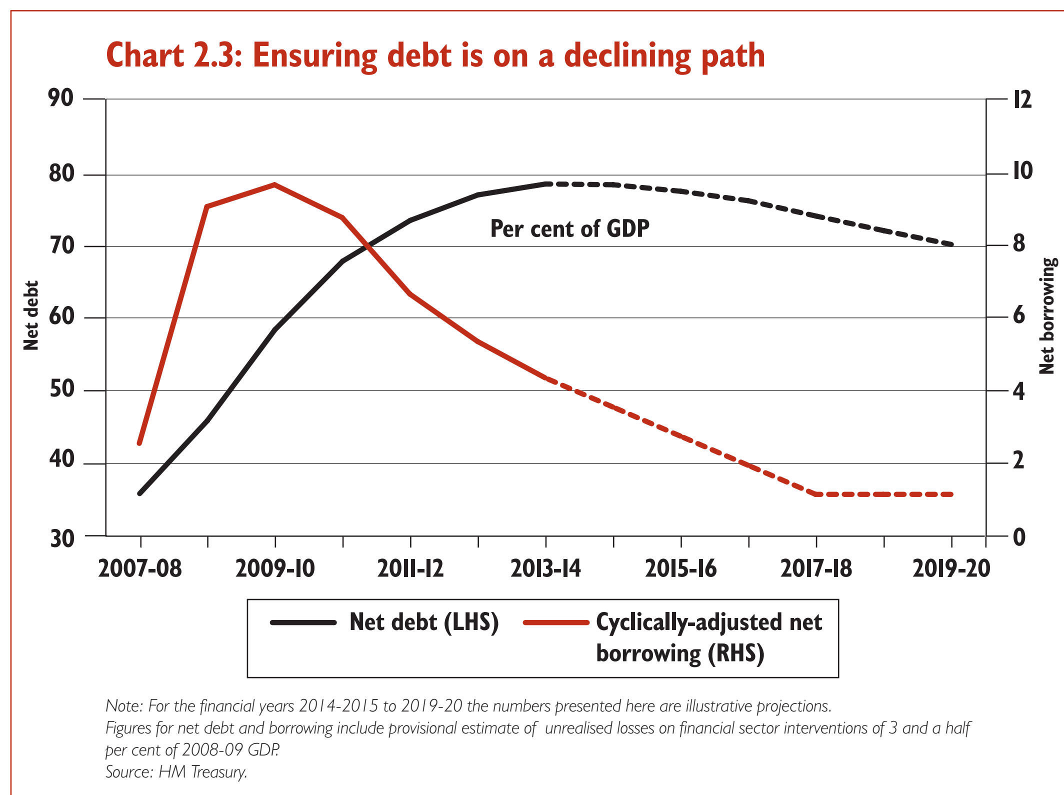
Note: For the financial years 2014-15 to 2019-20 the numbers presented here are illustrative projections
Figures include the on-going impact of a provisional estimate of unrealised losses on financial sector interventions of 3 and a half per cent of 2008-09 GDP
Source: HM Treasury.

Declining net debt to GDP ratio

2.82 Public sector net debt (PSND), including unrealised losses from financial sector interventions, increases over the period to 2013-14, in particular in 2009-10 and 2010-11, reflecting the additional borrowing in these years. It then stabilises at around 79 per cent of GDP by the end of the forecast period.

2.83 This Budget puts the public finances on a path to ensure that the level of public sector net debt will fall as a proportion of GDP in the medium term. Chart 2.3 shows that cyclically-adjusted PSNB is projected to decline from its peak in 2009-10, as a result of the Government's planned fiscal consolidation, standing at 4.5 per cent at the end of the projection period in 2013-14. The chart shows illustrative projections based on a further improvement of 0.8 per cent of GDP a year in the cyclically-adjusted current budget and the assumption that public sector net investment will be held constant at 1¼ per cent of GDP. The illustrative projections show that, under these assumptions, cyclically-adjusted PSNB will continue to fall and the public debt to GDP ratio will be declining in 2017-18, once the global shocks have worked their way through the economy in full.

Chart 2.3: Ensuring debt is on a declining path



Note: For the financial years 2014-2015 to 2019-20 the numbers presented here are illustrative projections. Figures for net debt and borrowing include provisional estimate of unrealised losses on financial sector interventions of 3 and a half per cent of 2008-09 GDP.
Source: HM Treasury.

Consistency with the temporary operating rule

2.84 The fiscal projections set out in this Budget are consistent with returning to cyclically-adjusted current balance by 2017-18, when the global shocks will have worked their way through the economy in full, and debt falling as a proportion of GDP by 2015-16. This is consistent with the Government's temporary fiscal operating rule, announced in the 2008 Pre-Budget Report.

Stability and Growth Pact

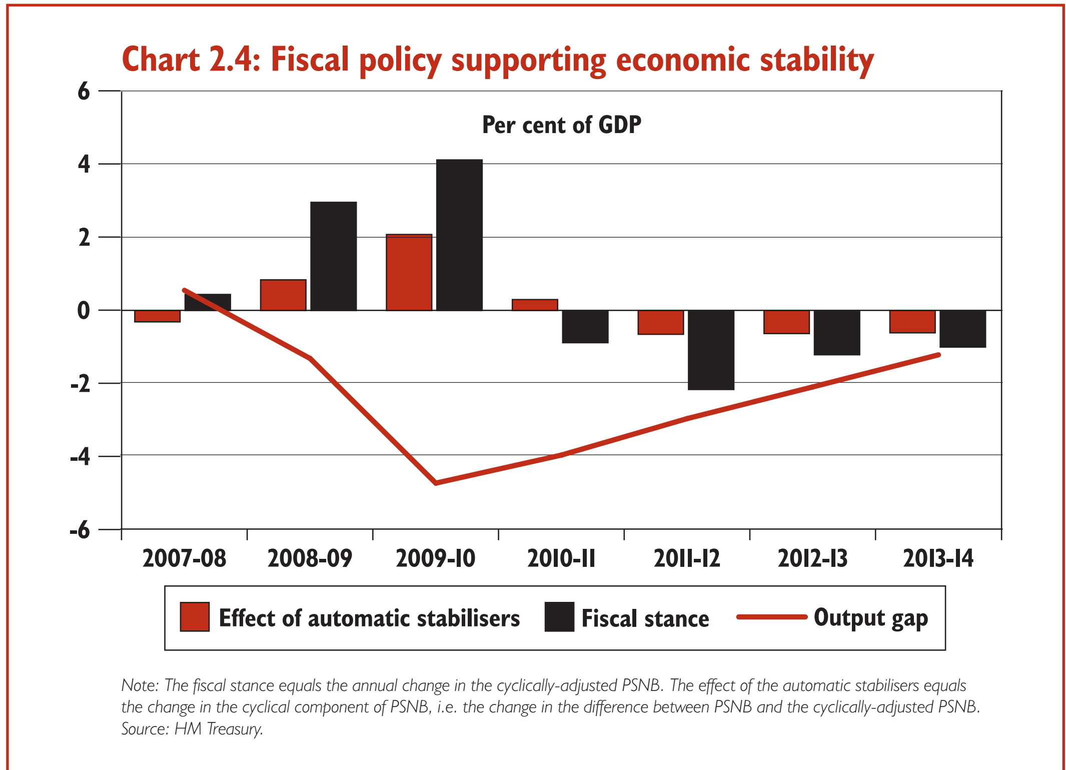
2.85 EU leaders have agreed that the flexibility provided for in the Stability and Growth Pact should be used, and that fiscal consolidation should be undertaken in line with economic recovery. Under the excessive deficit procedure of the Stability and Growth Pact, the EU's Economic and Financial Affairs Council has recommended that the UK brings its deficit below the 3 per cent reference value by 2013-14, with an average annual fiscal effort of more than 1 per cent of GDP from 2010-11. The Treaty debt and deficit measures are show in Table 2.6.

Economic impact

2.86 The overall impact of fiscal policy on the economy can be assessed by examining changes in public sector net borrowing (PSNB). Chart 2.4 shows that both the automatic

stabilisers and the fiscal stance act to provide a considerable degree of support to the economy in 2008-09 and 2009-10, during the economic downturn. From 2010-11 the fiscal stance tightens to deliver a reduction in borrowing at a time when the economy is expected to be recovering and able to support the fiscal consolidation, while the automatic stabilisers continue to provide some support in 2010-11, reflecting the lagged impact of the downturn on spending.

Chart 2.4: Fiscal policy supporting economic stability



Note: The fiscal stance equals the annual change in the cyclically-adjusted PSNB. The effect of the automatic stabilisers equals the change in the cyclical component of PSNB, i.e. the change in the difference between PSNB and the cyclically-adjusted PSNB.
Source: HM Treasury.

Table 2.6: Summary of public sector finances

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Fiscal consolidation							
Surplus on current budget	-0.4	-3.6	-9.3	-9.4	-7.2	-5.6	-4.3
Cyclically-adjusted surplus on current budget	-0.7	-3.1	-6.7	-6.4	-4.9	-3.9	-3.2
Consolidation in the cyclically-adjusted surplus on current budget [1]	-	-	-	0.2	1.5	1.0	0.7
Economic impact							
Net investment	2.1	2.6	3.1	2.5	1.9	1.6	1.3
Public sector net borrowing (PSNB)	2.4	6.3	12.4	11.9	9.1	7.2	5.5
Cyclically-adjusted PSNB	2.7	5.7	9.8	8.9	6.8	5.5	4.5
Sustainability							
Public sector net debt[2,3]	36.5	43.0	55.4	65.0	70.9	74.5	76.2
Core debt[2,3]	36.6	42.5	52.4	59.2	63.2	65.7	66.9
Net worth[4]	28.9	25.5	21.1	10.5	4.0	-0.3	-2.9
Primary balance	-0.9	-4.6	-10.8	-9.3	-6.1	-4.1	-2.5
Financing							
Central government net cash requirement	2.3	11.3	15.6	12.3	9.6	7.3	6.0
Public sector net cash requirement[3]	1.5	4.2	13.3	12.3	9.7	7.5	6.0
Stability and Growth Pact							
Treaty deficit[5]	2.8	7.1	12.6	12.0	9.2	7.3	5.8
Cyclically-adjusted Treaty deficit[5]	3.1	6.6	10.0	9.0	6.9	5.7	4.7
Treaty debt ratio[6]	43.2	55.2	71.9	82.1	87.2	89.9	90.7
Memo: Output gap	0.6	-1.3	-4.8	-4.0	-3.0	-2.1	-1.2

Note: Figures on a National Accounts basis unless otherwise indicated.

[1] Change in the cyclically-adjusted surplus on the previous year.

[2] Debt at end March; GDP centred on end March.

[3] Excluding liabilities and unrealised losses from financial sector interventions.

[4] Estimate at end December; GDP centred on end December.

[5] General government net borrowing on a Maastricht basis.

[6] General government gross debt measures on a Maastricht basis.

Financing and debt management

2.87 As is the case for other countries, debt issuance in the UK will be higher in 2009-10 than in preceding years. Debt agencies around the world, including the UK Debt Management Office, have an important and essential role in delivering increased debt issuance successfully in the interests of the taxpayer.

2.88 The forecast for the central government net cash requirement (CGNCR) for 2008-09 is £162.4 billion, an increase of £9.5 billion from the 2008 Pre-Budget Report forecast of £152.9 billion.

2.89 The projection for the CGNCR in 2009-10 is £220.8 billion. Gross gilt redemptions are projected at £16.6 billion. Following the relatively large contribution to net financing of £12.5 billion in 2008-09, National Savings and Investments is not expected to make a net contribution to financing in 2009-10, but will broadly maintain the existing level of stock. This projection assumes gross inflows of £13.9 billion in 2009-10.

2.90 The forecast for the net financing requirement in 2009-10 is £237.8 billion. The net financing requirement will be met by:

- gross gilt issuance of £220.0 billion;
- an increase in the Treasury bill stock of £21.6 billion to £65.6 billion; and
- a change in the short-term debt level reflecting the Government's decision to repay £3.8 billion of the remaining balance of the Ways and Means Advance at the Bank of England.

2.91 As set out in the Chancellor's letter to the Governor of the Bank of England of 3 March 2009, debt issuance strategy will not change in response to the Bank's programme of asset purchases financed by the provision of central bank money set out earlier in this chapter. The debt management objective remains "*to minimise, over the long-term, the costs of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the aims of monetary policy*".

2.92 Auctions will remain the Government's primary method by which to issue gilts. However, the Government has decided to use supplementary methods to issue gilts in 2009-10. In particular, the Government has decided to use syndication, and to extend the use of mini tenders, which were first used in October 2008, to issue gilts. Projected gross gilt issuance of £220 billion in 2009-10 will be issued as follows:

- £183 billion (or 83 per cent of total) to be issued by auction;
- £25 billion (or 11 per cent of total) to be issued by syndication; and
- £12 billion (or 6 per cent of total) to be issued by mini tender.

2.93 The use of syndication and mini tenders will facilitate higher issuance of long maturity and index-linked gilts. In 2009-10, in total, the Government is projected to issue:

- £74 billion of short conventional gilts (i.e. 1-7 year maturity), or 34 per cent of total;
- £70 billion of medium conventional gilts (i.e. 7-15 year maturity), or 32 per cent of total;
- £46 billion of long conventional gilts (i.e. maturity of above 15 years), or 21 per cent of total; and
- £30 billion of index-linked gilts, or 13 per cent of total.

2.94 Full details and a revised financing table can be found in Chapter C. Further details can be found in the *Debt and reserves management report 2009-10*, published alongside the Budget.[8]

[8] *Debt and reserves management report 2009-10*, HM Treasury, April 2009

Transparency in the public finances

Assumptions underpinning forecast

2.95 Consistent with the *Code for fiscal stability*, the projections for the public finances include the effects of firm decisions announced in this Budget or since the 2008 Pre-Budget Report, which are summarised in Chapter 1.

2.96 These projections are based on a range of assumptions and judgements on the public finances and the economy, and the interactions between them. A number of these are designed to provide caution and these are audited by the National Audit Office (NAO). Further information on these assumptions is set out in Chapter C

2.97 For Budget 2009, the Comptroller and Auditor General has audited the assumptions for trend growth, short-term interest rates, privatisation proceeds and the Treasury's cyclical-adjustment methodology. His conclusions are outlined in Chapter C.

2.98 Box 2.7 sets out the Goverment's approach to making provision for financial sector interventions in the fiscal forecast.

Box 2.7: Approach to making provision for losses on financial sector interventions in the fiscal forecast

As set out above, to ensure transparency and responsible management of the public finances, the Government is setting out fiscal projections including an estimate of unrealised losses from financial sector interventions, equal to 3½ per cent of GDP. This provisional estimate is the high end of a range of estimated outcomes for the net impact of future losses on financial sector interventions.

Given the inherent uncertainty, it is not possible to produce a robust estimate of the scale and profile of losses over time. Instead, the fiscal judgement is based on a single estimate, reflecting losses expected to be incurred at some point in the future.

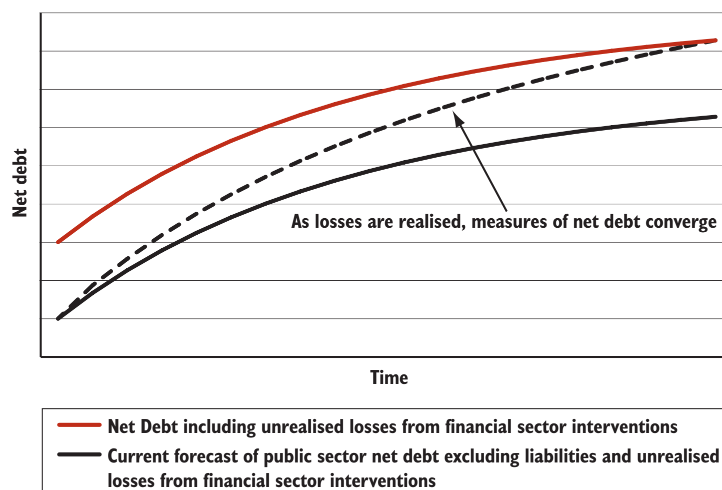
This estimate recognises the full losses in the 2008-09 financial year, in a manner similar to the principle of provisioning for future costs in commercial accounting. This does not reflect cash borrowing in 2008-09, but is instead a recognition that transactions undertaken, and commitments entered into, in that year are expected to have consequences of this magnitude in the future. The higher borrowing results in a higher estimate of debt, extending across the forecast period, and reflecting the Government's current provisional estimate of the medium-term fiscal impact of its financial sector interventions.

To ensure transparency in reporting on the impact of financial sector interventions on the public finances, the Government will publish information on three different bases:

- *including financial sector interventions on a National Accounts basis*: These measures reflect the treatment of financial sector interventions as determined by the national accounts, including temporary and exceptional effects from, for example, the inclusion of the balance sheets and operations of banks classified to the public sector;
- *excluding liabilities and unrealised losses from financial sector interventions*: These measures remove the temporary effects of financial sector interventions on the fiscal aggregates. As losses are realised for central government, and so can be reliably included in the fiscal projections, they will score in these measures; and
- *including unrealised losses on financial sector interventions*: These measures include the anticipated future loss stemming from the Government's financial sector interventions, and so are better measures of the sustainability of the medium-term fiscal position than those on the other two measurement bases. They remove the temporary effects of financial sector interventions on the fiscal aggregates.

As losses crystallise, outturns for net debt, excluding liabilities and unrealised losses, will converge on the projection including the estimate of future losses. This effect is illustrated below.

Chart a: Implications of financial sector losses for debt measures



Risks and uncertainty

2.99 The public finance projections are always subject to a significant degree of uncertainty. As set out earlier in the chapter, and in more detail in Chapter B, the magnitude and complexity of the shocks currently affecting the global economy means the economic outlook is particularly uncertain at the current time. The economic growth path is a key driver of borrowing and debt. As set out in *Public finances and the cycle*,[9] published alongside the 2008 Pre-Budget Report, a 1 percentage point increase (decrease) in the output gap typically leads to a decrease (increase) in PSNB of 0.5 per cent in that year and 0.2 per cent in the following year, based on an average cycle.

2.100 The outlook for the financial sector, which has been an important source of tax receipts in the UK, is another key uncertainty in the fiscal forecast. The forecast currently assumes that the sector expands from 2010-11 before returning to long-term average growth rates, but that, consistent with a rebalancing of the UK economy in the medium term, it is a less important source of receipts than it has been in the past. Chapter C contains further information on the forecast for financial and housing sector receipts.

2.101 As set out further in Chapter C, during a recessionary period in particular, the NAO-audited assumptions on oil prices, equity prices and the VAT gap build in increased caution to the medium-term forecast.

LONG-TERM FISCAL ISSUES

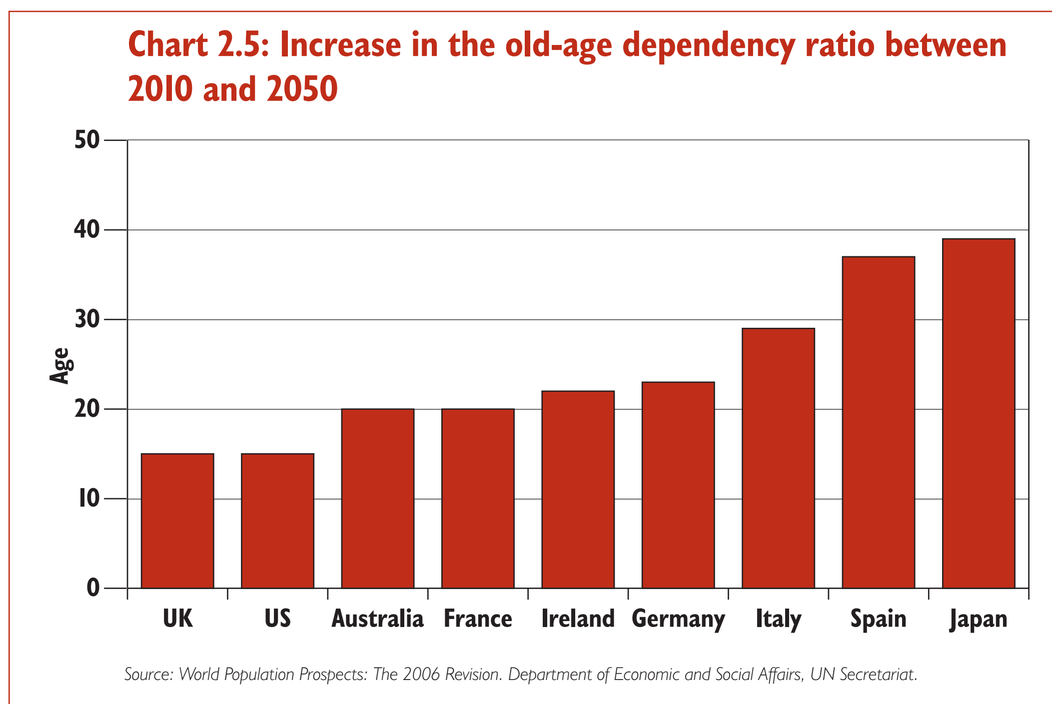
2.102 The temporary fiscal operating rule introduced in the 2008 Pre-Budget Report is designed to underpin a sustained fiscal consolidation once the economy is recovering, and the Budget sets out plans to deliver a sustained fiscal consolidation once the economy emerges from the downturn. This will put the public finances on a sustainable path in the medium term. It is important also to monitor challenges for the public finances in the long term.

2.103 Beyond the period covered in the projections above, the economy and public finances are likely to see the effects of demographic change. As recently highlighted by the International Monetary Fund (IMF) in the context of the impact on countries across the world of the current crisis *"in spite of the large fiscal costs of the crisis, the major threat to long-term fiscal solvency is still represented, at least in advanced countries, by unfavourable demographic trends"*.[10]

Demographic change

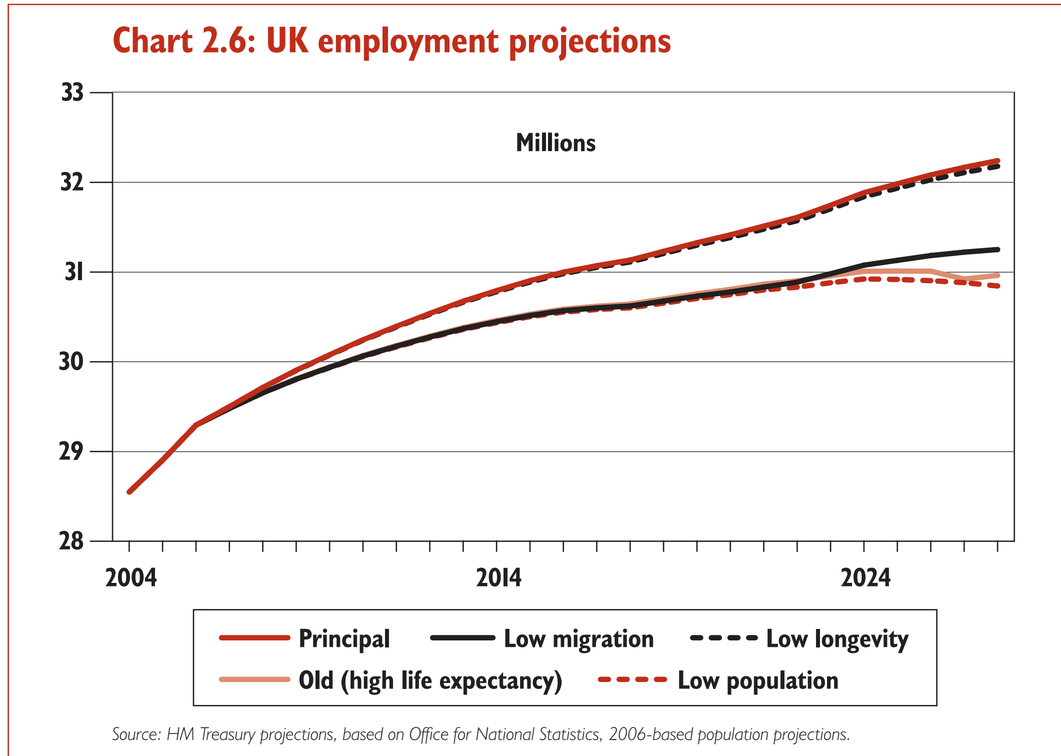
2.104 Demographic change poses challenges for the economy and public finances in the long term, as the increase in dependents (i.e. children and the retired, who tend to be net consumers of output and public goods and services) is greater than the increase of working-age population (who tend to be net contributors). The main driver of this change is the ageing of populations, a trend that is common across most developed countries. In the UK this means that the old-age dependency ratio (people aged 65 and above versus those aged 16 to 64) is projected to increase by around 15 percentage points from 2010 to 2050. While this is a significant increase, it is relatively low in comparison with some other developed countries, as shown in Chart 2.5, and according to the EU's Economic Policy Committee (2008) it is the lowest increase among European countries, bar one.

[9] *Public Finances and the Cycle: Treasury Economic Working Paper No.5*, HM Treasury, November 2008.
[10] *The State of Public Finances: Outlook and Medium-Term Policies after the 2008 Crisis*, International Monetary Fund, March 2009



2.105 As set out Box 2.6 above, in considering fiscal sustainability a range of factors are important and analysis must take into account economic growth, sustainability of taxes and intergenerational fairness. Managing the public finances so as to support economic growth ensures a robust economy and improvements in living standards. This is important to provide future revenues to finance public services and spending, and thereby ensure that future obligations can be met. High and stable economic growth in the long term will ensure prosperity for future generations and underpin the long-term sustainability of the public finances.

2.106 Demographic change affects the economy mainly through its impact on the proportion of the population of working age and consequently on the level of employment. The Office for National Statistics published its latest population projections in October 2007 and these can be used to provide an estimate of the working-age population over the long term. Employment levels can be projected by using these estimates to model the impact of an ageing workforce on overall participation (with older workers generally having lower participation rates than younger workers) and the effect of current young cohorts gradually replacing current older cohorts. Chart 2.6 shows the results of this analysis for different population variants and it is apparent that, despite adverse demographic change, employment is projected to continue to grow over the long term.



Long-term fiscal impacts

2.107 The Government remains committed to the principle of transparency in the public finances. The *2008 Long-term public finance report*[11] provided a comprehensive assessment of the impact of demographic change on the public finances, based on long-term fiscal projections. While demographic structures will change in the longer term, the UK compares favourably in that respect with other European countries, as explained above. The next Long-term public finance report will be published in 2009 and will be able to reflect the EU Economic Policy Committee's latest, 2009, budgetary projections, which give fifty-year projections of age-related expenditure across EU countries. Budget 2009 set out projections for net debt, cyclically-adjusted net borrowing and current balance until 2019-20, consistent with the requirement of the *Code for fiscal stability.*

[11] *2008 Long-term public finance report*, HM Treasury, March 2008.

3 Financial stability

The world economy was hit by a global credit shock in mid-2007. Since then, global financial markets have suffered a sustained period of stress and instability. The intensification of the financial market stress into the worst global financial crisis for generations delivered a severe blow to an already weakened world economy, precipitating a steep and synchronised global downturn. The world economy is forecast to contract in 2009 for the first time in the post-war period.

Financial markets are critical to the well-being of all citizens and the success of all businesses in this country. They also strongly influence economic growth and development across the world. They are the core mechanism for allocating resources efficiently in an economy and a key driver of productivity, growth and opportunities. Financial instability, to the extent that it disrupts the functioning of financial markets, can therefore affect everybody.

Governments around the world have provided significant support to strengthen their financial systems. At the London Summit, G20 Leaders committed to take all necessary action to restore the flow of credit and ensure the soundness of systemically important institutions.

The Government has taken decisive action to support the stability of the financial system and wider economy. Tackling a downturn of this nature and dealing with its consequences requires a comprehensive policy response to support the economy: fiscal and monetary policy, financial sector interventions, and targeted support for individuals and businesses.

The action taken by the Government since October 2008 has been successful in preventing the collapse of the financial system and ensuring that no retail depositors in UK banks or building societies lost money. These interventions have supported the wider economy, and they are helping individuals and businesses. The Government will continue to do whatever it takes to maintain financial stability through its objectives to ensure stability and restore confidence in the financial system, protect retail depositors' money and safeguard the interests of taxpayers.

This chapter sets out the Government's response to financial market disruption in two areas. First, it describes the Government's immediate response aimed at ensuring the stability of the financial system, involving:

- targeted action for individual financial institutions; and
- a comprehensive system-wide response, including action to ensure liquidity, strengthen bank capital, guarantee certain wholesale funding, deal with impaired assets, and increase lending in the economy.

Second, it sets out the Government's view of the longer-term action required to renew financial markets for the future. This chapter introduces a forthcoming paper by the Government, covering:

- key elements of the Government's approach to the future of financial markets;
- steps already taken to achieve this approach, including the Turner Review, leading work in the G20, and the Banking Act 2009; and
- further important action, including renewing financial regulation, reducing the impact of bank failure, protecting and supporting consumers, improving efficiency and competition in capital markets, and strengthening regulators and the international regulatory framework.

The impact of Government intervention

3.1 In response to the current financial market stress and instability, the Government has taken decisive and immediate steps to limit the negative effects on the economy. Key sets of measures were introduced in October 2008, and again in January 2009. These and other measures are described in detail later in the chapter.

Mechanisms **3.2** The Government's interventions have been targeted at tackling problems in individual institutions, addressing system-wide instability, and getting credit flowing through the economy once more. These interventions share the common purpose of protecting the customers of financial institutions – people and businesses – from the consequences of financial instability and restricted access to credit. In particular:

- by dealing with specific institutions such as Northern Rock and Bradford & Bingley, the Government ensured that problems at one institution did not spread through the banking system, that no retail depositor in UK banks or building societies lost money, and that borrowers were not unduly disrupted;
- by acting decisively as the global financial crisis raised system-wide risks in October 2008, to prevent the collapse of the banking system and the massive costs that would have entailed for businesses and individuals, and by comprehensively addressing the needs for liquidity, capital, and funding, the Government ensured that the banking system was in a position to support the economy through the provision of credit to creditworthy borrowers; and
- by acting to limit the risks attached to banks' existing assets, through the Asset Protection Scheme, and by agreeing quantified and legally-binding lending commitments with banks accessing Government support, the Government has enabled around £40 billion of additional lending to be made available to individuals and businesses in 2009 and 2010.

3.3 The Government's comprehensive and coherent series of interventions have therefore protected the economy from the worst costs of financial instability or bank failures, provided the resources and certainty necessary for credit growth, and agreed commitments that will get credit flowing to creditworthy borrowers, and so support economic recovery.

Supporting the economy **3.4** These actions alone are not able to ensure economic recovery. Instead they form part of the wider set of comprehensive and complementary policy actions to support the economy, as set out in Chapter 2, including:

- providing broader support for the economy by implementing a timely, targeted and temporary fiscal stimulus and allowing the automatic stabilisers to operate in full;
- sharp cuts in interest rates by the Bank of England's Monetary Policy Committee;
- authorising the use of a new monetary policy instrument by the Bank of England to ensure that the inflation target can be met;
- introducing more targeted measures to mitigate the risk of a deeper or more prolonged downturn and to provide additional support to those who need it most; and
- implementing a clear plan for sustained fiscal consolidation.

Early indications **3.5** It will take time for the effective functioning of financial markets to be fully restored, but there are already some signs that steps to increase lending and confidence are affecting the availability of credit. The Bank of England's latest *Credit Conditions Survey* and *Trends in Lending* report, drawing on data collected on behalf of the Lending Panel, to the Lending Panel suggest a slight easing in the availability of credit to companies during the first quarter of 2009, and expectations of further easing in the second quarter. The availability of credit to households continued to tighten, although it is expected to ease in the coming months. These

developments are shown in Charts 3.1 and 3.2. The latest Bank of England data show that while effective interest rates paid by households and companies have not fallen by the same amount as Bank Rate has been cut, they have declined significantly.

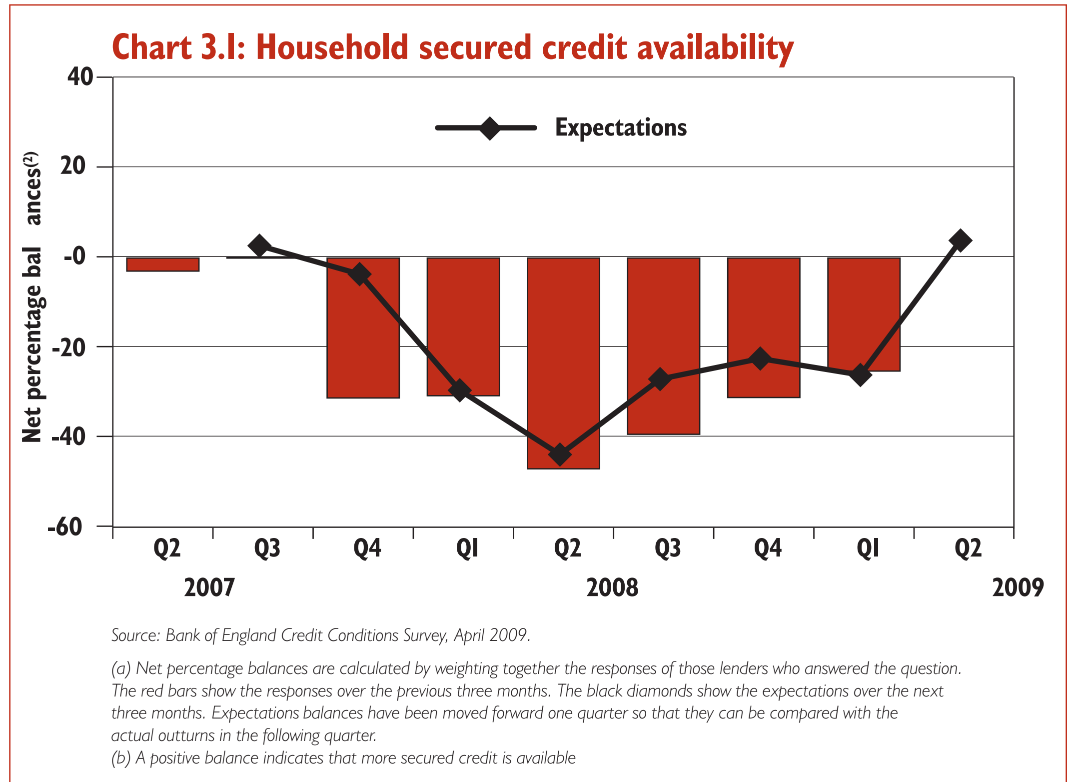


Chart 3.1: Household secured credit availability

Source: Bank of England Credit Conditions Survey, April 2009.

(a) Net percentage balances are calculated by weighting together the responses of those lenders who answered the question. The red bars show the responses over the previous three months. The black diamonds show the expectations over the next three months. Expectations balances have been moved forward one quarter so that they can be compared with the actual outturns in the following quarter.

(b) A positive balance indicates that more secured credit is available

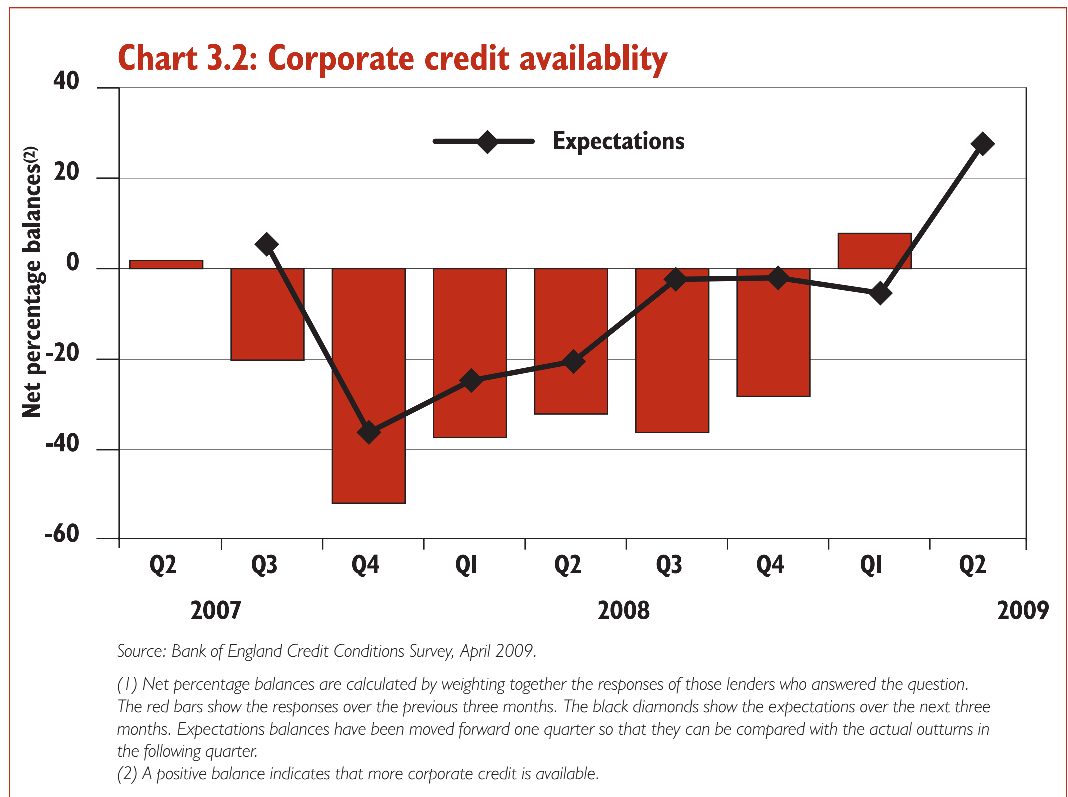


Chart 3.2: Corporate credit availablity

Source: Bank of England Credit Conditions Survey, April 2009.

(1) Net percentage balances are calculated by weighting together the responses of those lenders who answered the question. The red bars show the responses over the previous three months. The black diamonds show the expectations over the next three months. Expectations balances have been moved forward one quarter so that they can be compared with the actual outturns in the following quarter.

(2) A positive balance indicates that more corporate credit is available.

3.6 By taking comprehensive and complementary policy actions in a timely manner, the Government's interventions will work together to support the economy, individuals and businesses. The effect of Government intervention on the public finances is addressed in Chapter 2. In addition, the action that the Government has taken to mitigate the impact of turbulent financial markets on creditworthy businesses and individuals, is set out in Chapters 4 and 5 respectively.

DISRUPTION TO GLOBAL FINANCIAL MARKETS AND THE ECONOMIC DOWNTURN

Events since summer 2007

Global financial crisis

3.7 The world economy was hit by a succession of shocks during 2007 and 2008. The global credit shock, triggered by problems in the US subprime mortgage market in mid-2007, caused a tightening of credit conditions and institutional failures across advanced economies. The surge in global commodity prices through to mid-2008 squeezed real incomes further, pushing many advanced economies into recession.

3.8 In mid-September 2008, in the aftermath of the failure of Lehman Brothers in the US, there was an intensification of the stress in global credit markets, leading to the worst financial crisis for generations. As it became clear that the stability of not just individual institutions but the entire banking system was at risk, with potentially devastating consequences for UK households and businesses, the Government announced in October 2008 a comprehensive package both to support the stability of the banking system and to protect retail depositors (set out in more detail in the 2008 Pre-Budget Report).

Developments since November 2008

World economic downturn

3.9 From autumn 2008 the intensification of the stress in global credit markets into the worst global financial crisis for generations delivered a severe blow to an already weakened world economy, precipitating a steep and synchronised global downturn. The recession has further impacted the financial system, increasing household and company credit risk, leading to further falls in asset prices and illiquidity in several key markets. This has exposed system-wide vulnerabilities, rooted in uncertainties about the value of banks' assets, and amplified by excessive leverage, which has generated significant funding difficulties for some institutions.

3.10 These developments have affected financial institutions around the world, and resulted in interventions in many countries. Since November 2008 these have included the rescue of Bank of America and re-structuring of Citigroup in the United States; the nationalisation of Anglo-Irish Bank in Ireland; the proposed nationalisation of Hypo RE and the rescue of Commerzbank in Germany among others (see Box 3.3 for further details).

Impacts on the wider economy

Impacts on bank lending

3.11 The ability of financial institutions to provide credit necessary to support the wider economy is affected by many factors. Banks lend a multiple of their capital, so in normal times additional capital has a powerful multiplier effect on total lending. Banks fund lending through a variety of sources, including retail deposits and wholesale capital markets. Other wholesale sources are available in normal times, for example interbank markets, to fill any funding gap between loans and deposits. The presence of non-bank lenders and foreign institutions also boosts total lending capacity. Each of these sources has recently been acting to depress credit growth:

- when banks fear future losses, they try to reduce the multiple of loans to capital to provide a buffer against potential losses, so additional capital may not deliver additional lending;
- the withdrawal of wholesale funding sources has required banks to find other funding sources or to reduce new lending to a level that can be supported by retail deposits; and
- the withdrawal of some lending institutions from the UK market, with many global banks retrenching behind national borders.

3.12 The global economic downturn and associated increase in credit losses are creating costly levels of uncertainty around the value of assets held on banks' balance sheets. Both the complexity of structured products and the uncertainty around economic losses mean that banks and their investors have been unable to predict the degree of losses on these assets with any confidence. This uncertainty and lack of confidence is leading banks to hold more capital to protect themselves against worst-case scenarios. As a result, banks have not been providing sufficient credit to creditworthy borrowers for fear that they will be left without enough capital. Investors have also been reluctant to provide funds to the banks due to lack of confidence, further eroding their capacity to lend, with damaging consequences for the wider economy.

3.13 Bank of England data shows that secured lending to households increased by an average of £7¼ billion a month in 2007, which fell to £3½ billion a month in the second half of 2008 and £2¾ billion in the first two months of 2009. Lending to private non-financial companies fell from £5¾ billion a month in 2007 to an average monthly decline of £½ billion in the second half of 2008.[1]

Box 3.1: Why financial markets matter

Ensuring financial stability is central to the Government's economic objectives; not for the financial sector itself but for the economy as a whole. Efficient, fair and stable markets are essential to all developed economies. Financial markets:

- allocate capital through the investment chain;
- help businesses and households to manage risk; and
- provide the payments systems and accounts for holding and transmitting funds necessary to allow trade and business to take place.

Financial instability, to the extent that it creates losses in the financial system and disrupts its ability to support the economy, can affect everybody. If a retail financial institution fails, customers can be denied access to their savings unless adequate protections are in place. If the wholesale funding markets dry up, banks can no longer finance themselves to extend loans to individuals and firms on reasonable terms so a lack of confidence in the financial system can have a very damaging effect on everyday economic activity.

[1] M4 lending excluding the effects of securitisation and loan transfers, seasonally adjusted.

ENSURING FINANCIAL STABILITY: RESPONDING TO THE IMMEDIATE CHALLENGES

The UK framework

3.14 In the UK, the Financial Services Authority (FSA) is responsible, under the Financial Services and Markets Act 2000 (FSMA), for financial regulation and supervision. The FSA, the Bank of England, and the Treasury work closely together on matters relating to financial stability, as set out in a Memorandum of Understanding. Each of the authorities has separate, but complementary, roles.

3.15 The Government has strengthened and updated the framework for financial stability in the Banking Act 2009, which includes changes to the objectives and role of the Bank of England (see Box 3.7 for further details).

International arrangements

3.16 International cooperation to ensure financial stability has become increasingly important as the degree of global financial integration has risen. Much of this cooperation takes place within the European Union or through non-legislative bodies such as the International Monetary Fund (IMF), the new Financial Stability Board (FSB) or global standard-setting bodies like the International Accounting Standards Board (IASB).

3.17 Many of the actions set out below have been developed and implemented through the frameworks described above, in the UK and in some cases internationally.

Action targeted at specific institutions

3.18 Government action to deal with specific institutions has been undertaken through its consistent objectives to:

- support stability and restore confidence in the financial system;
- protect retail depositors' money; and
- safeguard the interests of taxpayers.

Northern Rock

3.19 Northern Rock was taken into temporary public ownership in February 2008 using the Banking (Special Provisions) Act 2008, after experiencing severe funding problems. A new business plan was published in March 2008. Economic conditions have changed significantly since then and as a result, on 23 February 2009, the Government announced that Northern Rock will increase mortgage lending by up to £14 billion over the next two years. The new lending will be on commercial terms, to help build a high quality mortgage book and viable bank for sale. To maximise the bank's capacity for new lending, Northern Rock will be restructured so that the back book of mortgages is managed separately to its other business. The Government will increase the loan to Northern Rock and extend the repayment schedule. The capital requirement for the revised strategy will be within the potential £3 billion of support previously announced by the Government in August 2008. These plans are subject to State Aid approval by the European Commission.

Bradford & Bingley

3.20 In September 2008, the Government again used the Banking (Special Provisions) Act 2008 to take swift action in relation to Bradford & Bingley. The retail deposits and branches of Bradford & Bingley were transferred to Abbey following a competitive sale process. To enable this transfer, the Financial Services Compensation Scheme (FSCS) paid out approximately £14 billion, funded through a loan from the Treasury, and the Treasury paid out approximately £4 billion in addition. The remainder of Bradford & Bingley's business was taken into public ownership. Now in public ownership, Bradford & Bingley has developed a business plan for the wind-down of the bank and has published the Executive Summary of this plan on its website. Since November 2008, the Treasury has approved Bradford & Bingley's business plan and has submitted a Restructuring Aid notification to the European Commission. The FSCS and the Treasury will be repaid through the proceeds of the wind-down and realisation of the assets of the remaining business of Bradford & Bingley in public ownership.

London Scottish

3.21 On 30 November 2008, the FSA determined that London Scottish Bank plc should be prevented from accepting further deposits as it no longer met the FSA's threshold conditions for authorisation, particularly in relation to its financial position. The bank was placed into administration later that evening by the Court on the application of its directors and Ernst & Young were appointed as administrator. The FSCS was triggered so that retail deposits up to the compensation limit of £50,000 were protected. The Government stepped in quickly to protect all retail depositors (including deposits above £50,000) in order to maintain consumer confidence and preserve financial stability.

Dunfermline Building Society

3.22 On 30 March 2009, action was taken to resolve Dunfermline Building Society after the FSA, in consultation with the Treasury and Bank of England, determined on 28 March 2009 that the conditions for the society to be dealt with under the special resolution regime of the Banking Act 2009 were met. Under the Act, Dunfermline's retail and wholesale deposits, branches, head office and own-originated residential mortgages were transferred to Nationwide Building Society. This followed a competitive sale process conducted by the Bank of England over the weekend of 28-29 March. Dunfermline's social housing loans and related deposits have been placed into a bridge bank, wholly owned by the Bank of England, so that the best outcome for this part of Dunfermline's business can be determined. A court order was made on 30 March 2009 to place the remainder of Dunfermline's business into a Special Administration Procedure and to appoint an administrator.

System-wide responses

3.23 As set out above, financial market conditions deteriorated significantly following the collapse of Lehman Brothers in September 2008. The problems were no longer confined to specific institutions but affected the entire system. The likelihood of the banking system collapsing, with profoundly damaging consequences for the wider economy, had increased.

Bank of England liquidity measures

3.24 At the onset of the crisis, banks became increasingly uncertain about their ability to meet potential demands quickly due to the illiquidity of financial markets. To tackle this, the Bank of England put in place a series of changes to its liquidity operations. Those changes, such as the provision of additional reserves and term auctions against a wide range of collateral, started in autumn 2007. The Special Liquidity Scheme (SLS) was introduced in April 2008. The SLS provided liquidity by allowing institutions to swap their pre-existing assets, (which had become illiquid) for Treasury bills over a three-year period, which are more easily converted into cash. In September 2008, following further deterioration in financial markets, the drawdown window was extended. In October 2008 authorities announced that at least £200 billion would be made available to banks under the scheme.

3.25 The drawdown period for the SLS closed on 30 January 2009. On 3 February, the Bank of England reported that £185 billion of Treasury bills has been taken up under the SLS in exchange for high quality private sector assets of £287 billion in nominal value terms. The illiquidity of financial markets continued as the financial crisis precipitated a global recession. The Discount Window Facility (DWF) was introduced in October 2008 as a permanent feature of the Bank of England's operations. It allows banks to swap high-quality illiquid assets for gilts (or cash under some circumstances). Initially for a period of 30 days, the DWF was extended in January 2009 to also provide a facility for up to 12 months.

Recapitalisation

3.26 As concerns shifted from banks' ability to access liquidity to the solvency of financial institutions, the Government addressed this source of extreme stress by announcing the Bank Recapitalisation Scheme in October 2008. In November and December 2008 the shareholders of the Royal Bank of Scotland (RBS), Lloyds TSB and HBOS approved their recapitalisation through the Government recapitalisation scheme and the Government subsequently invested £20 billion in RBS and £17 billion in what is now Lloyds Banking Group (created following the merger of Lloyds TSB and HBOS in January 2009). Other financial institutions announced plans to raise their capital levels without Government support. The Government, in consultation with UKFI, has since agreed to convert the RBS and Lloyds Banking Group (Lloyds) preference shares, plus accrued coupon and underwriting fees, into ordinary shares.

Credit Guarantee Scheme

3.27 The Credit Guarantee Scheme (CGS) was also announced in October 2008. The purpose of the CGS is to help restore confidence by making available to eligible institutions government guarantees of eligible debt issuance. The Treasury acts as guarantor for the use of the CGS, while the Debt Management Office handles the operational aspects of the Scheme. On 15 December 2008 an announcement was made changing the fees, lengthening the Scheme, and extending eligible currencies of issue beyond sterling, dollars and euros. On 19 January 2009, the Government announced that the drawdown window would be extended. Following approval from the European Commission the window has been extended from 9 April to 13 October 2009 and is to be extended further to 31 December 2009, subject to further approval from the Commission. Over £100 billion of debt issued by eligible institutions has been guaranteed under the Scheme.

Managing the Government's investments

3.28 The Government set up a company, UK Financial Investments Ltd (UKFI), on 3 November 2008 to manage its investments in financial institutions on a commercial basis. A Framework Agreement between the Treasury and UKFI governs the company's activities and sets out its relationship to the Treasury[2]. UKFI has an overarching objective to protect and create value for the taxpayer as shareholder with due regard to the maintenance of financial stability and to act in a way that promotes competition. This includes:

- acting in a way that is consistent with the Treasury's stated aim that it should not be a permanent investor in UK financial institutions, maximising sustainable value for the taxpayer, taking account of risks;
- maintaining financial stability by having due regard to the impact of its value realisation decisions; and
- promoting competition in a way that is consistent with a UK financial services industry that operates to the benefit of consumers and respects the commercial decisions of the financial institutions.

[2] www.ukfi.gov.uk.

Developments since November 2008

Asset Protection Scheme

3.29 As conditions in financial markets deteriorated further and created a global economic recession, uncertainty around the level of credit losses banks might sustain continued. In such circumstances it becomes necessary for governments to bear some of the risk attached to banks' existing assets by providing a manageable maximum loss on these assets to restore confidence in the financial system, and ultimately to increase lending to individuals and businesses. On 19 January 2009 the Government announced its intention to offer an Asset Protection Scheme to restore confidence in the banks and get credit flowing again, by dealing with the losses associated with impaired assets.

3.30 Details of the Asset Protection Scheme were published on 26 February 2009. Under the scheme, the Government provides protection against future credit losses on certain assets in exchange for a fee. A 'first loss' (similar to the excess in insurance policies) remains with the institution. The Government protection will cover 90 per cent of the credit losses exceeding this amount, with the participating institution retaining the residual exposure. The scheme has been designed to draw a line under problems arising from impaired assets, by putting a floor to banks' exposure to losses associated with these assets. This should enable the healthier core of banks' commercial business to attract investments and deposits and make loans to creditworthy businesses and households.

3.31 RBS and Lloyds have both announced their intention to participate in the scheme, as described in Box 3.2. Implementation of the Asset Protection Scheme will be subject to further due diligence by the Treasury and its advisers, execution of legally binding documentation, satisfaction of the application criteria and asset eligibility criteria of the Scheme, and satisfaction of applicable conditions precedent to the accession of the Scheme, including regulatory, State Aid and shareholder approvals.

Box 3.2: Asset Protection Scheme agreements in principle

On 26 February 2009, RBS announced its intention to participate in the Asset Protection Scheme. RBS intends to protect £325 billion of eligible assets. Key elements of the announcement include:

- RBS will pay a fee of £6.5 billion in B shares (non-voting ordinary shares, which constitute Core Tier 1 capital). They have also agreed for a number of years not to claim certain UK tax losses and allowances.
- RBS will bear a first loss amount of £42.2 billion in relation to protected assets. Thereafter losses will be borne 90 per cent by the Treasury and 10 per cent by RBS.
- In addition, and conditional on RBS' participation in the Scheme, the Government has agreed to inject up to £19 billion more capital in the form of B shares – £13 billion on accession and £6 billion at RBS' option after the end of 2009.

On 7 March 2009, Lloyds announced its intention to participate in the Asset Protection Scheme. Lloyds intends to protect £260 billion of eligible assets. Key elements of the announcement include:

- Lloyds will pay a fee of £15.6 billion for participation in the Scheme. The fee will be satisfied through the issuance of B shares (non-voting ordinary shares, which constitute Core Tier 1 capital).
- Lloyds will bear a first loss amount of £35.2 billion in relation to protected assets. Thereafter losses will be borne 90 per cent by the Treasury and 10 per cent by Lloyds.

Both RBS and Lloyds have committed to additional lending, the details of which are set out later in this chapter.

Further work on due diligence is currently taking place to ensure that the Government has a full understanding of the risks and costs that the scheme will involve before agreements are finalised.

Asset Purchase Facility

3.32 The Asset Purchase Facility (APF) was announced on 19 January 2009. The APF is operated by the Bank of England. Initially, provision was made to purchase up to £50 billion of eligible private sector assets (commercial paper, corporate bonds, syndicated loans, paper issued under the CGS and asset-backed securities created in viable securistisation structures). As of 17 April 2009, the APF had purchased £2.4 billion of commercial paper, and £0.5 billion off corporate bonds. The Bank of England is considering whether it might extend the APF to purchase a wider range of private sector assets, consistent with the objectives of the facility. While the APF aims to improve liquidity in financial markets, it also provides a framework that the Monetary Policy Committee (MPC) of the Bank of England can use to conduct monetary policy through adjusting the supply of money. Until 5 March, purchases were financed by this issuance of Treasury bills. Following a request from the MPC, the Chancellor authorised the Bank of England to use the APF for monetary policy purposes and increased the total scale of the fund to £150 billion, up to £50 billion of which could be used for private sector asset purchases. Asset purchases since then have been financed by the issuance of central bank reserves at the Bank of England. Chapter 2 provides further information of the monetary policy framework and the Bank of England's use of the APF in its quantitative easing policy.

Asset-Backed Securities Guarantee Scheme

3.33 On 19 January 2009, the Government announced it would establish a guarantee scheme for asset-backed securities. **The Government announces that the scheme is available, at first until October 2009, for banks and building societies to use alongside the existing CGS to support their lending in the economy.** The scheme, which has been approved by the European Commission, extends the funding options open to banks and building societies under the existing CGS to residential mortgage-backed securities (RMBS).

3.34 Following discussions with the industry, the Government is announcing two types of guarantee to be attached to triple-A rated securities: a credit guarantee and a liquidity guarantee. The Debt Management Office will make guarantees available to banks and building societies wishing to access the scheme on the terms set out in the Market Notice and scheme rules.

3.35 The Government is setting high quality criteria, and encouraging high quality reporting standards, in order to help lay the foundations for stronger markets in the future. The Government welcomes the European Securitisation Forum's (ESF) recently published new reporting standards for European RMBS and will require participants in the guarantee scheme to comply with international best practice. The Government encourages the industry to bring forward standardised reporting templates for investors, and agree common definitions of terms this year.

3.36 The Government and FSA, working closely with industry, will also review the current regulatory regime for covered bonds, which was introduced one year ago. This review will consider the current regime's impact on the UK market and further steps to enhance investor confidence, and will report by the 2009 Pre-Budget Report.

Lending commitments and actions

3.37 Action to ensure the stability of the financial system is a necessary precondition for economic recovery. The Government's responses are designed to support lending in the UK economy, an important part of supporting the economy through the downturn, and benefiting individuals and businesses.

Lending commitments

3.38 Quantified and legally binding lending commitments will be agreed with banks accessing government support through the Asset Protection Scheme and the extended Credit Guarantee Scheme. Such lending commitments – on commercial terms, and subject to market demand – have already been agreed with both RBS and Lloyds. RBS will lend an additional £25

billion on commercial terms over the 12 months from March 2009 – £9 billion of mortgage lending and £16 billion of business lending. Lloyds will lend an additional £14 billion on commercial terms over the 12 months from March 2009 – £3 billion of mortgage lending and £11 billion of business lending. Similar lending commitments have been made in respect of the subsequent 12 months and will be reviewed to ensure they reflect economic circumstances at that time. A robust monitoring framework has been put in place, and the Government will report to Parliament annually on the delivery of these agreements.

3.39 As described earlier in this chapter, on 23 February 2009 the Government announced that Northern Rock will undertake new lending of about £5 billion in 2009, and £3-9 billion a year from 2010 onwards, subject to market demand.

Lending Panel

3.40 At the 2008 Pre-Budget Report, the Government announced the creation of a new Lending Panel to monitor lending to businesses and households and drive up standards of industry best practice in lending decisions. As part of this new monitoring approach, the Bank of England is publishing a monthly report – *Trends in Lending* – the first of which was published on 21 April 2009.

International actions

Global issues

3.41 Governments around the world have been working to tackle similar problems to those faced by the UK (see Box 3.3). As a result of the downturn across the world, cross-border flows are growing more slowly than domestic flows and some banks are favouring domestic lending over foreign lending. It is vital that national measures aimed at restoring lending and repairing the financial system do not encourage a retreat into domestic financial markets and end up linking deleveraging with deglobalisation.

International action

3.42 In particular, concerted action at the international level is needed to:

- boost market confidence by creating a positive contagion effect across banks;
- ensure that global banks are addressed effectively and coherently by the different national authorities in which they operate; and
- reduce negative spillovers such as distortions in competition and domestic retrenchment.

G20 framework for financial repair and recovery

3.43 In March this year, the G20 Finance Ministers and Central Bank Governors agreed a framework for financial repair and recovery, committing to taking decisive action, where needed, and to use all available tools to restore the full functioning of financial markets. In particular, they committed to underpin the flow of credit, both domestically and globally, by:

- providing liquidity support, including through government guarantees to financial institutions' liabilities;
- injecting capital into financial institutions;
- protecting savings and deposits; and
- agreeing a set of principles for a cooperative and consistent approach to programmes addressing impaired assets.

Box 3.3: Financial stability measures taken internationally

The IMF recommended in its 2009 Financial Stability Report that governments should pursue a broad three-pronged approach – liquidity provision, capital injections, and dealing with problem assets – to encourage bank balance sheet cleansing and restore the financial sector functionality and confidence necessary to sustain economic recovery. Countries have been responding to the financial crisis by adapting this mix of measures to their own national circumstances:

1. **liquidity provision:** liquidity and debt issuance guarantees have played a crucial role in helping governments and markets to manage the deleveraging process and mitigate the increased cost of funding;
2. **capital injections:** following the recapitalisation by the UK in October, many EU Member States, as well as the US, Japan, South Korea, Switzerland and others, have offered capital injections to banks (see table 3.1);

Table 3.1: Global Capital Injections

Capital Injections	Private US$bn	Public US$bn	Public Sector as percentage of total
Total capital	505.3	567.7	52.9
America	253.6	392.5	60.8
Europe	219.3	111.8	43.8
Asia	32.3	3.4	9.5

Source: Bloomberg 8 April 2009. Figures relate to the period from Q3 2007 to 8 April 2009 and have been rounded to one decimal place.

3. **dealing with problem assets:** as the crisis has deepened and spread, it has become clear that the key priority is to address the problem of impaired assets on banks' balance sheets, which is severely constraining banks' ability and willingness to resume lending. For example:
   - in October 2008, the Swiss government decided to transfer up to $60 billion of illiquid securities and other assets from UBS's balance sheet to a separate entity in an attempt to eliminate uncertainty;
   - the Belgium and US governments have opted for insurance schemes to enable Dexia in Belgium and Citigroup and Bank of America in the US to rebuild investors' confidence in their capacity to withstand severe further losses; and
   - the US and Ireland have announced new systemic initiatives aimed at reducing the uncertainties created by losses in real estate asset prices. The US plans to enlist private sector investors with the help of US Treasury equity and non-recourse guaranteed debt facilities to purchase real estate-related assets from banks and other financial institutions. Ireland's programme also aims at cleaning banks' balance sheets of certain real estate-related assets, through a new asset management company, which with government funds will purchase assets from Irish banks and manage them on a commercial basis.

To ensure the effectiveness of these measures and minimise market distortions, G20 Finance Ministers and Central Bank Governors agreed on 14 March 2009 to a set of principles for a cooperative and consistent approach to programmes addressing impaired assets.

RENEWING FINANCIAL MARKETS FOR THE FUTURE

The need for renewal and reform

3.44 The recent failures of financial markets require a systematic approach to prevent such difficulties happening again. It is also important that reforms tackle the decline in trust and confidence in financial markets, among consumers and wider market participants. The changing nature of financial markets, including the consolidation of the banking sector and the significant increase in state intervention, pose further questions.

3.45 The Government will, in a document to be published before the summer, describe its approach to the future of financial markets and set out the actions necessary to achieve it. The Government will seek financial markets, in the UK and internationally, that:

- are open and competitive, meeting the needs of all constituents in society and the wider economy efficiently and fairly;
- enjoy and inspire the trust and confidence of all users, including consumers;
- are subject to stronger regulation that reduces the likelihood of damaging market and institutional failures; and
- have effective mechanisms for dealing with the failure of financial institutions when, nevertheless, they do occur.

Steps taken **3.46** The Government has already taken a number of important steps described below:

- **the Banking Act 2009 –** this addressed the immediate need for a comprehensive regime for dealing with bank failures and other important aspects of financial stability and depositor protection (explained in Box 3.7 below);
- **the Turner Review of financial regulation –** in October 2008 the Chancellor asked Lord Turner, the Chairman of the FSA, to make recommendations on the changes in regulation and supervisory approach needed to create a more robust banking system for the future. The Government welcomes the Review's recommendations and the accompanying FSA Discussion Paper, published on 18 March 2009 (see Box 3.4 for more details)[3];
- **progress in the G20 and other international fora –** many of the regulatory changes necessary will need international agreement. The Government is leading the debate on the future of financial markets. Leaders and Finance Ministers of the G20 met in London on 2 April 2009 and agreed a broad range of measures to strengthen the financial system (see Box 3.5). Further progress will be needed to take this forward. The UK has also contributed to progress in this area within other international fora, such as the G7 and in the EU;
- **the Walker Review of corporate governance –** the Government announced in February 2009 that Sir David Walker would conduct an independent review to cover the effectiveness of risk management at board level (including the incentives in remuneration policy to manage risk responsibly and the balance of skills, experience and independence required on the boards of UK banking institutions); the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees; the role of institutional shareholders in engaging effectively with companies and monitoring of

[3] The Turner Review can be found on the FSA website, www.fsa.gov.uk

boards; and whether the UK approach is consistent with international practice and how national and international best practice can be promulgated. A consultation document will be published in summer 2009 with conclusions in autumn 2009. The Government's view on remuneration practices in banks is discussed in Box 3.7 below; and

- **the Foot Review of British offshore financial centres –** the Government announced on 2 December 2008 that Michael Foot would carry out an independent review, covering the areas of financial supervision and transparency; taxation, in relation to financial stability, sustainability and future competitiveness; financial crisis management and resolution arrangements; and international cooperation. A progress report of the Foot Review, setting out its scope and issues for consultation, was published on 21 April 2009.[4]

Box 3.4: The Turner Review

The Turner Review set out 32 recommended actions to improve financial regulation and create a more robust banking system for the future. The Review makes a number of recommendations that have already been enacted in the UK, such as a resolution regime for the orderly wind down of failed banks (provided by the Banking Act 2009), or that are being tackled, such as changes to corporate governance and risk management of financial institutions being examined by the Walker Review. Key areas within which detailed recommendations are made are summarised below:

The supervisory framework: The Review acknowledges that far-reaching changes are already being made to the FSA approach to supervision. More broadly, it recommends that supervisory coverage should follow the principle of economic substance not legal form, and that regulators should have powers to extend prudential regulation or impose restrictions on institutions that create risks to financial stability. The Review recommends that the Bank of England and the FSA should collaborate on macro-prudential analysis and that international coordination of bank supervision should be enhanced through the use of supervisory colleges. It also recommends that credit rating agencies should be subject to supervision.

Prudential regulation: The Review recommends a broad range of changes to be considered, including increasing the quantity and quality of capital in the global banking system; reducing the pro-cyclicality of regulatory standards; implementing a maximum gross leverage ratio; and far-reaching changes to bank liquidity regulation.

Risk management and governance: The Review concludes that a firm's remuneration strategy should not encourage the taking of undue risk, and recommends that the role of non-executive directors at large complex financial institutions should be re-considered.

Resolution and consumer protection: The Review recommends that, at a consumer level, retail deposit insurance should be sufficiently generous to cover the vast majority of retail depositors and the extent of coverage should be clearly communicated to retail depositors.

The credit default swap market: The Review recommends that there should be increased use of central counterparties to cover the standardised contracts that account for the majority of credit default swap trading.

While many of the recommendations are for the FSA to introduce through its own rules, some others require international or EU agreement, on which the Government will work closely with the FSA and the Bank of England. Others may require legislative changes for which the Government will be responsible.

[4] The report can be found at: www.hm-treasury.gov.uk

Box 3.5: Progress made by the G20

The G20 agreed to take action to build a stronger and more globally consistent supervisory and regulatory framework for the future. Building on, and responding to, the actions set out at the Washington Summit in November 2008, the G20 agreed major reforms based on the principles of strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets and reinforcing international cooperation, including:

- to establish a new Financial Stability Board (FSB) with a strengthened mandate, as a successor to the Financial Stability Forum (FSF), including all G20 countries, FSF members, Spain, and the European Commission;
- that the FSB should collaborate with the IMF to provide early warning of macroeconomic and financial risks and the actions needed to address them;
- to reshape regulatory systems so that authorities are able to identify and take account of macro-prudential risks;
- to extend regulation and oversight to all systemically important financial institutions, instruments and markets. This will include systemically important hedge funds;
- to endorse and implement the FSF's new principles on pay and compensation and to support sustainable compensation schemes;
- to take action, once recovery is assured, to improve the quality, quantity, and international consistency of capital in the banking system;
- to take action against non-cooperative jurisdictions, including tax havens;
- to call on the accounting standard setters to work with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards; and
- to extend regulatory oversight and registration to credit rating agencies to ensure they meet the international code of good practice.

G20 Leaders instructed Finance Ministers to complete the implementation of the decisions in line with the timetable set out in the Washington Action Plan. The FSB and the IMF will work with other relevant bodies to provide a full report to Finance Ministers in Scotland in November.

Further action required

3.47 The Government will propose action covering five areas:

- **renewing financial regulation** – including legislative changes where needed to support changes recommended in the Turner Review and to deliver the G20 conclusions;
- **reducing the impact of the failure of financial firms** – including implementing actions under the Banking Act 2009 and securing action internationally to improve cross-border arrangements for dealing with failures;
- **protecting and supporting consumers** – including practical measures to boost financial capability and tighten up consumer-focused regulation;
- **improving efficiency and competition in financial markets** – including considering ways to make it easier for new entrants to join the banking market and to strengthen the diversity of market participants, as well as action to maintain the competitive position of the UK as the leading global financial centre; and

- **strengthening regulators and the international regulatory framework** – including action in the UK to ensure that the FSA has sufficient powers and internationally to improve cross-border cooperation..

Further information on these actions is set out below.

Renewing financial regulation

3.48 A key longer-term challenge for financial markets is to reform regulation. The problems in financial markets have highlighted serious failures in the global financial regulatory system. There is international consensus on the need to strengthen regulation in light of recent events, including in the G20.

Strengthening regulation

3.49 Regulation and supervision of financial markets and institutions need to be strengthened across the world, and be capable of adapting to innovative and evolving markets. In particular:

- there have been failures of market discipline to prevent deficiencies emerging in corporate governance and risk management in the institutional investment chain;
- the quantity and quality of capital, and liquidity risk management standards, have been proven to be inadequate. Bank balance sheets were excessively leveraged and there has been an over-reliance on short-term wholesale funding;
- markets have proved to be more systemic than previously understood, and in many cases have failed to deliver the infrastructure or transparency necessary to minimise systemic risks; and
- the existing regulatory system focuses on the ability of individual financial institutions to survive shocks. This has proved inadequate for protecting the wider macroeconomic system.

International action

3.50 As financial markets and institutions are global in nature, the debate on the future of financial regulation requires international negotiation and agreement. At a global level this debate is continuing through the G20, with the UK as current chair (as discussed in Box 3.5 above).

Progress in the EU

3.51 The EU has also made progress with changes to financial regulation. Most recently the de Larosière Report has made a number of recommendations for EU financial services and supervision. The Chancellor wrote to his EU colleagues on 3 March 2009 setting out the UK's position on EU financial regulation and supervision. In his letter he welcomed the report of the de Larosière group, as a good basis for further discussions. The letter set out a number of principles for EU supervision and regulation:

- prudential and conduct-of-business issues cannot be separated and need to be considered together;
- supervisory and crisis-management arrangements need to be consistent and aligned;
- EU arrangements need to fit with global practice;
- through all of this, Government's must continue to support the development of open, global markets; and
- arrangements should be independent and accountable.

3.52 In this context, the Chancellor made four proposals, to form the basis for the EU's response, which the Government will take forward in European meetings over the coming months: the need for an effective early warning system; a new independent rule-making body, which should become a regulatory authority and a forum for reviewing national supervisors; the development of rules for clearing and settlement systems to improve operational and prudential standards; and a fundamental review of the risks and safeguards around cross-border branching models, to consider issues such as home versus host responsibilities and effective cooperation between national deposit guarantee schemes.

Next steps

3.53 To deliver the changes necessary to renew financial regulation, the Government will:

- strengthen market discipline with reforms to reduce the deficiencies seen in corporate governance and lead the way in developing responsible remuneration practices. Measures are needed to strengthen responsible shareholder engagement, remuneration and risk management practices. Remuneration is discussed in more detail in box 3.6;
- strengthen the regulation of financial services firms, once the recovery is assured, by improving the quantity and quality of bank capital, tightening liquidity regulation and placing simple and effective limits to mitigate excessive leverage and increase future financial stability. The Government will support the FSA and the Bank of England in achieving these changes internationally;
- reduce the systemic risk of markets by working urgently to improve transparency. The Government strongly supports international efforts to improve transparency. The London summit agreed to call on accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards; and
- ensure that all systemically important institutions are subject to appropriate regulation and oversight and consider the institutional arrangements in the UK necessary to deliver a macro-prudential approach. The Government will consider further options to implement such an approach in the UK (see Box 3.11).

Box 3.6: Remuneration practices in banks

There is widespread consensus that remuneration practices in banks contributed to the market disruption. Staff in certain areas of banking were incentivised to pursue overly risky practices, which although profitable in the short term, did not take appropriate account of risk over the long term. That many of these longer term risks are difficult to quantify cannot justify them being understated by senior management. The Government is clear that the banking industry, both in the UK and globally, needs to develop sustainable long-term remuneration policies that take better account of risk.

In the UK, the FSA has published a Code of Practice on remuneration, which it intends to add to the FSA handbook; the Code is currently being consulted on and the FSA aims to have it in place for firms' 2009 remuneration review processes. In parallel, the Walker Review is looking, among other things, at strengthening remuneration practices as part of improvements to corporate governance. Neither the FSA's work nor the Walker Review are intended to dictate the quantum of remuneration, either for individuals or at the level of groups or institutions. This remains a matter for those institutions. Rather, the Walker Review will look at how boards can oversee the establishment of appropriate remuneration policies that avoid contributing to excessive risk taking and financial instability.

It is clear that to be most effective, international cooperation is needed on remuneration policies to avoid a race-to-the-bottom in terms of attracting financial services between countries. The UK has played a leading role in developing an international approach. The FSA was a key player in the preparation of the Financial Stability Forum's (FSF's) Principles for Sound Compensation Practices report that G20 Leaders agreed at the London Summit to endorse and implement. The FSF's principles state that there should be: effective governance of compensation; effective alignment of compensation with prudent risk taking; and, effective supervisory oversight and engagement by stakeholders. The FSF report stated that these principles will be implemented by firms and supported by work at the national level; as the FSA is currently doing in the UK.

Furthermore, UKFI, which is wholly owned by the Government and operates on a commercial basis, is overseeing the remuneration conditions attached to subscribing to the Government's recapitalisation fund and working with RBS and Lloyds in the context of the Asset Protection Scheme. UKFI has worked to ensure that the banks subscribing to these schemes offer incentives based on the Government's principles on remuneration, including no rewards for failure, and to protect the interest of the taxpayer as a shareholder.

Reducing the impacts of the failure of financial firms

Banking Act 2009

3.54 The Banking Act 2009 received Royal Assent on 12 February 2009 and is a major reform in reducing the impact of a bank failure. The Act builds on existing arrangements to enhance the ability of the Treasury, the FSA and the Bank of England to deal with crises in the banking system, to protect retail depositors and to maintain financial stability. Box 3.7 sets out the main features of the Act.

Box 3.7: Banking Act 2009

The Government's approach to the Act was informed by the following high-level objectives:

- strengthening the stability of the financial system;
- reducing the likelihood of individual banks facing difficulties;
- reducing the impact if, nevertheless, they do;
- ensuring effective protection for retail depositors if they were to fail; and
- strengthening the Bank of England and ensuring effective co-ordinated actions by authorities in UK and internationally.

Key features of the Act include:

Prevention: Reducing the likelihood of bank failure by strengthening the existing regulatory structures, including:

- new powers for the FSA to collect information relating to financial stability;
- a statutory financial stability role for the Bank of England;
- the creation of the new Financial Stability Committee;
- improved arrangements for the provision of liquidity assistance by the Authorities, directly addressing issues that arose over Northern Rock; and
- formal regulation of inter-bank payments systems.

Resolution: The Act's centrepiece is a permanent and proportionate special resolution regime, providing the Authorities with a range of tools to deal with banks and building societies in financial difficulties. These include:

- a power to facilitate private sector purchase;
- powers to transfer some or all of a bank to a public sector bridge bank;
- the ability to take a bank into temporary public ownership; and
- new insolvency and administration procedures for banks and building societies, and powers to introduce a new insolvency regime for investment banks.

Compensation: Measures to improve the legal framework and efficiency of the FSCS, and measures to allow for the use of the National Loans Fund to provide the FSCS with immediate liquidity; a power to pre-fund the FSCS in the future; and measures further to protect holders of banknotes issued by commercial banks in Scotland and Northern Ireland.

3.55 The Government has already commenced important parts of the Banking Act 2009, including parts 1, 2 and 3 that introduce the special resolution regime. However, the Government is bringing forward further important steps to improve arrangements for dealing with failures in the financial system. As a result:

- as indicated in the Pre-Budget Report, the Government is conducting a detailed review of the arrangements surrounding the insolvency of investment banks. To support this work, the Treasury has established an expert review group, to consider whether it would be appropriate to make changes to market or regulatory practice, or to lay secondary legislation, to address the issues that have emerged around prime brokerage; and
- the Government will also outline a programme of consultations to implement other parts of the Banking Act.

3.56 The authorities have taken decisive action to protect bank consumers should a bank fail, including the Banking Act 2009 measures to increase the efficiency of the FSCS (as outlined in Box 3.7), and increasing the deposit compensation limit to £50,000. The Government will propose measures both in the UK and through the EU to continue to increase consumer protection, including:

- consulting on proposals to allow the FSCS to operate more effectively across a wider remit;
- working with the European Commission and other Member States to ensure that the EU develops tools for early intervention and crisis management, building on the UK reforms put forward in the Banking Act 2009; and
- continuing to support reforms to strengthen deposit guarantee arrangements in the EU and to press for the introduction of guarantee schemes to cover insurance across the EEA.

Protecting and supporting consumers

3.57 The recent disruption has seriously affected consumers' trust and confidence in financial markets. These developments come in addition to longstanding problems in retail financial services markets. The Government is already acting to address some of these problems, including by improving financial capability, reducing financial exclusion and introducing straightforward stakeholder products. The FSA's retail distribution review will help to improve the quality of advice, and remove so-called commission bias from the market.

Retail Financial Services Forum

3.58 In the 2008 Pre-Budget Report, the Government announced the establishment of the Retail Financial Services Forum (RFSF), chaired by the Economic Secretary to the Treasury. The RFSF has a remit to champion retail financial consumers' interests and help restore confidence in financial services. The Government will ask the RFSF to act as a steering group for the development of some of the proposals set out below and will identify and take forward others.

3.59 In its forthcoming document, the Government will put forward measures to support:

- confident and capable consumers, able to exert competitive pressure on the industry – such as arrangements for delivering consumer education;
- high quality financial guidance – through taking steps to prepare for a national Money Guidance service, following the Thoresen Review published in March 2008 (see Chapter 5 for more details on measures to help consumers make confident, informed financial decisions);
- access for all citizens to simple, transparent, value for money products which meet their needs – including work through the RFSF and legislative changes where needed;
- appropriate levels of consumer protection – including an effective framework of mortgage and credit regulation; and
- swift redress if things do go wrong.

Improving efficiency and competition

3.60 This chapter has described the importance of the financial system to the wider economy and society. In addition, the financial sector is itself a major source of income, exports, and employment to the UK.

Banking industry structure

3.61 Financial markets have changed substantially in recent years. Consolidation has accelerated, with a move towards larger financial institutions in many countries, including the UK. These developments are, to an extent, commercial matters. But they are also of concern for public policy – given their impacts on competition, consumers, and potentially, financial stability. There have been arguments made in favour of limiting banks in terms of the type of activity they undertake or the scale and complexity they can achieve. These issues are discussed in Box 3.8.

Box 3.8: Alternative approaches to regulating the banking sector

The banking sector can be regulated in a number of ways. One such way would be to introduce 'Glass-Steagall'-type provisions in the UK to divide investment-banking activities from core activities such as deposit-taking and lending, creating a 'narrow' versus 'broad' bank divide.[a] Others have suggested that it might be desirable to limit the scale and complexity of banking institutions.

The arguments in support of such approaches generally focus on the need and ability to protect the core banking system from risks to depositors, the taxpayer and wider financial stability, while arguing that implicit or explicit guarantees should not be used to facilitate other forms of speculative activity. The complexity of institutions does appear in some cases to have contributed to difficulties in managing risk and, potentially, supervision. Smaller, simpler institutions can be tackled much more effectively through resolution tools, such as the Banking Act in the UK, than more complex ones. And, of course, the failure of those larger firms is likely to be much more damaging if it does occur.

However, there are arguments against this type of divide. In the past, contagion to other parts of the system was largely seen as taking place through depositors. Events of the last 18 months have demonstrated that channels of contagion have become more varied and complex. Banks of all sizes have encountered difficulties recently and it is difficult to say that larger banks are more likely to fail than small ones or vice versa. Narrower banks, such as Northern Rock and London Scottish in the UK, have experienced difficulties as well as broad banks, such as RBS. Dividing commercial and investment banking businesses would not address counterparty risk exposures between banks, nor would it necessarily insulate pure deposit taking institutions from the failure of a large investment bank, so some of the issues raised by current market disruption would remain. It is also the case that broader and larger banks allow for stronger connections between the banking sector and capital markets, potentially benefiting market efficiency.

Resolving these tensions is a difficult judgment. However, the Government is not persuaded of the case for introducing 'Glass-Stegall'-type approaches. The most appropriate way to support banking stability is to ensure that new capital and liquidity requirements are designed to constrain activities that are inherently more risky, such as some types of proprietary trading; while ensuring that banks are structured to facilitate sensible resolution if things go wrong; and that they be prohibited from using overly complex structures that inhibit effective risk management – or face considerably higher capital requirements as a result. The Government will consider these issues more fully in its forthcoming paper.

[a] Glass-Steagall laws refer to provisions within the 1933 US Banking Act that created a separation of banking activities between commercial and investment banks. These measures were withdrawn in the US in the late 1990s.

Challenges

3.62 Key challenges for the medium-term to improve efficiency and competition include:

- planning for a coordinated reduction of state involvement in specific institutions over time, and acting to reduce distortions through the G20 and EU;
- considering steps to make it easier for new entrants to the financial services market in the context of the strengthening of financial regulation and consolidation within the financial sector; and
- supporting alternative ownership and business models to provide financial services (for example see discussion of mutual societies in Box 3.9). While global markets provide real benefits to customers and the wider economy, sometimes individuals and firms will want to deal with local providers, which understand and adapt to local circumstances.

3.63 As a result the Government will:

- continue to work closely with the G20 and the EU to ensure a coordinated reduction of state involvement in the financial sector;
- consider, building on the OFT financial services strategy published in April 2009[5], how best to encourage new entrants to the financial services markets; and
- put forward proposals to encourage a diversity of ownership structures of financial institutions, in particular encouraging mutuals.

Box 3.9: Diversity of ownership and encouraging mutuals

Throughout the world, most countries have a variety of different types of credit institutions. In the US, there are large, mostly international, banks and state-run banks and savings institutions. In the rest of Europe, many countries have a strong presence of mutually-owned or even state-owned banking institutions. In the UK, the building society sector has traditionally had a strong role in providing mortgages and saving products, alongside commercial banks. Credit unions also provide an alternative to mainstream financial providers in local communities. Maintaining a diversity of ownership and business models provides some additional resilience. Diversity also provides a source of competition and choice in the market for consumers.

The Government has a longstanding aim of enabling the mutual sector to grow and serve a wider section of the community. Together, mutual societies – building societies, friendly societies, industrial and provident societies and credit unions – across the UK have a combined membership of over 30 million and total assets of over £400 billion.

As well as providing choice in financial services provision, the mutuals sector also contributes to financial inclusion and the strengthening of local communities. As institutions, they command a relatively high degree of trust among consumers, which is all the more important in today's economic climate.

The Government has supported a number of pieces of legislation to modernise the mutuals business model and achieve a level of parity with the company form. The Government is announcing an important tax change in relation to mergers between some financial mutuals, as noted later in this chapter. The Government will put forward further proposals in its forthcoming paper to strengthen the mutual sector. This will include actions relating to the development and design of capital instruments and the potential for shared services between mutuals.

[5] www.oft.gov.uk

Dialogue with financial and professional services

3.64 The Government remains confident in the UK's position as a leading global finance centre in the medium- to long-term. In addition to shaping the future regulatory environment, the industry and the Government are working collaboratively on independent and joint actions that will strengthen the position of the UK financial and professional services sector over the next 10-15 years. As part of this work, the Government will press ahead with the implementation of the conclusions of the Rights Issues Review.

3.65 More generally, the Government will:

- continue to work closely with industry to prioritise and respond to the challenges facing sub-sectors such as insurance and asset management;
- consider, following the report of the Financial Services Global Competitiveness group, co-chaired by Sir Win Bischoff, to be published shortly, actions required to ensure that the UK financial services sector can maximise its contribution to its clients in the long-term;
- respond to the issues highlighted by the professional services industry in a recent report to Government, as crucial to its ability to contribute to the UK's productivity over the medium- to longer-term, such as nurturing skills and ensuring effective regulation; and
- continue deepening its economic and financial dialogues with key emerging markets such as China and India, providing a strong focus on market opportunities for UK-based firms.

Taxation of asset management

3.66 Budget 2009 brings to a conclusion work on an extensive package of measures to enhance the competitiveness of the UK as a centre for asset management (see Box 3.10).

Box 3.10: Taxation of asset management in the UK

Since publication of the Investment Management Association (IMA)/KPMG report on *Taxation and the Competitiveness of UK Funds*, the Government and the asset management industry have worked closely together to identify areas where tax reform could enhance the competitiveness of the UK in this sector. Advances to date include improved trust and understanding between Government, the FSA and the industry through quarterly meetings; a new tax efficient structure for funds which invest in property; replacing the tax rules for the Qualified Investor Scheme; HMRC guidance to give greater certainty on trading and investment regarding certain financial services transactions; and extensive consultation on options for reform of stamp duty reserve tax (SDRT) Schedule 19.

Budget 2009 announces further measures which will bring a conclusion to this work:

- launching a new **Tax Elected Funds regime to enable Authorised Investment Funds (AIFs)** to market themselves more competitively; and
- legislating to **clarify whether certain transactions will be taxed as trading or investment for UK AIFs** and equivalent offshore funds.

The proposals set out in the IMA/KPMG report regarding SDRT Schedule 19 have also been considered very carefully, and the possibility of reform has been discussed at length. However, following extensive consultation and discussion with the industry **the Government has decided not to go ahead with reform of Schedule 19 at this time but to retain the current regime**.

Discussions with the broader asset management industry have highlighted other areas where tax reform can enhance UK competitiveness. Budget 2009 announces **a new tax framework for Investment Trust Companies** to enable tax-efficient investment in interest bearing assets.

Taken together this package of measures makes significant progress towards enhancing the competitiveness of the UK as a key international centre for asset management.

Islamic finance

3.67 The Government can also announce three further measures on alternative finance as part of the ongoing drive to promote the UK as a centre for Islamic finance:

- provision of **relief from stamp duty land tax (SDLT)** in respect of transactions undertaken as part of the issue of alternative finance property investment bonds;
- provision of **relief from tax on capital gains** in respect of these types of transactions; and
- **clarification of how the capital allowances regime will interact with these changes** on SDLT and tax on capital gains.

These changes aim to align tax treatment of alternative finance products with their conventional equivalents.

Taxation of mutual societies

3.68 A measure will be introduced to enable the removal of tax barriers to transfers of business between mutual societies taking place on or after 22 April 2009.

Strengthening regulators and the international regulatory framework

UK regulatory system

3.69 Recent actions taken to safeguard and strengthen the UK's banking system and wider financial stability have demonstrated the ability of the Bank of England, the FSA and the Treasury to work together in an effective and timely manner to stabilise banks and support the long-term strength of the economy. It is also important that lessons are learned from the experience of recent events. The FSA recognised weaknesses in its supervision of Northern Rock and has implemented a far-reaching supervisory enhancement programme to improve its supervision of at-risk firms. The Banking Act 2009 strengthened the Bank of England's role in financial stability and modernised its governance arrangements. Finally, new challenges have arisen, in particular for the FSCS, given its significant borrowing and potential future role in managing any pre-funded scheme.

3.70 Following on from this work, the Government will bring forward proposals regarding the governance and accountability of the FSCS and the Financial Ombudsman Service to ensure that they are best able to respond to these challenges.

Macro-prudential approach

3.71 The G20 and the Turner Review considered the importance of a macro-prudential approach. Financial regulation to date has been based largely on the premise that if individual banks are sound, then the financial system overall is sound. This, as we now know, is insufficient for financial and economic stability. While each institution may have acted in compliance with its regulations, the rapid rise in leverage, asset prices, financial interconnectedness; and consequent deterioration in credit quality across the system created fragilities which allowed shocks to be amplified through markets and across institutions to such an extent as to risk undermining the capital supporting the entire banking system. As outlined in Box 3.11 below, the Government will consider further options to deliver a macro-prudential approach effectively in the UK.

International framework

3.72 Internationally, institutional changes are also required and the Government will take a lead through:

- continuing to press for the establishment of supervisory colleges, in line with the G20 commitment to establish the remaining colleges for significant cross-border firms by June 2009, to strengthen their ability to monitor and deal with risks in individual firms;

- with the FSA and the Bank of England, setting up cross-border stability groups with those countries with which it has significant shared financial market interests, consistent with the G20 commitment to implement the FSB principles for cross border crisis management immediately; and
- reviewing the sustainability of the current business models of offshore financial jurisdictions, as discussed in the Foot Review, described earlier in this chapter.

Box 3.11: Macro-prudential approach to financial regulation

A macro-prudential approach to regulation is designed to reduce the frequency and impact of systemic financial crises. It is "macro" in the sense that it goes beyond treating each customer, institution, or market in isolation but recognises the links between them both in an economic upturn and how they might change in a downturn.

The recent financial market disruption has highlighted several possible market failures that can create systemic risk, although real time diagnosis and solutions are often far more challenging than might first appear. Examples include asset bubbles, pro-cyclical bank capital, excessive leverage, fire sales in systemically important asset markets, opaque counter-party credit risk chains and institutions, markets or products too big or interconnected to fail. While not exhaustive, this list captures some of the interactions that are at the centre of the recent financial disruption.

A macro-prudential approach needs to be designed to complement traditional institution-by-institution prudential regulation to take account of how financial institutions interact together through markets with the aim of preventing systemic crises. It is not a panacea but a necessary part of a comprehensive macroeconomic framework for stability.

Internationally, a new Financial Stability Board (FSB) has been established to take account of macro-prudential risks. The FSB's mandate includes monitoring and advising on market developments and best practice in regulatory standards; and collaborating with the IMF on macro-prudential surveillance. G20 leaders have also agreed to reshape their regulatory systems so that they are able to identify and take account of macro-prudential risks and to extend regulation and oversight to all systemically important financial institutions, instruments and markets. Alongside this, in the EU, there is general support for establishing an EU-level macro-prudential body. This body should interact with the new wider international arrangements being discussed within the G20.

In the UK, the Government will put forward proposals on the best institutional arrangements to deliver an effective macro-prudential approach, involving the FSA, the Bank of England, and the Treasury. This will include consideration of what arrangements are necessary to identify and respond to macro-prudential risks and how this will operate within the Government's existing macroeconomic framework. Some of the key issues to consider will be:

- how best to incorporate a macro-prudential approach into the framework consistent with the guiding principles and responsibilities described in the Memorandum of Understanding, discussed earlier in this chapter;
- ensuring that any macro-prudential approach takes advantage of synergies with the existing capabilities and expertise of the relevant authorities;
- ensuring that the different authorities' macro-prudential responsibilities are consistent with their current objectives and responsibilities; and
- interactions between a macro-prudential approach and the wider macroeconomic framework.

Further steps

3.73 Building on issues discussed in this chapter, the Government will, before the summer, set out its approach to renewing financial markets for the long term, exploring these issues in greater detail and updating on progress on the G20 work and an outline programme for the implementation of the Banking Act 2009.

4 SUPPORTING BUSINESS

As set out in Chapter 2, the financial crisis has caused a steep and synchronised global downturn. This chapter outlines how Government support, alongside action to restore the flow of credit in the financial system, is helping businesses across the UK. Budget 2009 builds on this support with targeted measures that will help businesses' short-term cashflow, including:

- **further support to loss-making businesses, by extending the enhanced loss relief announced in the 2008 Pre-Budget Report for an additional year and expanding HMRC's Business Payment Support Service;**
- **enabling businesses to spread payment of this year's inflation up-rating to business rates over three years, as announced on 31 March 2009;**
- **a 'top-up' trade credit insurance scheme to help businesses maintain their finances, in which Government will offer to match private sector trade credit insurance provision, for a temporary period, if insurers reduce cover to any UK business; and**
- **for a temporary period, a vehicle scrappage scheme, co-funded with industry, that will enable consumers who scrap vehicles older than ten years to replace them with new vehicles at a discount of £2,000.**

Over the last decade, the UK has built up key strengths that provide a platform for growth as the UK emerges from the recession. Consistent with the strategic vision set out in *Building Britain's Future: New Industry, New Jobs*[a] published 20 April 2009, Budget 2009 announces a package of measures that will support the adjustment towards renewed economic growth and improve the UK's competitiveness, offering:

- **an increase in capital allowances for new investment to 40 per cent for one year, with effect from April 2009, to allow a higher proportion of private investment to be offset in that year against taxable profits;**
- **a £750 million Strategic Investment Fund to support advanced industrial projects of strategic importance, of which a third of the funding will be earmarked specifically for low carbon projects; and**
- **the implementation of a package of reforms to the taxation of foreign profits, including the introduction of an exemption for foreign dividends, supported by a limited restriction to the interest deduction rules.**

[a] *Building Britain's Future: New Industry, New Jobs*, HM Government, April 2009

SUPPORTING BUSINESS: RESPONSE TO THE IMMEDIATE CHALLENGES

4.1 The global downturn has hit confidence across the UK economy, with the recent British Chambers of Commerce *Quarterly Economic Survey* reporting historically low levels of business confidence across manufacturing and service sectors. The recession has put UK company finances under increasing pressure, with profits falling in the second half of 2008. Businesses have had to respond by drawing on cash deposits, cutting back on hiring and reducing investment.

Action to restore the flow of credit

4.2 The instability experienced in credit markets has had a widespread impact on all businesses, leading to restricted credit conditions and a decline in market confidence. As the global downturn intensified, the Government responded by taking decisive action to restore

the flow of credit to credit-worthy businesses and individuals, as outlined in Chapter 3. In October 2008, the Government introduced a support package that prevented the collapse of the banking system, stabilised the financial sector and protected savers. As set out in Chapter 3, the Government has secured commitments to additional business lending by banks participating in the Asset Protection Scheme. This will help improve confidence in the financial sector as a whole, as well as support business lending and investment.

Supporting the economy

4.3 As global demand for goods and services has fallen, the Government took action in the 2008 Pre-Budget Report to stimulate the economy to help UK businesses through the recession, announcing a package equivalent to 1 per cent of GDP in 2009-10. As part of this stimulus package, the Government reduced the standard rate of VAT to 15 per cent on 1 December 2008. This temporary reduction has provided support to businesses by stimulating consumer spending, helping reduce business debt, and supporting demand. In addition, the 2008 Pre-Budget Report announced the bringing forward of £3 billion of public investment from 2010-11 to 2008-09 and 2009-10. To date, investment in energy efficiency, transport, further and higher education, and improving the social housing stock, has helped secure jobs and sustain businesses across the UK.

Ensuring sound public finances

4.4 Sound public finances are essential for macroeconomic stability, which gives businesses and individuals the confidence to plan and invest for the long term. The Government has set out its strategy to reduce borrowing as the economy recovers, as outlined in Chapter 2.

HELPING BUSINESSES: SUPPORT FOR CASHFLOW

4.5 Alongside measures to stabilise the financial system and boost demand, the Government has taken action to address the specific cashflow problems facing business as a result of the recession.

HMRC Business Support Service

4.6 The 2008 Pre-Budget Report launched HMRC's new Business Payment Support Service to offer help to businesses facing temporary financial difficulties to spread tax payments over a timetable they can afford. Box 4.1 sets out the number of businesses that have benefited from this service so far. HMRC will continue to offer this service for as long as it is needed **and, from 22 April 2009, this service will be expanded to allow businesses expecting to make losses to offset these against tax bills due on profits from the previous year which they are unable to pay.**

Box 4.1: Business Payment Support Service

In total, by 19 April 2009, the service has helped over 100,000 businesses, who collectively employ over 600,000 people, spread tax payments worth almost £2 billion. This has included corporation tax, VAT and payroll taxes including employers' National Insurance Contributions. Support has been provided across UK regions and sectors.

Table 4.1: Regional impacts of HMRC Business Support Service

Region	Number of agreements	Value of support received (£ million)
East Midlands	8,470	147
East of England	10,200	177
London	12,660	286
North East	3,430	59
North West	12,460	212
Northern Ireland	3,140	59
Scotland	7,250	132
South East	17,650	318
South West	13,170	186
Wales	4,540	63
West Midlands	9,790	179
Yorkshire & Humberside	9,200	156

Source: HM Revenue & Customs

Loss carry-back

4.7 The 2008 Pre-Budget Report announced a temporary, one-year extension of trading loss carry-back for businesses from one to three years, for losses up to £50,000. **To support more businesses through the downturn, this temporary extension will now apply for two years from 24 November 2008 for companies, and for the 2008-09 and 2009-10 tax years for unincorporated businesses.** Together, these changes are expected to give around 140,000 loss-making businesses greater tax repayments to support their cashflow.

Business rates

4.8 As announced on 31 March 2009, the Government will enable businesses to spread the payment of the April 2009 inflation up-rating to business rates over three years. The Government will also allow those affected by the end of the 2005 transitional relief scheme to spread payment of the increase in their bills over three years. Business ratepayers are now able to defer around £700 million across 1.8 million properties.

4.9 In the 2008 Pre-Budget Report, the Government announced a temporary increase for the year 2009-10 to the threshold at which an empty property becomes liable for business rates. This change came into effect on 1 April 2009, and over 70 per cent of business properties will not be liable for business rates in 2009-10 if they fall empty. This will be of particular help to small businesses managing the short-term pressures arising from difficult property market conditions.

Wider support for SMEs

4.10 To help those small businesses affected by the recession, the 2008 Pre-Budget Report announced that the small companies' rate of corporation tax would remain at 21 per cent for 2009-10. This will help around 800,000 payers of the small companies' rate in the UK. **In addition, the Government will increase from 1 May 2009 the VAT registration threshold in line with inflation from £67,000 to £68,000,** keeping around 6,000 small businesses out of the VAT system.

Access to finance

4.11 Recognising the problems that businesses across the country have faced as a result of tightened credit conditions, the Government has announced measures to improve the availability of finance to credit-worthy businesses. The delivery of these measures has helped businesses gain access to finance and improved short-term cashflow, as set out in Box 4.2.

Box 4.2 Improving the availability of finance for Small and Medium-sized Enterprises (SMEs)

Over the last six months the Government has introduced four new schemes to help businesses that are experiencing problems accessing finance. Progress against these schemes is detailed below:

- **Enterprise Finance Guarantee** – provides participating banks with a 75 per cent Government guarantee on individual loans to viable businesses with less than £25 million turnover. Since its launch on 14 January 2009, nearly £290 million of eligible applications from over 2,500 small businesses have been assessed, are being processed, or have been granted.
- **Working Capital Scheme** – delivering against its commitments, the scheme was launched on 2 March 2009 and since then the Government has signed £1 billion of guarantees with banks for their working capital lending portfolios totaling £2 billion, freeing up capital to enable banks to provide additional lending to businesses. The additional lending delivered as a result of the Working Capital Scheme will contribute to the lending agreements agreed by banks from 1 March 2009.
- **The Capital for Enterprise Fund** – is being delivered by fund managers Aberdeen Assets and Octopus Investments. Applications for £49 million of investment (out of a total fund size of £75 million) have been received and are being assessed.
- **RDA transition loan funds** – these funds have enabled 156 businesses to borrow almost £18 million to date, out of the total £56 million. As the Enterprise Finance Guarantee is now fully operational, these funds will close once fully committed.

Working capital scheme

4.12 Together with other Government interventions, including the Asset Proctection Scheme, the Working Capital Scheme (WCS) is helping to stabilise the financial system, providing banks with the capital required to meet businesses' lending requirements. In addition, the Government will be using the WCS to introduce new schemes aimed at improving firms' cashflow, including the Trade Credit Insurance Scheme, and the proposed new Export Credits Guarantee Department letters of credit – further detailed below.

Prompt Payment

4.13 To offer further support and help SMEs' cashflow, all central government departments have signed up to the Prompt Payment initiative helping bring forward payments from 30 to 10 working days. Government departments have made good progress against this target and, in March 2009, 90 per cent of payments against a total annual value of around £66 billion were made within 10 days. Payment times to suppliers have also improved in Local Authorities and, based on current performance, up to £16 billion of payments will be made within 10 days.

Trade Credit Insurance

4.14 In line with the Government's objective of providing targeted support to address specific challenges that business are facing, the **Government announces a 'top-up' trade credit insurance scheme to help UK businesses maintain their finances.** Under this scheme, the Government will offer to 'top-up' private sector trade credit insurance provision for six months, as outlined in Box 4.3. The scheme will be available to the 14,000 businesses that already use trade credit insurance and will mitigate against disruption to the supply chain and cashflow of the 250,000 companies they do business with, if their trade credit limits are reduced.

Box 4.3 Government Trade Credit Insurance

14,000 companies of all sizes currently buy trade credit insurance against supplies to over 250,000 UK businesses as a guarantee that their bills will be paid. Suppliers who experience reductions in credit limits may choose to stop future deliveries or refuse to extend credit, adding to pressures on firms potentially already facing difficulties and tending to reduce the level of trade.

From May 2009 until end December 2009, suppliers will be able to purchase six-months' 'top-up' insurance from the Government if credit limits on their UK customers are reduced, backdated to 1 April 2009, providing another alternative to the abrupt disruption of supply and cashflow, and giving time for the businesses affected to adjust to changing circumstances.

The Government has worked collaboratively with the private sector insurers, who will provide this product on the Government's behalf, to design a scheme that is well targeted and protects taxpayers' interests. Therefore, the amount available to each supplier if a company's credit limit is reduced will be that which either restores cover to the original amount, doubles the amount the company is able to obtain from the private sector, or £1 million, whichever is the lower.

The aggregate level of insurance provided under the scheme will be capped at £5 billion, and companies from all sectors of industry and from all stages of the UK supply chain will benefit from the increased certainty that this scheme provides.

ECGD Letters of Credit Scheme

4.15 To further support trade and short-term cashflow, the **Export Credits Guarantee Department (ECGD) will consult shortly on a new facility to provide Government support for short-term trade finance through sharing risks with banks in confirming letters of credit** – a facility that would give exporters greater certainty of payment when selling goods in difficult markets. Before the summer, the Government will conclude a review into what other support ECGD could provide to help exporters deal with the consequences of the current instability in financial markets.

Vehicle scrappage scheme

4.16 To give a boost to the car industry during the current downturn, the **Government announces the introduction of a vehicle scrappage scheme.** A discount of £2,000 will be offered to consumers buying a new vehicle to replace a vehicle more than ten years old which they have owned for more than twelve months. The Government will set aside £300 million for this scheme with funding matched by manufacturers participating in the scheme. The Government will work with industry to introduce the scheme next month. The scheme will end by the start of March 2010, or when funding for the scheme has been used if earlier.

Business rescue procedures

4.17 The Government will work to ensure that the regulations and procedures for dealing with troubled companies work to facilitate company rescues whenever they are appropriate, that the maximum economic value is rescued from companies that get into difficulties, and that the knock-on effects of company insolvencies on their creditors are minimised. **Budget 2009 announces that the Insolvency Service will consult on:**

- **providing for new funding lent to companies in Company Voluntary Arrangement (CVA) or administration to have absolute priority status, to allow firms in difficulties to access the funding they need to get back on track; and**
- **extending the moratorium on creditor action against small companies trying to agree a Company Voluntary Arrangement to medium and large companies, so giving them breathing space to try to reach agreement with creditors.**

4.18 To prevent creditors from being treated unfairly through abuse of pre-pack sales, **the Insolvency Service will also publish a report in June 2009 on the operation of the first six months of the regime monitoring pre-pack sales and will then publish further follow-up reports on an annual basis.**

PREPARING FOR THE RECOVERY: ENCOURAGING INVESTMENT

4.19 The global recession has triggered a restructuring of economies around the world. As the UK economy begins to recover and rebalance towards saving, investment and exports, private sector investment is likely to account for a larger proportion of economic growth. The Government will aid this rebalancing with support for private investment in the short term, alongside the highest level of public sector net investment as a share of the economy for 30 years in 2009-10, as outlined in Chapter 6. The Government will also continue to build on the various reforms and investment programmes of the last decade to enhance productivity growth.

Supporting private investment

4.20 Private sector investment drives economic growth and prosperity. Business investment accounts for around 10 per cent of GDP, and also affects future growth through improvements to productivity. Tighter credit conditions coupled with demand uncertainty, caused by the global economic downturn, have led to a reduction in private investment over the past year, and investment is expected to fall further this year. The Government is implementing targeted action that will support business investment and help the economic recovery.

First-year capital allowances

4.21 To encourage investment, **the Government will introduce a first-year capital allowance of 40 per cent for one year with effect from April 2009. Firms investing over £50,000 in qualifying plant and machinery in 2009-10 will benefit from a higher rate of tax relief on investment.** The 95 per cent of firms that currently invest up to £50,000 will continue to benefit from the Annual Investment Allowance that enables business to offset their capital expenditure against taxable profits.

Investment in energy and infrastructure

4.22 The Government recognises the important role that investment in infrastructure will play in securing a prosperous economic future. Government spending on transport has increased by 70 per cent in real terms over the last ten years, helping to deliver over 130 major road schemes and improve journey time reliability on the railways. In addition, the UK will need to replace the equivalent of half of its current energy generation capacity over the next two decades, with an expected £100 billion of investment over the next 10 years to deliver the Government's renewable energy target.

Regulated sectors

4.23 Companies in the regulated sectors will be making significant investment over the coming years, as set out in Box 4.4. As well as supporting the economy now, this investment will help ensure that the UK has the right infrastructure in place to prosper in the recovery. The Government strongly encourages companies in these sectors to work with the regulators to bring more investment forward where it is also in the interests of customers.

Box 4.4 Investment in regulated sectors

The regulated sectors will undertake a significant amount of investment over future years:

- in the regulated gas and electricity networks, investment for 2009-10 and 2010-11 is expected to be over £4 billion a year – nearly 50 per cent higher than the level of five years ago. This includes network enhancement projects and additional investment to help prepare the networks for renewable generation to meet energy security and climate change objectives for 2020 and beyond. Ofgem is also currently consulting on approval for a further £450 million of investment to connect two of the Scottish Islands' grids to the UK mainland;
- in the rail sector, Network Rail published an expenditure programme of some £34.6 billion last month for the five-year period commencing April 2009, with capital investment expected to be in excess of £4.5 billion in both 2009-10 and 2010-11. There is around £7 billion more capital investment in the new regulatory period compared with the last five years. This investment will see the completion of a wide programme of platform extensions, the rebuilding of Reading and Birmingham New Street stations, and completion of significant phases of the Thameslink upgrade. This is in addition to the significant programme of non-regulated investment in the rail industry;
- in the water industry, company business plans identify investment of £8.5 billion between 2008 to 2010, with nearly £4 billion expected in 2009-10 alone. This investment will contribute to the continued maintenance of infrastructure and the improvement of quality standards. Ofwat is working with water companies to agree substantial levels of investment for the next price review period and has given a preliminary assessment that £19 billion of investment should be financed over the period. The earlier certainty this gives companies should enable investment during 2010-11 to show a smooth transition to the new regulatory period; and
- the current settlement for the regulated airports (Heathrow, Gatwick and Stansted) allows for investment of £1.5 billion in 2009-10 and £1.3 billion in 2010-11, an increase of around 12 per cent compared to investment in 2007-09. This represents a substantial investment programme at a challenging time for the aviation industry.

Investment in UK's future energy sources

4.24 Following the consultation launched at the 2008 Pre-Budget Report, **the Government announces a package of measures to encourage the economic recovery of the UK's oil and gas reserves. This package will include the introduction of incentives to encourage investment in small and technically challenging fields,** which could assist in unlocking around 2 billion barrels of the UK's remaining oil and gas reserves. The package also includes **measures to assist asset trades and give companies the certainty and stability they need to underpin investment.**

4.25 The Government's energy policy is driving £50 billion of low-carbon investment, as outlined in Chapter 7. Budget 2009 introduces measures that will benefit businesses in the transition to a low-carbon economy, such as loans to increase energy efficiency. Other measures will drive low-carbon energy projects, such as action to improve the project economics for combined heat and power, offshore wind, and support for low-carbon manufacturing. The Government is also taking action to encourage the use of renewable heat and microgeneration technologies. These measures will support investment and job creation in the energy sector.

Road and rail networks

4.26 Budget 2009 confirms investment that will improve rail services for passengers and freight customers. Over £15 billion of Government investment in the rail industry has been confirmed for the next 5 years, underpinning investment in passenger rail operations and Network Rail's infrastructure investment programme, as set out in Box 4.4. In addition, around £200 million will fund the development of a Strategic Freight Network, improving links between major ports, freight terminals and distribution depots. This will help reduce costs to industry and support green objectives by switching freight traffic from road to rail. The Government also remains committed to maximising value for money from future sale of the key assets of London and Continental Railways Ltd., following completion of its restructuring.

4.27 An important part of the Government's infrastructure strategy targets the reduction of road congestion and journey times on strategic road corridors. As part of the National Roads Programme, the Highways Agency is in the final stages of negotiations to sign the M25 widening contract, with works planned to begin next month. This project will deliver significant journey time reliability benefits as well as employing up to 4,000 people a year during the construction period.

Efficient water markets

4.28 In the face of economic and environmental challenges, there is an increasing need to find ways to allocate, treat and use water more efficiently. The Government welcomes the independent *Cave Review: Competition and Innovation in Water Markets*[1], which publishes its final report alongside Budget 2009, as set out in Box 4.5.

Box 4.5 The Cave Review: Competition and Innovation in Water Markets

The Government welcomes the Review's findings on competition and innovation and will now take them forward in England. The Government will consult with stakeholders on the implementation of:

- the legal separation of large companies' retail operations to drive competition and deliver efficiencies in the supply of water to business users, following further work by Ofwat to establish whether it would be appropriate to introduce a threshold below which the Government would not mandate small companies to separate and, if so, the level at which this should be set;
- a package of further reforms to the upstream water supply licensing regime which includes the creation of new licenses and replacing the cost principle for supplies to incumbents, retailers, or large customers with a criteria to be determined by Ofwat outside legislation; and
- reforming the mergers regime for water and the inset regime that allow suppliers to replace another under limited circumstances.

The Government will take forward further work on the Review's recommendation to assign a value to water to drive efficiency in the usage of the underlying resource, and will discuss with stakeholders ways to take forward proposals to improve the water industry's ability to innovate.

The Government agrees with the Review's conclusions that the current case for extending competition to households is not convincing. Extending retail competition will remain a decision for the UK and Welsh Assembly Governments, on the basis of advice from Ofwat and industry stakeholders. The Department for Environment, Food and Rural Affairs will, before the summer recess, issue a consultation on the retail competition package in its entirety so that its outcome can be included in the final Floods and Water Management Bill, and will also set out in detail how the Government intends to take forward the rest of the Review's recommendations.

[1] *Cave Review: Competition and Innovation in Water Markets*, DEFRA, April 2009.

4.29 Maintaining a regulatory system that allows companies access to appropriate finance at affordable prices is a key priority for the Government. As part of a gradual approach to furthering competition in water markets, the Government will look to take forward measures following consultation with companies, investors, and other stakeholders.

Improving the UK's skills base

Supporting development of skills

4.30 The economic downturn presents new challenges and the Government has responded through measures to support businesses and individuals, as set out in Box 4.6. Budget 2009 announces further support through extra training places for 18-24 year olds, as part of the package to support the long-term unemployed set out in Chapter 5. Over the longer term, the Government remains committed to a more demand-led system for skills and achieving a world-class skills base by 2020, as outlined in the 2006 Leitch Review of skills.[2]

Box 4.6 Skills

Since October 2008 the Government has announced a package of measures that will help businesses and individuals develop their skills during the downturn. Progress on these schemes is detailed below:

- the Government has enhanced its offer to SMEs, making them the focus of the £350 million increase in Train to Gain resources between now and 2010-11. From January 2009, SMEs have been able to access a more flexible offer, including funding for units of qualifications in business-critical areas. This has been well received by employers;
- in January 2009 the Government committed to delivering 35,000 additional apprenticeships this year. At least 21,000 of these will be in the public sector. The new National Apprenticeship Service launched this month is fully functional and working to expand apprenticeships and provide a single point of contact for employers and apprentices; and
- the Economic Challenge Investment Fund is a matched funding scheme backed by the Higher Education Funding Council for England. This will provide investment totalling £59 million, which will give support to businesses and others as a route to economic recovery. In total the fund will benefit over 10,000 businesses and nearly 50,000 individuals.

The Government has also taken action to respond to growing unemployment, including support now available for over 100,000 individuals made redundant or reaching six months of unemployment, as outlined in Chapter 5.

Train to Gain

4.31 The established Train to Gain service is responding to the needs of employers with total funding available rising to £925 million in 2009-10 and over £1 billion by 2010-11. From April 2009, Train to Gain and Business Link brokers have come together under the Business Link brand offering a fully integrated information, diagnostic and brokerage service to employers. The Train to Gain service is providing sector specific support through Compacts agreed with Sector Skills Councils. These Compacts, now worth over £600 million, offer flexibilities to respond to the specific needs of employers within a sector, for example by providing support for repeat qualifications or higher level skills.

[2] *Leitch Review of skills: Prosperity for all in the global economy - world class skills*, HM Treasury, December 2006.

Focussing on innovation

4.32 The UK has one of the strongest science and research bases in the world, and future prosperity will depend increasingly on making the UK a leading knowledge economy. Budget 2009 sets out progress in delivering the Government's long-term strategy and further steps to support business innovation.

Access to growth capital

4.33 To address under-provision of venture capital for technology and high-growth businesses, the Government launched Enterprise Capital Funds. Over the last decade we have seen providers of development capital moving further away from smaller investments. As set out in *Building Britain's Future: New Industry, New jobs*, the Government will launch a review to consider whether, and in what form, further intervention could increase the supply of long-term growth capital to small and medium sized businesses. This will include options for a Public-Private Partnership similar to the predecessor of 3i, the Industrial and Commercial Finance Corporation, leveraging private sector capital to address gaps in growth finance and risk capital.

Tax and innovation

4.34 As part of the Government's commitments to examine the challenges facing the UK tax system and ensure its competitiveness, and its focus on supporting the high-value added priority sectors in which the UK can excell in the future, the Government will consider the evidence for changes to the way the tax system encourages innovative activity and the relative attractiveness to global firms as they make decisions on where to locate their research and development and other innovation activities. Working with representatives across the business community, the Government will examine the balance of taxation of innovative activity, including intellectual property. The Government will assess the evidence on the potential impacts of any reforms on economic activity, such as the development and exploitation of patents and other intellectual property, location of manufacturing, research and development, investment and employment (as well as where intellectual property assets are held), and on tax receipts. The Government will consider further with industry and set out its assessment and proposed approach before the 2009 Pre-Budget Report. This assessment will draw on the expertise of the Business-Government Forum on Tax and Globalisation and on existing analysis such as the *Review and Refresh of Bioscience 2015* report, as well as a wider range of stakeholders.

Technology Strategy Board

4.35 The Technology Strategy Board (TSB) is the Government's lead agency for supporting business innovation. Building on international best practice, the TSB is investing in new challenge-led funding mechanisms, and will launch four more Innovation Platforms in the current spending period. It is also investing in technology demonstration projects, such as the Low Carbon Vehicles Demonstrator Competition, and will implement a reformed Small Business Research Initiative (SBRI) across Government from April 2009, to help SMEs gain better access to Government research and development procurement opportunities. **The Government will set aside £50 million as part of the new Strategic Investment Fund to enable the TSB to increase its capacity to support innovation in areas which have high potential to drive future growth, such as low-carbon technologies, advanced manufacturing and the life sciences.**

STEM skills

4.36 To further improve the teaching and learning of science, technology, engineering and mathematics (STEM), the Department for Children, Schools and Families (DCSF) has announced investment of £3 million in the coming year for the Triple Science Support Programme to provide additional training for 2,000 teachers, roll out a national mentoring programme for non-specialist chemistry and physics teachers, and launch a pilot programme to target up to 20 Local Authorities with low or no uptake of triple science. **DCSF will also invest £2 million over the next two years on additional support to widen post-16 participation in physics and mathematics,** including specialist professional development programmes for teachers and working with schools to review whole school attitudes to science and maths.

Enhancing the UK's competitiveness

Strategic Investment Fund

4.37 *Building Britain's Future: New Industry, New Jobs* identifies the way that Government action can support the UK's economic renewal and future growth, for example by building on the UK's strengths in manufacturing, services and the science base. In support of this, to ensure the UK is in a stronger position to take advantage of opportunities as the global economy returns to growth, **the Government will establish a £750 million Strategic Investment Fund** to support advanced industrial projects of strategic importance. £250 million of this fund will be earmarked for low-carbon investments, a further £50 million for the TSB and £10 million for UK Trade and Investment (UKTI).

Supporting exports

4.38 The UK's trading strengths and its ability to access export markets will be an important contributor to future prosperity. The April 2009 London Summit set out an ambitious programme to promote global trade, including ensuring the availability of at least $250 billion over the next two years to support trade finance through national export credit and investment agencies and through the Multilateral Development Banks. To improve the availability of support for trade, **the Government will look at the existing and potential support offered by ECGD, and the ECGD's operating framework, with the aim of ensuring the organisation can play a significant role in supporting UK exporters during the economic recovery.** This review will be concluded before the autumn. In addition, to help UK businesses better showcase their strengths to overseas customers and markets, **the Government is channelling £10 million of the Strategic Investment Fund into UKTI to be spent on events to promote UK sector expertise both in the UK and abroad.**

Digital Britain

4.39 A modern knowledge-based economy will need to be underpinned by a strong communications infrastructure. Building on the UK's strong wired and wireless digital communications networks, the Government's ongoing Digital Britain Report has identified further challenges that need to be addressed now in order to ensure an even stronger platform for the future.

4.40 Budget 2009 announces that **the Government will pursue Universal Service in broadband, at a speed of 2 Megabits per second, by no later than 2012**. This target will allow virtually everyone to experience the benefits of broadband, including the increasing delivery of public services online. It will also offer advantages to UK businesses, both those located in areas that will benefit from the network upgrade and those that make use of online channels to engage with their customers. Universal Service will be complemented with **further support to improve basic digital skills and promote broadband take-up**, in order to ensure that adoption of broadband continues to grow in line with the expanding opportunities available. The Government will consult with the BBC Trust on how the emerging underspend from the Digital Switchover Help Scheme can be drawn on to fund Universal Service and take-up. If necessary, the cost would also be met through additional funding mechanisms, as set out in the Digital Britain Interim Report. Details will be set out in the Final Digital Britain Report.

4.41 The Government also recognises the important role that next-generation broadband can play in developing the UK's digital communications infrastructure. In advance of the Digital Britain final report, **the Government will review the powers and duties of Ofcom to ensure it can strike the right balance between delivering competition and encouraging investment in the communications infrastructure**. In addition, the temporary increase in capital allowances for new investment, outlined above, will support businesses investing in the communications infrastructure. To stimulate economic activity, **the Government has also approved 'Digital Region', a £100 million project led by Yorkshire Forward**, which will roll out next-generation broadband to South Yorkshire.

4.42 Access to suitable radio spectrum is critical to the future extension of mobile communications technologies. The Digital Britain Report is currently concluding the Spectrum Modernisation Programme to enable the early deployment of next-generation mobile networks. Internationally, it will also be important to agree this summer a revised EU Telecommunications Framework. These actions will provide the sector with further opportunities for innovation, competitiveness and growth, including through commitments to move towards greater liberalisation of spectrum, which supports up to 2.5 per cent of the EU's GDP.

Creative industries

4.43 In 2008, the Government published *Creative Britain*[3] - a strategy for supporting this important sector of the economy. Since then, the Government has launched a number of programmes in support of this strategy. These include ten Find your Talent pathways, a £25 million programme to provide children with opportunities to take part in a wide range of high quality cultural experiences, and a £10 million programme of research and development for the creative industries, led by the TSB, which is awarding grants to almost 300 UK-based companies and academic institutions. The Government will continue to build on this work. In June 2009, the Government will publish national best-practice advice on business support for the creative industries for Business Links in each participating region. In July 2009, the Local Government Association and the Work Foundation will publish a toolkit of actions to help Local Authorities support creative industries in their areas. In October 2009, the first Creativity and Business International Network (C&binet) conference will take place, which will raise the international profile of the UK's creative industries and address a range of issues of importance to creative sectors, including intellectual property. To improve the skills base of the creative industries, Sector Compacts with the Sector Skills Councils that cover the creative industries will tailor Train to Gain provision to meet the particular needs of employers.

Life sciences

4.44 Life sciences research presents significant potential for new applications and markets in advanced economies with ageing populations. The Government has created a new Office for the Life Sciences (OLS), which will work with industry to make further improvements in the operating environment for the pharmaceutical, medical biotechnology, and healthcare technology industries in the UK, culminating in the publication of a Life Sciences Industrial Strategy this summer. As a first step, the Government will publish its response to Sir David Cooksey's *Review and Refresh of Bioscience 2015* in May 2009. This will set out action in a number of priority areas, including stronger incentives to support participation in clinical research and steps to promote innovation in the NHS, and action to tackle regulatory barriers and skills gaps.

Low-carbon

4.45 The low carbon and environmental goods and services sector in the UK is projected to grow by up to £45 billion by 2015, taking its total up to £150 billion, as set out in Chapter 7. By then the sector could employ 1.3 million, up by 400,000 from today. The shift towards a more sustainable economy and the rising demand for low carbon products and services will present further challenges and opportunities for UK businesses.

4.46 In support of further opportunities for wind and marine energy, manufacturing and other low carbon investments, **£250 million will be allocated from the new Strategic Investment Fund to help UK industry benefit from low-carbon investment opportunities. Combined with further funding set out in Chapter 7, this will mean £405 million to support the development of the low-carbon energy and advanced green manufacturing sector in the UK.** The funding will not only support the development and deployment of low-carbon technologies but will also help attract and protect investment in the UK's renewables sector.

[3] *Creative Britain: New Talents for the New Economy*, DCMS, February 2008.

Investment across the regions

4.47 Successful regions and places are essential in a globalised economy to drive competitiveness and support businesses in the UK. Over the past decade, the Government has devolved decision-making to the most appropriate administrative level, recognising the need for programmes to take account of regional and local economic conditions and to be tailored to meet local needs effectively.

4.48 Recognising the importance of city-regions to future growth, **the Government announces new pilot city-regions in Greater Manchester and Leeds.** The pilots will be overseen at ministerial level, and will draw on recent work from the Manchester Independent Economic Review and on innovation in the Leeds city-region in order to agree joint priorities with the Government that will support economic growth. The Government will work with the pilots to develop proposals for new strategy-setting powers over adult skills funding, expected to be in place within three to six months, new joint investment boards with RDAs, the Home and Communities Agency (HCA) and other partners to coordinate and align investment and pilot new employment programmes.

4.49 The Government is also interested in developing new opportunities for innovative financing mechanisms to support locally driven investment in growth and regeneration. **The Government will work with interested local authorities and city-regions to assess the scope for accelerating development by allowing investment in infrastructure to be financed from the increased property tax base that could be enabled by the existence of improved infrastructure.** As part of this, the Government will explore with local authorities the potential benefits, costs and feasibility of piloting such an approach. In the 2009 Pre-Budget Report, the Government will report on this analysis and the options for taking it forward.

ENSURING THE UK REMAINS AN ATTRACTIVE PLACE TO DO BUSINESS

Reforming tax and regulation

Foreign profits

4.50 The 2008 Pre-Budget Report announced reforms to the taxation of foreign profits, representing a move towards a more territorial system of taxing foreign subsidiaries. **The Government announces the introduction from 1 July 2009 of an exemption from tax for foreign dividends received by all companies. This will be supported by a limited restriction to the interest deduction rules, which has been refined following discussions with business and will be introduced for accounting periods beginning on or after 1 January 2010.** Furthermore, consequential changes to the controlled foreign companies (CFC) rules and replacement of the Treasury Consent rules with a post-transaction reporting requirement will be introduced from 1 July 2009.

4.51 In addition, **the Government announces that it will exempt from tax dividends received from UK companies by corporate members of the Lloyd's insurance market; this will align their tax treatment with that of general insurance companies.**

4.52 The 2008 Pre-Budget Report signalled the Government's intention to continue to examine longer-term options to reform the UK's CFC rules. The reform aims to enhance UK competitiveness by seeking to improve the way the CFC rules achieve their objective of taxing profits diverted from the UK. Initial evidence gathering is under way and a liaison committee has been established to strengthen business involvement and complement wider consultation with stakeholders.

Tax simplification

4.53 The Government announces further progress on tax simplification from its four reviews:

- **VAT rules and administration: from 1 April 2009, the Government simplified the operation of the VAT standard partial exemption method, reducing compliance costs for up to 120,000 mainly smaller businesses.**
- **anti-avoidance legislation: the Government will consult this summer on proposed improvements to transactions in securities legislation and publish a discussion document on the greater alignment of purpose tests in tax law.**
- **corporation tax rules for related companies: the Government will simplify the corporate gains rules for notional transfers within a group of companies and will publish a discussion document on further simplification of group aspects of corporate gains by the summer. The Government will also consult this summer on further simplification of the associated company rules.**
- **corporation tax calculations and returns for smaller companies:** responses to the 2008 Pre-Budget Report discussion document, a summary of which will be published shortly, indicated little support for the options outlined and the Government will not pursue these. There was greater interest in simplifying accounting requirements, and BERR will draw on these responses when considering the scope to simplify accounting rules for micro companies under European Commission proposals. HMRC will consider whether any changes create scope to make simplifications to the tax calculations for micro companies.

4.54 As set out in this and other chapters, the Government also announces further targeted tax simplifications to reduce burdens on business, benefiting sectors across the UK economy. These measures include **permanently aligning the three-line account threshold for income tax self-assessment with the VAT registration threshold, enabling around an additional 800,000 businesses to submit shorter tax returns.**

4.55 Since 2006, the Government has implemented or committed to new measures that will deliver savings to business of around £540 million a year. **Alongside Budget 2009, HMRC is publishing an update on progress against its administrative burden reduction targets along with details of measures it is taking to support businesses.**[4]

Regulation

4.56 The Government is continuing its drive to minimise regulatory burdens, to improve the quality of new regulation and to review and simplify existing regulation. Departments are on track to reduce administrative burdens of regulation by 25 per cent between 2005 and 2010, saving business £3.4 billion a year. To ensure that national and local regulators help business to comply with the law efficiently, the recently launched voluntary Primary Authority Scheme will provide greater certainty to businesses that deal with multiple local authorities.

4.57 To improve the quality of regulation and ensure that it is assessed as to whether it has achieved its objectives, in 2008 the Government committed to publishing reviews of all Acts of Parliament passed since 2005 within three to five years of Royal Assent. The Cabinet Office is working with all departments to ensure that Government delivers on this commitment. The first such review was published in December 2008 and all reviews on other Acts of Parliament passed in 2005 will be published by 2010.

[4] *Delivering a new relationship with business: Reducing burdens and supporting business*, HMRC, April 2009.

4.58 The Government has announced that it will establish a new regulatory management framework, which will include a sub-committee of the National Economic Council and a new advisory panel, the Regulatory Policy Committee. The Government has also committed to publish its forward programme of regulation regularly to increase the transparency of the regulatory process, and to set further targets for simplifying regulation between 2010 and 2015. The Government will work closely with EU partners to strengthen the EU better regulation agenda and ensure the current pressures on business are taken into account when new European regulation is being considered.

Supporting enterprise

Public procurement for SMEs

4.59 Following the recommendations of the Glover Committee, the Government will introduce a series of reforms by the end of this year to improve access to Government contracts for SMEs. These include the measurement of SME spend, flagging SME-friendly contracts, guidance and tools for simplified pre-qualification procedures, and training for procurers and SMEs. A single, free of charge, opportunities portal will be delivered by December 2010.

Business Support Simplification Programme

4.60 The Government launched in March 2009 the Solutions for Business portfolio, which defines the range of business support provided by all levels of Government – nationally, regionally and locally. All new forms of business support will also be delivered through this portfolio. This is a step towards delivering the Business Support Simplification Programme, which will reduce the number of Government schemes from over 3,000 to no more than 100 by March 2010. Building on this, the Government will publish, alongside the 2009 Pre-Budget Report, a detailed report on progress against delivery that will set out what has been achieved, give early indications of the associated benefits, and outline the strategy for maintaining and building on this simplified framework in the future.

Venture Capital Schemes

4.61 In addition, **the Government announces four legislative changes to the Enterprise Investment Scheme (EIS), as a result of consultation last year, that will simplify and improve the operation of the scheme.** One of the changes, relaxing the timing rules for employing money raised from an EIS share issue, will also be applied to the Venture Capital Trust and Corporate Venturing Schemes.

5 Helping people fairly

Low inflation and interest rates mean many households will have higher real incomes in 2009. In addition, households have benefited from action that the Government has taken to support economic recovery, including an increase in the personal allowance and a temporary cut in VAT. However, the Government recognises that many households have been hit by the downturn, including those affected by rising unemployment or by falling hours or wages.

Budget 2009 announces further Government action to support employment, to help savers and families with children, to support pensioners and to help people manage their finances, including:

- **an additional £1.7 billion set aside for the Department for Work and Pensions** to sustain the high numbers of individuals currently moving off Jobseeker's Allowance in the early months of each claim and provide support for the minority who remain unemployed for longer periods;
- **a guaranteed job, training or work placement for all 18-24 year olds who reach 12 months unemployed** to ensure no young people are left behind due to long-term unemployment;
- **an additional payment alongside this year's Winter Fuel Payment, worth £100 for households with someone aged over 80 and £50 for households with someone aged over 60**;
- **an increase in the annual investment limit for Individual Saving Accounts to £10,200, up to £5,100 of which can be saved in cash.** These higher limits will be available to people aged 50 and over from 6 October 2009 and available to all from 6 April 2010, directly benefiting over five million people who currently use their full ISA allowance;
- **an increase to the child element of the Child Tax Credit of an additional £20 a year above indexation from April 2010,** providing valuable support to families with children;
- **an additional £125 million in 2009-10 and £145 million in 2010-11 allocated to the Social Fund;** and
- **an increase in the level of statutory redundancy pay, making the weekly rate £380.**

Budget 2009 also announces a package of measures to help homeowners, homebuyers and the housing market:

- **a £600 million funding package of measures to build more homes through unlocking sites currently sitting dormant;** and
- **an extension of the stamp duty holiday for all houses costing up to £175,000 until 31 December 2009.**

In addition, Budget 2009 announces:

- **that from April 2010, an additional rate of income tax of 50 per cent will apply to income over £150,000, and the income tax personal allowance will be restricted for those with incomes over £100,000;**
- **that from April 2011, tax relief on pensions contributions will be restricted for those with incomes of £150,000 and over, and tapered down until it is 20 per cent;** and
- **changes to alcohol and tobacco duties, and a package of measures which will protect £3 billion of tax receipts a year by 2010-11 from tax evasion and avoidance.**

5.1 Budget 2009 announces further action by the Government to support households, building on measures announced at and since the 2008 Pre-Budget Report. The Budget also announces changes to income tax and pensions tax relief which will ensure that those individuals with the highest incomes make the largest contribution to fiscal consolidation.

5.2 Action to support the stability and effective functioning of the financial system, as set out in Chapter 3, has secured people's savings and allowed banks to continue to provide finance to support businesses, jobs and growth.

5.3 Many households are also benefiting from the combination of falling energy and mortgage costs, factors which are also contributing to low inflation:

- reductions in interest rates mean that, on average, the 4.5 million people on tracker mortgages are saving £230 per month. They will also benefit those who have come to the end of fixed rate deals who would otherwise have faced a rise in their repayment costs;
- CPI inflation has fallen from 5.2 per cent in September 2008 to 2.9 per cent in March 2009. RPI inflation, which includes mortgage interest payments, was –0.4 per cent in March 2009 and is forecast to fall further this year. This means that for those in work real incomes will grow; and
- households that rely on state sources of income such as benefits or pensions will have seen gains from April, with the largest cash increase in benefits since the early 1990s. These households will see further increases in their purchasing power next April as benefits are held constant while prices fall, and the basic State Pension increases by 2.5 per cent.

5.4 These gains have been reinforced by action taken by the Government at the Pre-Budget Report to provide broader support for the economy through the fiscal stimulus, and to provide additional financial support for those who need it most. Families and individuals are already receiving this additional support:

- from the reduction in VAT from 17.5 per cent to 15 per cent throughout 2009;
- 22 million basic rate taxpayers under 65 gain £145 in 2009-10 from increases to the personal allowance, up from £120 in 2008-09, as compared to the position in April 2008;
- 7.5 million families with children and 12 million pensioners have benefited from bringing forward increases to Child Benefit and the Child Tax Credit, the introduction of the Health in Pregnancy Grant, and the one-off £60 payment to pensioners made earlier this year; and
- around 355,000 households who have experienced a drop in income are receiving more tax credits than they would otherwise have done, and have therefore benefited from the inbuilt flexibility and responsiveness of the tax credits system.

5.5 However, the Government recognises that many households are facing more difficult circumstances, and uncertainty, as a result of the downturn. Budget 2009 provides additional targeted support to help those who have been hit hardest.

Supporting Working Households

Tax credits flexibility

5.6 The tax credit system, put in place by this Government, is specifically designed to provide additional support when people need it most. In the year ahead, the inbuilt flexibility of the tax credits system will provide extra support to families that find themselves living on a lower income.

Box 5.1: Tax credits – flexible support when household income changes

Tax credits are available to nine out of ten families with children, and to 1.5 million working people without children on low incomes. The Government spent an extra £4 billion on tax credits in 2008-09 compared to the previous year, and in April significantly increased the support available. The additional help available as a result of the inbuilt flexibility of tax credits can be substantial:

- a working couple with two children whose income falls from £25,000 to £10,000 per year could benefit by up to an extra £112 per week; and
- a couple working on the National Minimum Wage (NMW) without children where one partner becomes unemployed could become eligible for up to £68 per week.

Tax credits can also help people experiencing changes to their work situation by continuing to provide support for four weeks after people cease to qualify for the Working Tax Credit (WTC).

The Government recognises that many people are now working reduced hours and so **from 31 July this protection, worth up to £32 per week for someone on NMW, will be extended to cover people who would lose their entitlement to WTC because of a move to part-time working. The Budget also announces extensions to this protection to include support for childcare.**

People can notify HMRC of their changed income and circumstances over the phone, and they could rapidly benefit from the additional support. This support is benefiting an even larger number of households than normal, with around 355,000 households who were living on a lower income in March receiving on average £35 more per week in tax credits, 55,000 more than at the same time last year. **From the end of this month HMRC will also refocus its tax credit marketing to remind people to provide up-to-date information if their circumstances change.**

Increasing take-up of Working Tax Credit for those without children

5.7 Take-up of tax credits by families with children is already very high. **HMRC has now set an ambitious target to raise take-up of WTC among people without children by 100,000 by April 2011.** HMRC will continue to expand its work with employers to increase take-up, which is now reaching around 750,000 employees at over 50 organisations, and its work with Jobcentre Plus to help those going in and out of work. **In the coming year HMRC will also begin new research-driven marketing aimed at the half a million people who stand to gain the most from taking up WTC, and launch a pilot using data from Pay As You Earn records to identify and contact potentially eligible people.**

The Working Tax Credit and the National Minimum Wage

5.8 At the same time, the Government will continue to improve incentives for people to participate and progress in the labour market to ensure that people are well placed to make the most of the opportunities available now, and when growth in the economy resumes. From this April, the Government has increased the support available through WTC. The Government also acted on the recommendations of the independent Low Pay Commission (LPC) by increasing the hourly NMW from 1 October 2008: to £5.73 for adults; to £4.77 for 18-21 year olds; and to £3.53 for 16-17 year olds. The LPC will publish their recommendations for October 2009 NMW rates in May 2009.

Improving gains to work

5.9 These steps help to ensure that people have an incentive to enter the labour market. Table 5.1 shows that, since introducting the NMW in April 1999, the Government has substantially increased the minimum income that people can expect when moving into work.

Table 5.1: Weekly minimum income guarantees (MIGs)

	April 1999	April 2009	Percentage increase in real terms[1]
Family[2] with one child, full-time work	£182	£305	31%
Family[2] with one child, part-time work	£136	£237	36%
Single person, 25 or over, full-time work	£113	£196	35%
Couple, no children, 25 or over, full-time work	£117	£232	55%
Single disabled person in full-time work	£139	£244	37%
Single disabled person in part-time work	£109	£176	26%

Assumes the prevailing rate of NMW and that the family is eligible for Family Credit/Disability Working Allowance and Working Tax Credit/Child Tax Credit. Full-time work is assumed to be 35 hours. Part-time work is assumed to be 16 hours.

[1] RPI growth is taken from HM Treasury's economic forecasts.

[2] Applies to lone-parent families and couples with children alike.

The poverty trap

5.10 Marginal deduction rates (MDRs) are one measure of the extent of the poverty trap, which occurs when those in work have limited incentives to increase their earnings. They show how much of each additional pound of earnings is lost due to taxes and withdrawn benefits or tax credits. Table 5.2 shows the reduction in the number of families facing MDRs in excess of 70 per cent since 1997. The increased numbers facing MDRs of between 60 and 70 per cent reflects the introduction and increased generosity of tax credits since 1999, which has extended financial support to many more families, including, for the first time, those without children.

Table 5.2: The effect of the Government's reforms on high marginal deduction rates

Marginal deduction rate[1]	Before Budget 1998	2009-10 system of tax and benefits
Over 100 per cent	5,000	0
Over 90 per cent	130,000	60,000
Over 80 per cent	300,000	225,000
Over 70 per cent	740,000	305,000
Over 60 per cent	760,000	1,960,000

[1] Marginal deduction rates are for working heads of families in receipt of income-related benefits or tax credits where at least one person works 16 hours or more a week, and the head of the family is not receiving pensioner or disability premia.

Note: Figures are cumulative. Estimates for the 2009-10 system of taxes and benefits are calibrated to tax credits statistics for April 2007, and earlier data for Housing and Council Tax Benefits. The estimates make explicit allowance for families newly entitled to Housing and Council Tax Benefits from October 2009, but any such estimates are subject to significant uncertainties, in particular concerning likely take-up.

Supporting families to reduce child poverty

Tackling child poverty

5.11 Between the late 1970s and the mid 1990s child poverty in the UK doubled. In 1999, the Government pledged to eradicate child poverty within a generation. As a result of investment across the UK significant progress has been made. Between 1998-99 and 2006-07 some 600,000 children were lifted out of relative poverty. Measures announced in and since Budget 2007 will lift around 500,000 more children out of relative poverty.

How families are being supported already

5.12 Despite this progress the Government recognises that the global economic difficulties have meant that many families across the country are facing new pressures. The Government's priority is to help all households, particularly the vulnerable. The 2008 Pre-Budget Report set out the following increases in financial support, which families are now receiving:

- the bringing forward of increases to Child Benefit, worth over £22 on average to families, between January 2009 and April 2009, to support all families across the UK;
- the bringing forward of the Government's commitment to increase the child element of the Child Tax Credit by £25 above indexation from April 2010 to April 2009, so that the child element increased by £150 a year in April 2009; and
- the introduction in April 2009 of the Health in Pregnancy Grant, worth £190 for all women after the 25th week of pregnancy, is expected to benefit 780,000 families a year.

5.13 Budget 2009 builds on this progress and sets out the next steps for supporting vulnerable groups through the downturn. To further help low-to-middle-income families, **the child element of the Child Tax Credit will increase by an additional £20 a year above indexation from April 2010 providing valuable support to families with children.**

5.14 As described in Box 5.1, the flexibility and responsiveness of tax credits is designed to tailor financial support to current circumstances and respond quickly to changing needs. To help minimise disruption to children in families falling out of work, and to ensure parents can continue to use childcare while they look for work, **the Government will amend the law to make clear that from 31 July the current four-week run-on of entitlement to WTC also covers the childcare element, worth on average £68 per week, including for couples when only one partner stops working.**

5.15 Take-up of tax credits is higher than for any previous system of income-related support. However, the Government is not complacent. Take-up of other benefits is not as high, and tackling child poverty for the long term will require ensuring that financial support reaches everyone who needs it. The Government is grateful for the work of the Take-up Taskforce, established at the 2008 Pre-Budget Report and will work to **join up the delivery of financial support and help local authorities in improving take-up of tax credits and benefits.**

The long term

5.16 The Government remains committed to the sustainable eradication of child poverty and will enshrine this target in legislation. Legislation will drive action to ensure the Government achieves its vision of a fairer society where every child has the opportunity to achieve their potential.

Box 5.2: Child poverty Bill

In *Ending Child Poverty: Making it Happen*,[1] published in January, the Government set out its proposals to legislate on the commitment to eradicate child poverty to ensure that it remains a national priority and that all parts of society are enabled to play their role in tackling child poverty. The Government will publish a summary of the consultation responses alongside the introduction of a Bill which will be published shortly. The Bill will:

- create a clear definition of success in primary legislation. Legislation will set child poverty targets using relative low income; persistent poverty; and material deprivation combined with low income indicators. In addition, reflecting the views of many respondents, **legislation will reflect the need to make progress on absolute low income;**
- create a clear and transparent accountability framework. Legislation will require the Government to publish a child poverty strategy, to be refreshed every three years, evaluating progress towards the 2020 vision and setting milestones for future action across a wide range of policy areas. In recognition of stakeholders' views, **legislation will also require the Government to have regard to advice published by an expert commission ahead of each three-year strategy;** and
- improve partnership working and collaboration to tackle child poverty at a local level. **Legislation will require local authorities and delivery partners to work together to tackle child poverty and to set out the contribution that they will make in their local areas.**

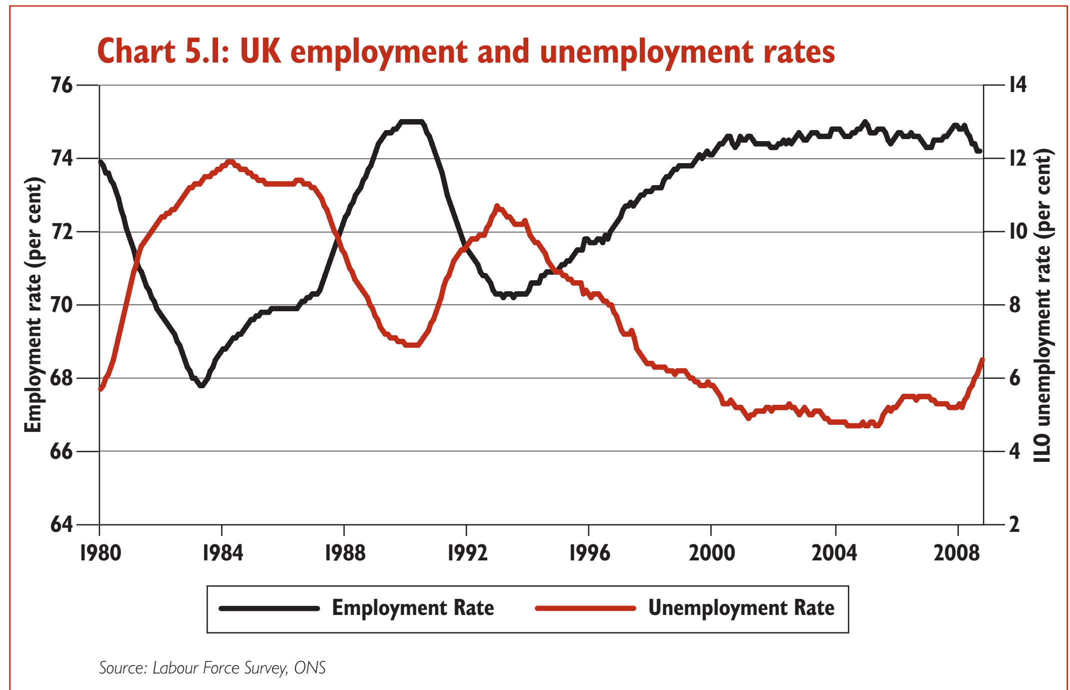
Labour market performance

5.17 The recent deterioration in the economy has put pressure on the labour market, and the Government recognises that many people are concerned about their employment prospects.

5.18 The UK labour market has entered the downturn from a position of strength. In January 2008, claimant count unemployment fell below 800,000 for the first time in over 32 years, and employment recorded a historic high in the three months to May 2008. However, unemployment has increased sharply since 2008, particularly during the first quarter of 2009.

5.19 Welfare reforms since 1997 have helped to create an open, dynamic and flexible labour market in the UK that is responding to the challenge of rising unemployment. Jobcentre Plus is also continuing to provide an effective service, ensuring large numbers of people move back into work quickly during this downturn.

[1] *Ending Child Poverty: Making it Happen*, HM Government, January 2009 (available at http://www.hm-treasury.gov.uk)

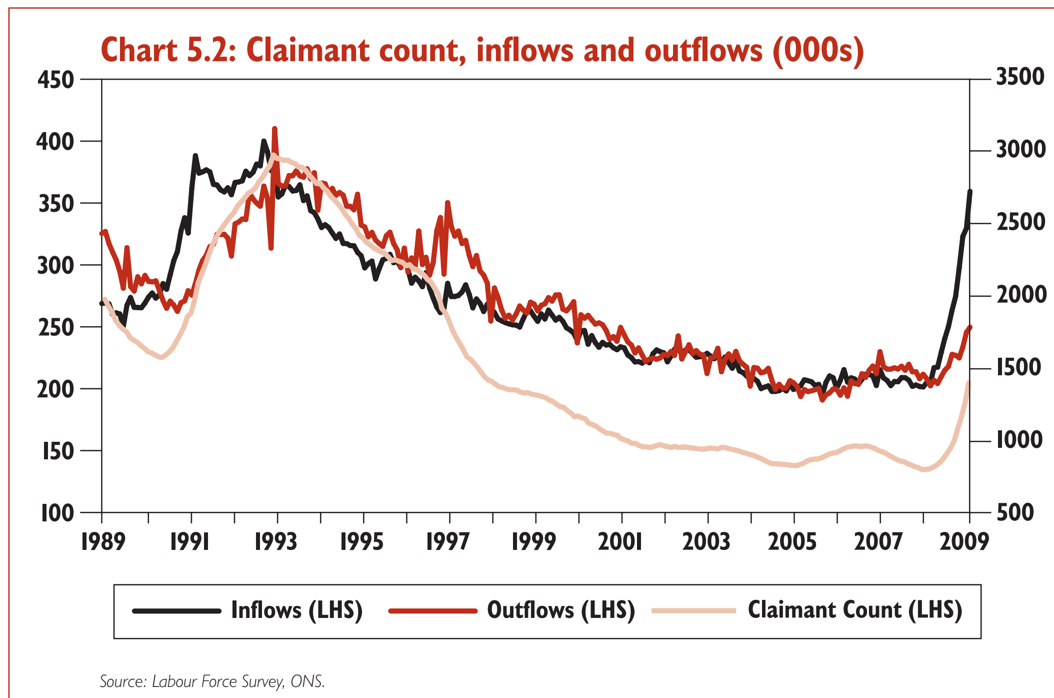


Responding to Labour Market Conditions

5.20 The loss of jobs can devastate families and communities, and as seen in the 1980s recession can lead to long-term detachment from the labour market. In particular, the concentration of unemployment amongst certain groups, or in certain areas, can have long-lasting social costs. The Government is therefore taking action now to help individuals move back to work as quickly as possible, and to support those most affected by unemployment.

Current Support – Jobcentre Plus

5.21 The reforms to Jobcentre Plus and Jobseekers Allowance (JSA) since 1997 have ensured that for the majority of new claimants, unemployment is short-lived, with 57 per cent of people moving off JSA within three months. Because of this, the rise in unemployment is starting from a much lower base than in the previous recession (see Chart 5.1). In addition, as Chart 5.2 shows, numbers moving off JSA have increased quickly – an average of a quarter of a million people a month in the start of the year. There continues to be considerable demand for new workers, with over 10,000 new vacancies being made available in Jobcentre Plus every working day.



Help announced at the Pre-Budget Report

5.22 The Government recognises that extra support is needed through the recession. That is why the 2008 Pre-Budget Report delivered a fiscal stimulus to bolster the economy, stimulate growth and increase demand for jobs, along with an additional £1.3 billion to support Jobcentre Plus delivery.

5.23 Action the Government has taken from the 2008 Pre-Budget Report onwards has already had a critical impact in supporting employment (see Box 5.3). In addition to the fiscal stimulus and support for Jobcentre Plus, the January Employment Summit announced a further £500 million package, offering support for up to 500,000 jobseekers. Along with systemic measures including the Asset Protection Scheme and Capital Guarantee Scheme, targeted business finance measures, including the Working Capital Scheme and Enterprise Finance Guarantees, are already playing a key role by supporting lending to employers. The Treasury Infrastructure Finance Unit was established on 3 March 2009 to lend to those Private Finance Initiative (PFI) projects that cannot raise sufficient debt finance due to current market conditions. It is safeguarding £13 billion of PFI projects currently in procurement – protecting tens of thousands of jobs across the construction sector.

Box 5.3: 2008 Pre-Budget Report Employment Package and January Employment Summit

The fiscal stimulus delivered at the 2008 Pre-Budget Report is expected to support employment across the economy. It was complemented by a substantial employment package including:

- £1.3 billion to ensure Jobcentre Plus can continue to deliver the JSA regime effectively for higher numbers of people. Despite rising unemployment, more than three out of four who claim unemployment benefits move off them within six months, and over a million people have moved back into work since November;
- £158 million to provide skills support to people under notice of redundancy, or who have become unemployed. Over two years this will help 40,000 people to improve their skills or re-enter the job market through a two to eight week personalised package of support;
- increased provision for the Rapid Response Service to expand its support to small-scale as well as large-scale redundancies. This service provides onsite support for employees in finding a new job, even before a redundancy takes place. Since the Pre-Budget Report over 1,500 employers have used the service;
- the creation of the National Employment Partnership between Government and major employers to agree strategies to help people back into work; and
- steps to expand Local Employment Partnerships (LEPs). Since their creation in 2007, over 145,000 individuals have found jobs through LEPs.

Further support was announced at the January Employment Summit to help the minority that remain unemployed for over six months. Support now includes up to £2,500 for employers that recruit and train those in receipt of JSA for six months or more, as well as training places, volunteering opportunities and financial support and advice for those wanting to set up their own business.

G20 – targeting growth and jobs

5.24 At the London Summit, G20 Leaders committed to support those affected by the downturn by creating employment opportunities. Leaders welcomed the reports of the London Jobs Summit and the key principles proposed, to support employment by stimulating growth and to focus on the most vulnerable through active labour market policies.

Providing support and employment opportunities across the economy

Further funding for Jobcentre Plus

5.25 The most effective way of limiting the impacts of unemployment on individuals, their families and communities is to ensure that the existing regime continues to deliver a rapid return to work. Therefore, **the Government is setting aside an additional £1.7 billion for the Department for Work and Pensions to ensure that Jobcentre Plus has the capacity to deliver a personalised service to individuals and the Flexible New Deal (FND) employment programme will provide individuals who become long-term unemployed with dedicated support from an employment specialist to help them move back into work.**

Guaranteed support for young people

5.26 The Government is committed to ensuring that no young person is permanently disadvantaged by the recession. The economic and social consequences of inaction would be scarring for individuals, families and their communities. Action taken at this Budget (see Box 5.4) will reduce the chance of detachment from work and maintain individuals' skills bases and productivity levels, enabling people to take advantage of opportunities as the economy moves into the upturn.

Box 5.4: Creating opportunities and supporting the long-term unemployed

The Government announces a range of measures that will help support the long-term unemployed including:

- guaranteeing everyone aged between 18 and 24 **who has been claiming JSA for 12 months a job, work placement or work-related skills training for at least six months**. If it becomes necessary to do so, the Government will work with local authorities and other delivery partners to determine how participation in one of these options could be made mandatory;
- **funding for Care First, offering 50,000 traineeships for young people in the care sector.** Social care providers will receive a subsidy for offering sustained employment and training to young people who have been out of work for 12 months. This will give them the skills and experience they need for a career in this growing sector;
- **funding for local authorities and partners to take forward the creation of 100,000 new jobs in socially useful activity. 10,000 of these will be green jobs;** and
- the public sector will ensure that 25 per cent of their external recruitment is targeted at individuals without a job.

To support communities most affected by rising unemployment, **the Government will allocate additional funding for local authorities to provide a further 50,000 jobs in areas of high unemployment across the country.**

5.27 To help provide adequate support for individuals who have been made redundant **the Government announces a one-off increase in the level of statutory redundancy pay, making the weekly rate £380.** The Government is also considering whether to introduce a new 'floor' which would set a minimum level for statutory redundancy payment rates, and would legislate on this in the next Parliament.

Creating opportunities across the economy

5.28 This Budget also provides additional employment opportunities through further investment in the UK's infrastructure, supports employment in key strategic industries and provides further targeted support to employers through the tax system. New investment in housing, low-carbon initiatives and other key infrastructure projects as set out in Chapters 6 and 7 will directly employ around 15,000 people in 2009-10. Support for strategic industries and enhanced capital allowances are set out in Chapter 4 and will further support employment throughout the economy.

5.29 Targeted cash-flow support for businesses through HMRC's Business Payment Support Service has already helped 100,000 businesses employing 600,000 people. Together with the Loss Carry Back tax changes the Government is extending in the Budget, over 1.5 million people will be working in firms receiving targeted government cash-flow support by April 2010.

A fair and effective benefit system

5.30 The Government's objectives for the working age benefits system are based on the following principles:

- maximising work incentives, to ensure that people are supported into employment and not left behind dependent on benefits;
- promoting fairness, by targeting support on those who need it most; and

- seeking affordability and value for money for taxpayers, to support sustainable public finances.

Welfare Reform White Paper

5.31 Over the last 11 years the Government has transformed a largely passive welfare state into an active one, based on a clear framework of rights and responsibilities. The Welfare Reform White Paper, *Raising expectations and increasing support: reforming welfare for the future,*[2] announced the next stage of reform that will require nearly everyone to take up the employment support available to them.

Housing Benefit reforms

5.32 The joint Department for Work and Pensions and HM Treasury internal review of Housing Benefit was announced at Budget 2008, to examine its effectiveness in promoting work incentives, efficiency and fairness, and providing value for money. Indications from this internal work are that some claimants may be able to afford accommodation that is out of reach of working families on low incomes. Furthermore, costs of Housing Benefit have been rising above inflation despite static caseloads. Taking steps to address these challenges while ensuring that claimants continue to have access to suitable accommodation will be difficult. The Government therefore intends to launch a consultation shortly on the measures it can take to improve the incentives for those returning to work and reduce total spending on Housing Benefit in the medium term, while maintaining access to suitable housing for those who cannot work.

5.33 The Local Housing Allowance (LHA) was introduced in April 2008, and costs have exceeded the planned expenditure for this policy. To bring the cost into line with what is affordable, whilst still ensuring all recipients can afford their rent, **the Budget announces that from April 2010 there will no longer be scope for anyone to receive more LHA than they have to pay in rent.** Existing claimants will move onto the new arrangements on the anniversary of their claim.

Helping people manage their finances

5.34 Alongside taking action to help those looking for work, and to support households feeling the impact of the economic downturn, the Government wants to assist people in making informed financial decisions and in accessing help if they need it. To build on the measures announced at the 2008 Pre-Budget Report, the Government is providing further support for those who need it most and helping to ensure that individuals are in a good position to manage their finances now, and as the economy recovers.

Social Fund

5.35 As the labour market becomes more difficult and access to affordable credit reduces, some people can find managing their budgets difficult. Social Fund loans provide interest free credit to vulnerable people, allowing them to meet, and spread the payment of, unexpected costs. **In recognition of increased demand on the Social Fund the Government will allocate the fund an additional £125 million in 2009-10 and £145 million in 2010-11.** This provides additional support to the Social Fund, as it makes around an additional two million loans over the next two years.

Growth Fund

5.36 Since 2005, the Government has committed £80 million to a financial inclusion Growth Fund. This has enabled third sector lenders, such as credit unions and Community Development Financial Institutions, to make over 160,000 affordable loans to financially excluded customers. **The Government believes it is vital to enable these lenders to continue to grow. The Government is therefore committing an extra £18.75 million to the Growth Fund, which will enable lenders to make an additional 85,000 loans by 2011.**

[2] *Raising expectations and increasing support: reforming welfare for the future*, Department for Work and Pensions, December 2008 (available at http://www.dwp.gov.uk).

Box 5.5: Raising levels of financial capability in the UK

The Government and the Financial Services Authority (FSA) last week launched the £12 million Money Guidance pathfinder, offering help with money issues online, over the phone and face-to-face across the North West and North East of England. The pathfinder builds on the FSA's Moneymadeclear website and helpline, which people can access wherever they are in the UK.

The Government is committed to ensuring that every adult in the UK will be able to access impartial financial guidance to help them make informed decisions and avoid the distress of unmanagable debt. **The Government announces that roll-out of a national Money Guidance Service will begin in 2010**, subject to preliminary findings from the pathfinder demonstrating that the serivice can be effective. It intends to introduce legislation to implement Money Guidance and to direct dormant account funds for finanacial capability to support delivery of the service.

The Government also believes that every child in the UK should learn in school how to deal with life's financial challenges confidently and capably. The Government will shortly publish the recommendations of an independent review on how best to make financial capability a statutory part of the secondary curriculum in England. Adults can also benefit from financial education, and **the Government welcomes Lloyds Banking Group's commitment to fund a £4 million programme to support financial capability through adult education, as part of the bank's recapitalisation agreement.**

Debt advice

5.37 Since April 2006 the Government has invested over £130 million in a face-to-face money advice project aimed at the most vulnerable households. So far the project has helped over 193,000 people with their debt problems. At the 2008 Pre-Budget Report the Government announced further support to allow everyone to access debt advice, which has helped almost 18,000 extra people since February 2009. Over 600,000 visits were made to Directgov pages on debt advice between January and March 2009.

5.38 In December the Government agreed a new set of fair principles with credit card companies to give breathing space to borrowers struggling to repay their debts. In addition, this summer the Department for Business, Enterprise and Regulatory Reform will publish a White Paper on consumer rights. This will set out proposals to provide further help to people in difficulty with their finances and proposals to strengthen the UK's credit regime, including proposals aimed at:

- maintaining access for the financially excluded and tackling the illegal money lending sector;
- promoting responsible lending and borrowing;
- raising standards in debt collection and to protect groups who are particularly vulnerable such as the mentally ill; and
- setting a longer-term direction for the sector and its regulation that will deliver continuing access to affordable credit, enhanced consumer protection and financial stability.

Financial inclusion

5.39 The Government is committed to ensuring that everyone has the opportunity to access the financial services needed to participate fully in society. The Government welcomes the Financial Inclusion Taskforce's report, published in April 2009, highlighting progress towards the Government's financial inclusion objectives and future priorities.

Promoting savings

5.40 The Government seeks to support saving and asset ownership for all across the lifecycle – from childhood, through working life and into retirement. Since 1997, the Government's savings strategy has focused on developing a range of savings opportunities suitable for each life stage, providing incentives for saving through the tax and benefit system, and empowering individuals with the capability to make the right savings choices.

5.41 The Government recognises that low interest rates, which are benefiting many people with mortgages, have meant that savers have seen their return from savings fall. In particular, this has affected those people who have retired, or are beginning to prepare for retirement, who are more reliant on their income from savings to meet day-to-day needs or fund discretionary purchases.

Individual Savings Accounts

5.42 Building on recent changes which increased investment limits for Individual Savings Accounts (ISAs) and made them more flexible, the Government is now taking targeted action to help people aged 50 and over with their savings. **For the tax year 2009-10, the annual ISA investment limit will increase for everyone aged 50 and over. Individuals will be able to save £10,200 in their ISA, up to £5,100 of which can be saved in cash.** To allow ISA providers time to adjust their systems, deposits above the current ISA allowance can only be made from October 2009.

5.43 This will enable people who have retired or are beginning to prepare for retirement to move taxed savings into a tax-advantaged ISA, rewarding those who have saved by improving their returns.

5.44 The Government also recognises that people need to be supported to save as the economy emerges from the downturn. **The Government will therefore extend these increases in the ISA limits to everyone from 6 April 2010. The annual ISA investment limit will increase for every adult to £10,200, up to £5,100 of which can be saved in cash.**

5.45 This will give over 18 million ISA holders the opportunity to increase their tax-advantaged savings and directly benefit over five million individuals who make full use of either their cash or their overall investment limits.

Saving Gateway

5.46 The Saving Gateway uses matching (a government contribution for each pound saved) to encourage saving for working-age people on lower incomes and to promote engagement with mainstream financial services. The Saving Gateway will be introduced nationally, with the first accounts available in 2010. To provide a strong and easily understood incentive to save, the Government will contribute 50 pence for each pound saved in the scheme.

5.47 The Saving Gateway Accounts Bill is currently before Parliament. The Government has sponsored an amendment to the Bill, to provide that **recipients of Carer's Allowance will be eligible to open Saving Gateway accounts, meaning that around half a million claimants of Carer's Allowance will now be eligible.** Overall, around eight million people will be eligible for the scheme.

Child Trust Fund

5.48 The Child Trust Fund (CTF) is a long term savings and investment account for children. It was introduced in 2005 to strengthen the saving habit of future generations, promote financial education and ensure that every child has access to their own financial asset on entering adult life. Over four million children now have a CTF.

5.49 The scheme provides £250 for all children at birth and age seven, with an additional £250 for children in lower income families. From 6 April 2009 the requirement for parents to send in their voucher when opening their child's account was removed, making account opening even easier. September 2009 will see the first Government payments to seven year olds.

Additional payments for disabled children

5.50 The Government recognises that disabled children are likely to have greater financial needs when they make the transition to adulthood. **The Government will contribute an additional £100 a year to the CTF accounts of all disabled children, with severely disabled children receiving £200 a year.**

Employee share schemes

5.51 The number of companies offering a tax-advantaged share scheme to their employees has doubled since 2000, with Save As You Earn (SAYE) and the Share Incentive Plan currently used by over four million people. The schemes encourage saving and asset ownership, allow employees to benefit from the growth potential offered by shares, and encourage employees to become greater stakeholders in their workplace. **The Government announces that it is introducing a package of measures that will improve the administration of SAYE.** This will support companies and administrators who run SAYE schemes to do so more efficiently and with minimal administrative burdens. The Government will keep tax-advantaged share schemes under review to ensure that the widest range of employees can benefit from them.

Supporting people in later life

5.52 The Government is committed to tackling pensioner poverty, promoting greater independence and well-being in later life, encouraging and rewarding saving, and enabling people to meet their income aspirations in retirement. In seeking to achieve this it provides incentives for people to save for their retirement, and supports all pensioners, with additional support targeted on those who need it most. In the downturn the Government's priority remains to support the most vulnerable.

Support for pensioners

5.53 Between 1996-97 and 2006-07, pensioners' incomes rose by 29 per cent in real terms. The basic State Pension has increased by seven per cent in real terms since 1997, while the introduction of Winter Fuel Payments helps older people to keep their homes warm. The Government also provides free off-peak bus travel, free eye tests and free prescriptions for those aged over 60, while those aged over 75 also receive a free television licence.

5.54 The Government introduced Pension Credit in 2003, guaranteeing a minimum income for pensioner households while rewarding those who have made modest additional provision for their retirement. In 2008-09, no single pensioner needed to live on less than £124 a week whereas in 1997 the poorest pensioners had to live on around £69 a week, an increase of over a third in real terms. The Government spent over £13 billion more in 2008-09 on pensioners than it would have if the policies in place in 1997 had continued, with around half of this expenditure going to the poorest third of pensioners. Overall, 900,000 pensioner households have been lifted out of relative poverty since 1997, and a pensioner is now no more likely to be in poverty than someone from the population as a whole.

5.55 In the 2008 Pre-Budget Report the Government set out further action to support pensioners, especially those on lower incomes, through the global economic downturn. This included:

- an above-indexation increase in the standard minimum income guarantee in Pension Credit which means no single pensioner need live on less than £130 a week in 2009-10 and no pensioner couple on less than £198 a week;

- a £4.55 a week increase in the full basic State Pension to £95.25 a week in 2009-10, effectively brought forward to January 2009 by making a payment of £60 to each pensioner earlier this year; and
- an increase in the age-related tax allowance to £9,490 for those aged between 65 and 74, and to £9,640 for those aged over 75.

5.56 Budget 2009 announces additional targeted support for pensioners to ensure they continue to receive support where it is needed most.

Winter Fuel Payments

5.57 The Government has committed to pay Winter Fuel Payments of £200 for households with someone aged over 60, and £300 with someone over 80, for the lifetime of this Parliament. To provide further support, **Budget 2009 announces an additional payment this winter, worth £100 for households with someone aged over 80 and £50 for households with someone aged over 60.** This will increase this winter's payments to £400 for households with someone aged over 80 and £250 for households with someone aged over 60.

Pensioners who receive income from savings

5.58 Historically low interest rates have particularly impacted on pensioners, who are more likely than people of working age to draw income from savings. The increases in ISA limits announced in the Budget will help those pensioners who pay tax on their savings. To provide additional support to lower-income pensioners who receive income from savings **the Government will:**

- **raise the capital disregard in Pension Credit, and pensioner-related Housing and Council Tax Benefit, from £6,000 to £10,000 in November 2009.** This will increase the income of 540,000 pensioner households by £4 per week on average; and
- **launch a new tax back campaign,** contacting all 2.7 million Pension Credit recipients to encourage them to claim back tax they may have overpaid on their savings income and, where possible, register to receive interest on their savings tax-free in future. This will be worth £200 on average to those pensioners who have overpaid tax in the past.

Maximising retirement income

5.59 By shopping around, people can increase their retirement income by up to 20 per cent. This is especially important in the downturn. **The new Moneymadeclear website and helpline will be available to support people across the UK who are approaching retirement,** to work out their options and help them to find the best annuity deals. This will build on the Government's existing work to help people to get the most out of their pension savings.

Social care

5.60 Demographic trends will result in a substantial increase in the number of people in need of care and support. Delivering a care and support system that meets the aspirations of everyone who needs care, while coping with increased demand for support, requires more than incremental increases in social care funding – it requires a radical rethink of the way the state helps people with care needs. Following extensive public engagement, the Government will in June consult in a Green Paper on a range of options to reform the existing social care system and other forms of support, to create a new offer for people who need care and support.

State pension reforms

5.61 Reforms to make the state pension fairer and more widely available will be implemented in April 2010 including a reduction in the number of qualifying years required for entitlement to the full basic State Pension and reforms to the system for crediting those with caring responsibilities to reflect the different ways in which people contribute to society. As a result of these changes around 70 per cent of women reaching state pension age will be entitled to a full basic State Pension compared to 50 per cent without reform. By 2025 around 90 per cent

will be entitled to a full basic State Pension. **Building on these reforms, the Government announces that grandparents and other adult family members who care for their grandchildren or other members of their family aged 12 or younger for 20 hours or more a week will be able to gain National Insurance credits toward the basic State Pension from April 2011.**

5.62 In addition to making more people eligible for a state pension, the Government has legislated to increase its generosity by introducing the earnings uprating of the basic State Pension. The Government remains committed to introduce earnings uprating of the basic State Pension in 2012-13, subject to affordability and the fiscal position, or in any event by the end of the next Parliament at the latest. This commitment ensures the balance is struck between meeting the challenges identified by the Pensions Commission and ensuring the sustainability of the Government's pension reforms.

Modernising pensions tax administration

5.63 Budget 2009 also announces changes to ensure that the pensions tax system responds to recent policy developments (see paragraphs 5.90 to 5.95). **The Government will also introduce minor changes to the pensions tax system in Finance Bill 2009, including the power to provide for payments from the Financial Assistance Scheme and the Financial Services Compensation Scheme to receive equivalent tax treatment as if they had been received from the original pension scheme or insurer.**

Helping homeowners and housing

5.64 The Government's objective for housing continues to be to ensure everyone has access to a decent home at a price they can afford. The financial market disruption and global economic downturn are continuing to impact on the housing market. House prices have fallen by around 20 per cent since their peak in late 2007, and unemployment and other economic factors are putting some households under financial pressure. The availability of credit remains constrained and, not withstanding recent increases, mortgage approvals for house purchases are close to historic lows. Low levels of effective demand have also had a negative effect on the house building industry.

5.65 In this context, Budget 2009 provides further support for homeowners, homebuyers and housing supply in addition to that already provided (see Box 5.6).

Box 5.6 Existing support for homeowners, homebuyers and housing supply

The Government announced a £1 billion housing package on 2 September 2008, which included:

- the Mortgage Rescue Scheme to help some of the most vulnerable households avoid repossession;
- improving Support for Mortgage Interest (SMI) arrangements by increasing the capital limit and reducing waiting periods for new working age claims;
- HomeBuy Direct, a new shared equity scheme, helping eligible first-time buyers get on the property ladder;
- bringing forward £400 million of spending to deliver new social housing; and
- a stamp duty land tax holiday on property sold for £175,000 or less.

The 2008 Pre-Budget Report announced:

- the bringing forward of £775 million spending on housing investment and regeneration as part of the fiscal stimulus, including £150 million on new social housing;
- the extension of the Mortgage Rescue Scheme to include second charge mortgages;
- the improvement of SMI by further increasing the capital limit to £200,000 for new working age claims and maintaining payments at Standard Interest Rate (SIR) of 6.08 per cent for six months from December 2008, for all claimants;
- that a lending panel would be established, bringing together Government, lenders and consumer groups;
- a commitment from the major lenders not to initiate repossession proceedings within at least three months of an account going into arrears; and
- extended debt advice for people in financial difficulties.

Support for homeowners in difficulty

5.66 The recent falls in interest rates mean that, overall, households are paying the smallest amount of interest as a proportion of income since records began in 1987. Bank Rate has fallen from five per cent in September 2008 to 0.5 per cent from March 2009, benefiting up to 4.5 million homeowners on tracker mortgages. However, increases in unemployment mean that some households are struggling to keep up their mortgage payments.

5.67 The Government is committed to ensuring that lenders lend responsibly, borrowers are protected, and there is appropriate support for those facing financial difficulties. Statutory regulation of mortgages by the FSA is now supported by a new mortgage pre-action protocol. This was introduced in November 2008, and provides clear guidance on actions the courts expect lenders to take before making a claim for possession. This helps to ensure that repossessions are a last resort and that lenders enter discussions with borrowers to find alternative solutions wherever possible.

5.68 Current economic conditions present new challenges, and the Government is committed to ensuring that the financial regulatory system remains up to date. At the 2008 Pre-Budget Report, the Government announced the creation of a new lending panel to monitor lending to businesses and households and drive up standards of industry best practice in lending decisions. As part of this new monitoring approach, the Bank of England is publishing a monetary report, *Trends in Lending*,[3] the first of which was published on 21 April, and draws on a new collection of data covering the major UK lenders.

5.69 The Mortgage Rescue Scheme and Homeowner Mortgage Support Scheme, together with changes to Support for Mortgage Interest (SMI) will help to ensure that homeowners who

[3] *Trends in Lending*, Bank of England, April 2009 (available at www.bankofengland.co.uk).

experience a temporary fall in income, lose employment, or are otherwise vulnerable, are able to remain in their homes. In light of house price falls over the past year, **the Government is extending its support for vulnerable homeowners in financial difficulty through widening the eligibility criteria for the Mortgage Rescue Scheme so that households in negative equity are not excluded**. As part of this the Government is announcing a £20 million fund to enable local authorities to extend small loans to families at risk of homelessness through repossession or eviction.

5.70 The Homeowner Mortgage Support Scheme went live on 21 April. The scheme defers some of borrowers' interest payments for up to two years, where this is appropriate to their individual circumstances and subject to suitable independent debt advice, with the Government guaranteeing a proportion of the deferred interest. Lenders covering more than 80 per cent of the mortage market will now be providing enhanced support to their customers in this way.

5.71 As interest rates remain low, leaving some people, particularly those with fixed rate mortgages, at risk of shortfalls, **the Budget announces that the Standard Interest Rate used to calculate SMI will be maintained at 6.08 per cent for a further six months before being reviewed.** This will benefit around 220,000 homeowners.

Support for homebuyers

5.72 Despite falling house prices, many prospective homebuyers are still finding it difficult to access the housing market due to restricted access to mortgage finance and increased deposit requirements.

5.73 To help support the availability of mortgage finance, on 19 January 2009, the Government announced it would establish a guarantee scheme for asset-backed securities. As set out in detail in Chapter 3, **the Budget announces that the scheme is available, at first until October 2009,** for banks and building societies to use alongside the existing Credit Guarantee Scheme (CGS) to support their lending in the economy. The scheme extends the funding options open to banks and building societies under the existing CGS to residential mortgage-backed securities (RMBS).

5.74 On 2 September 2008, the Government announced a stamp duty land tax (SDLT) holiday for all houses costing up to £175,000. Around 60 per cent of all residential purchases will be exempt from SDLT during the period of the holiday. **To provide further support for first time buyers, the Budget announces the Government is extending the holiday for four months, until 31 December 2009.**

Support for housing supply

5.75 Alongside the need to support homeowners and homebuyers in current conditions, the long-term challenges for housing supply remain, as set out in the Barker *Review of Housing Supply*.[4] That is why the Government has set an ambitious target of providing an additional 240,000 homes per year by 2016. It remains important to maintain momentum on improving the responsiveness of housing supply, both to meet the needs of a growing population in the future, and to support economic recovery, by reducing housing market volatility, helping macroeconomic stability, and supporting growth through increasing labour market flexibility. The Government is therefore focused on action to retain capacity and skills in the house building industry, and to promote conditions for a robust supply response as the housing market recovers.

5.76 **Budget 2009 announces a £600 million fund to stimulate housing development in the short-term and boost capacity in the house building industry.** In England this will deliver up to an additional 10,000 new homes through:

[4] *Review of Housing Supply – Delivering Stability: Securing our Future Housing Needs*, Kate Barker, March 2004 (available at www.barkerreview.org.uk)

- £400 million to unlock currently stalled housing developments, leveraging in private development finance through a combination of reducing up-front costs with equity, gap and infrastructure funding, and supporting viability with an expansion in the provision of HomeBuy Direct, and increased funding for affordable housing; and
- £100 million of new funding for local authorities to deliver new social housing at higher energy efficiency standards.

Preparing for a strong recovery

5.77 Building on the package to support housing supply in the short term, the Budget reaffirms the Government's long-term commitments on housing supply and looks to prepare the housing market to respond post-recovery.

5.78 The Government will report at the 2009 Pre-Budget Report on progress and set out its strategy to support a timely and effective housing supply response through the recovery, in order to maximise delivery of high quality, energy efficient homes, supporting our long term housing supply and environmental objectives. This will cover measures to:

- ensure sufficient land for development, through housing allocations in local plans and further action on public sector land, supported by a responsive and efficient planning system;
- deliver effective and coordinated infrastructure provision;
- promote a strong and diverse house building sector;
- continue to ensure the increased long-term supply of social and affordable housing; and
- ensure a proportionate approach to land-value capture and cumulative regulation.

5.79 As part of this, **the Government will identify, working with industry and other partners, the best regulatory and policy framework to support the Government's long-term housing objectives.**

5.80 As a first step, **the Government will assist industry by delaying the introduction of the community infrastructure levy until 6 April 2010.**

Supporting charities

5.81 A vibrant and thriving third sector is a key component of a fair, cohesive and enterprising society. The Government is committed to strengthening the resilience of the sector and helping to build its long-term financial sustainability, at a time when many organisations are experiencing increased demand on their services, declining corporate and contract income, and the effects of the global turbulence in the financial markets.

Hardship Loan Fund

5.82 In recognition of the immediate challenges this poses for the sector, building on the Government's £42.5 million action plan launched in February to support the third sector during the economic downturn.[5] **Budget 2009 announces the launch of new £20 million Hardship Fund** to provide grant support to third sector organisations, delivering front-line services to the most vulnerable and disadvantaged in society, that have been affected by the recession, with demonstrable resource constraints due to cash-flow difficulties of increased demand.

[5] *Real help for communities: Volunteers, charities and social enterprises*, Office of the Third Sector, February 2009.

Gift Aid

5.83 The Government continues to explore ideas to improve Gift Aid, and has commissioned research into the effect of redirecting higher-rate relief from donors to charities.

Social Investment Wholesale Bank

5.84 To support the long-term growth of a thriving third sector, **the Government will consult on the design and functions of a Social Investment Wholesale Bank** the Office of the Third Sector will report back with substantive proposals. As previously announced, funding available in England as a result of the implementation of the Dormant Banks and Building Societies Account Act 2008, will focus on youth facilities, financial inclusion and capability, and, if recourses permit, a Social Investment Wholesale Bank. A Social Investment Wholesale Bank would be a wholesaler of social investment finance, designed to support the long-term of a thriving third sector. By working with existing investors and lenders at the retail level, a Social Investment Wholesale Bank would aim to increase the supply of investment in the third sector, and strengthen demand for finance and develop the social investment market.

Substantial donors

5.85 The Government has considered its response to the consultation on the anti-avoidance rules around substantial donors to charity. **Budget announces further informal consultation with the sector to develop new rules based around an effective anti-avoidance purpose test.** The Government aims to bring forward proposals at the 2009 Pre-Budget Report, with a view to legislating in 2010.

Charity Authorised Investment Funds

5.86 The Government recognises the importance of Common Investment Funds and Common Deposit Funds to the charitable sector. **The Government will consult shortly in conjunction with the Charity Commission on ways to bring these funds more fully under the FSA's regulation whilst preserving their existing tax reliefs.**

A MODERN AND FAIR TAX SYSTEM

5.87 A modern and fair tax system helps individuals and businesses by encouraging work and saving, keeping pace with developments in business practice and the global economy and raising revenue. For the system to be effective everyone must pay his or her fair share.

Changes to the personal tax system from 2010-11 onwards

5.88 As set out in Chapter 2, the Government will build on the fiscal consolidation announced in the 2008 Pre-Budget Report. Further reforms to income tax will ensure that those individuals most able to, make more of a contribution to that consolidation. **From April 2010:**

- **an additional rate of income tax of 50 per cent will apply to income over £150,000, with a rate of 42.5 per cent for dividend income.** This replaces the introduction in April 2011 of the 45 per cent rate announced at the 2008 Pre-Budget Report;
- **the tax rate applicable to trusts will increase to 50 per cent; and**
- **the income tax personal allowance will gradually be restricted for those with incomes over £100,000. The personal allowance will be reduced at a rate of £1 for every £2 over £100,000 until completely withdrawn.** This replaces the two-stage withdrawal announced at the 2008 Pre-Budget Report.

5.89 These changes mean that no-one with an income under £100,000 will pay more income tax.

Pensions tax relief

5.90 Tax relief, estimated to be worth around £30 billion in 2007-08,[6] is provided on pension contributions to support pension saving and help individuals produce an income in retirement. This represents an important component of the Government's support for pension saving among low and middle-income earners. In 2006 the Government introduced a new simplified tax regime, responding to criticism that the tax regime for pension saving had become so complex that it was discouraging saving. In reforming the regime the Government sought to strike a balance between the interests of pension savers and the interests of the wider taxpayer. Seeking to achieve this, the Government maintained tax relief at the marginal rate but set two limits – a lifetime allowance, currently standing at £1.75 million, and an annual allowance currently standing at £245,000 or 100 per cent of income whichever is the lower.

5.91 Those on highest incomes benefit disproportionately from this relief, and the personal tax changes announced in this Budget would increase the value of the reliefs given to individuals with the highest incomes. This would exacerbate the current situation whereby in 2008-09 individuals with income over £150,000 represented 1.5 per cent of pensions savers, yet received a quarter of all tax relief on contributions (£6.1 billion). This amounted to an average of £27,000 per person, an amount in excess of median earnings, and compares with £1,000 for people who pay income tax at the basic rate.

5.92 The 2008 Pre-Budget Report announced that the Government would maintain the lifetime allowance at £1.8 million for five years up to and including 2015-16. To ensure fairness, affordability and sustainability of tax reliefs, **Budget 2009 announces that, in addition, from April 2011, tax relief on pension contributions will be restricted for those with incomes of £150,000 and over.** From that level of income, the value of pensions tax relief will be tapered down until it is 20 per cent for those on incomes over £180,000, making it worth the same for each pound of contribution to pension entitlement as for a basic rate income taxpayer. This restriction applies to all contributions, including employers', but employers will continue to receive full relief on their contributions into employees' pensions through corporation tax and NICs.

5.93 **The Government will consult business, pension fund trustees, the insurance and pensions industries, and other stakeholders to ensure that defined benefit pension schemes are treated fairly in relation to defined contribution pension schemes and personal pensions. It will want to arrive at the most appropriate method of valuing pension benefits of those with over £150,000 in defined benefit pension schemes and of valuing the related employer contributions.** The Government will use this consultation to engage with stakeholders to introduce the new system in a way that minimises administrative burdens.

5.94 Given the importance of consulting on this measure, introduction before 2011-12 would be inappropriate. This means that, in the absence of any further changes, it would be possible for individuals to take advantage of the pensions tax relief while it is still available to them at the higher rate by making substantial additional pension contributions prior to the restriction taking effect. The Government's assessment is that unless it takes action significant revenues would be at risk over the two years before implementation. In anticipation of the change, **the Government is therefore including legislation in this year's Finance Bill to prevent forestalling in this way whilst permitting individuals to continue to receive tax relief at the higher rate on the higher of £20,000 or their normal pattern of contributions. This legislation will apply with effect from 22 April 2009.** Those who have never earned in excess of £150,000 a year are unaffected, as are those who continue with their regular, at least quarterly, pattern of contributions or normal benefit accrual.

[6] Gross tax relief is estimated at £29.3 billion in 2007-08. Income tax receipts on pensions in payment is approximately £10.4 billion, making net tax relief £18.9 billion. This has doubled from a level of £9.3 billion in 1998-99. A further £8.2 billion is given as relief from National Insurance Contributions.

5.95 Following changes to the personal tax system, the Government will consider consequential changes to pension tax charges which are designed to recover the tax relief provided in certain circumstances. Pension tax charges apply, for example, when allowances are exceeded and in connection with unauthorised payments. The Government will provide details in the 2009 Pre-Budget Report.

Protecting tax revenues

5.96 Tax evasion and avoidance undermine fiscal sustainability, damage the delivery of policy objectives, impose significant costs on society and shift a greater tax burden on to ordinary taxpayers. Budget 2009 builds on previous progress by further tackling evasion and robustly challenging avoidance, continuing the delivery of a modern framework for HMRC's powers and helping ensure a fair tax system. The total changes will raise over £1 billion during the period 2009-10 to 2011-12, and protect a further £3 billion of tax receipts a year by 2010-11 from tax evasion and avoidance.

Offshore disclosure

5.97 Offshore accounts are being used by some to shield undeclared taxable income. HMRC will seek to issue notices requiring financial institutions to provide information about offshore account holders. **The Government announces that a New Disclosure Opportunity will run until March 2010.** This will give holders of offshore accounts an opportunity to disclose, of their own accord, if they have unpaid tax or duties and to settle debts. HMRC will persue those who do not disclose.

Box 5.7: International action to tackle tax evasion

The Government has been leading international efforts to tackle tax havens and tax evasion through its Presidency of the G20. At the London Summit earlier this month leaders:

- called on all countries to adopt the international standard for tax information exchange, which is vital to improving transparency and exchange of tax information between jurisdictions;
- noted the OECD's publication of a list of countries assessed by the Global Forum against the international standard for exchange of tax information;
- welcomed important new commitments from countries that had previously used banking secrecy to adhere to the international standard for tax information exchange;
- agreed to take firm action against jurisdictions that do not meet international tax standards, including standing ready to deploy counter measures to protect public finances and financial systems against jurisdictions that do not meet international standards of tax transparency; and
- agreed to develop proposals, by the end of 2009, to make it easier for developing countries to secure the benefits of a new cooperative tax environment.

Ensuring compliance in tax system

5.98 The Government announces a number of measures to ensure that businesses and individuals pay the right amount of tax and reduce the opportunity for evasion, avoidance or non-compliance:

- **it will legislate for the publication by HMRC of the names of both corporate and individual taxpayers who incur a penalty because they have deliberately understated more than £25,000 of tax;**
- **it will establish a statutory requirement for senior accounting officers of major corporates to certify personally that adequate controls to prepare accurate tax computations are in place;**

- **HMRC will require those who have incurred a penalty for deliberate understatement of over £5,000 of tax to provide more information about their tax affairs for up to five years** to ensure they have proper systems to be able to make a correct tax return; and
- **HMRC will shortly issue a draft code of practice on taxation for the banking sector, along with a consultation document.**

Disclosure regime Disclosure of Tax Avoidance Schemes (DOTAS) is an important part of the tax framework providing HMRC with early warning of avoidance schemes. DOTAS has already effectivley countered over £11 billion in avoidance opportunities since its introduction in 2004. **Budget 2009 announces that HMRC will begin discussions with a view to extending the avoidance 'hallmarks' to ensure they continue to bear down on avoidance and revising the penalty regime to introduce tougher sanctions for the non-compliant.**

Tax avoidance **5.99** The Government announces that it is taking action with immediate effect to address a number of avoidance schemes:

- the **introduction of a foreign exchange targeted anti-avoidance rule to prevent tax avoidance schemes** that seek to exploit the foreign exchange tax matching provisions;
- legislation to **stop abuse of the manufactured overseas dividend rules, and clarification of the double tax relief rules to counter abusive schemes;**
- legislation to **clarify the rules of the corporate intangible fixed asset regime by confirming that goodwill is treated as intended;**
- legislation **to target avoidance schemes involving financial products;**
- **changes to the North Sea fiscal regime to ensure companies cannot access tax relief for decommissioning oil and gas infrastructure years in advance of the decommissioning actually being carried out;** and
- legislation to **tackle avoidance where an employee or director of a company is provided with living accommodation through the payment of a lease premium rather than a full market rent for the use of the property.**

Principles-based approaches **5.100** Following consultation, the Government will **introduce principles-based legislation in the Finance Bill relating to disguised interest and transfers of income streams.**

Avoidance "Spotlight" **5.101** **The Budget announces that HMRC will soon publish a "Spotlight" on tax avoidance with details of a number of avoidance schemes that will be challenged when encountered.**

MTIC fraud **5.102** In March 2009, the Government secured European Council support for an extension to the UK's targeted reverse charge derogation until April 2011, preventing fraudsters from resuming activity in their goods of choice, and providing certainty for legitimate traders in these goods. In addition, changes to the VAT treatment of cross-border trade include **new arrangements, from 1 January 2010, for reporting and sharing information on the intra-EU sale of goods, further strengthening the Government's anti-fraud strategy.**

Alcohol fraud strategy **5.103** The Government is committed to tackling alcohol fraud, which damages legitimate businesses and costs jobs. **HMRC and the UK Borders Agency are setting out a comprehensive programme of work to target all forms of alcohol fraud and the criminal networks behind it alongside the Budget.**

Modernising tax administration

Review of HMRC powers

5.104 The Review of HMRC powers, deterrents and safeguards continues work to provide a modern framework of law and practice for HMRC, delivering greater consistency across taxes and strong safeguards for taxpayers. This work will support the majority of taxpayers who seek to meet their obligations, while ensuring HMRC can tackle the minority who try to gain an unfair advantage. **The Government announces legislation to:**

- **align the penalty regimes across taxes for late filing of returns and late payment of tax;**
- **harmonise, where practical, the way interest is charged and paid across all taxes** with one rate charged on underpayments and one rate paid out on overpayments, tracked to Bank Rate;
- **make it easier for taxpayers to pay what they owe on time and support HMRC in effectively tackling those who pay late,** with payment instalment schemes and powers to trace missing debtors, collect small debts through PAYE, and recover costs in successful court actions for debt; and
- **apply the new compliance checking framework for the main taxes to the other taxes,** providing for more aligned record keeping rules, information and inspection powers, and assessment and claim time limits.

A Charter for HMRC

5.105 Consultation continues on a new Charter that will provide a clear statement of the principles governing HMRC's relationship with citizens and businesses. **The Government 2009 announces that HMRC will launch the Charter by autumn 2009.**

Working with Tax Agents

5.106 The Government announces a first round of consultation looking at how **HMRC can build on its relationship with tax agents and professional bodies.**

Pay As You Earn

5.107 Pay As You Earn (PAYE) is a fundamental part of the UK tax system. Although it has been increasingly computerised, the fundamental process remains as it was when introduced in 1944. **The Government will consider whether the underlying processes could be improved to reduce costs to employers and the public purse, while still providing a high quality PAYE service.**

Updating error or mistake relief

5.108 The Government will **modernise the regime governing claims to recover overpaid income tax, capital gains tax and corporation tax to provide a simpler and more consistent approach with enhanced taxpayer safeguards.**

Cross border VAT changes 2010

5.109 The Government has worked closely with business over the **implementation of EU VAT changes on cross-border trade, which will begin on 1 January 2010.** This will modernise the VAT treatment of intra-EU supplies of services, streamline the recovery of VAT incurred in other EU countries and speed up the provision of information. The Government recognises the challenges this will bring for UK businesses and continues to discuss implementation issues with EU partners.

Making a fair contribution

Alcohol duty

5.110 Alcohol duty rates will increase by 2 per cent on 23 April 2009. This will add one penny to the price of a pint of beer, 13 pence to the price of a bottle of spirits and 4 pence to the price of a bottle of wine.

Tobacco duty

5.111 The Government is committed to maintaining high rates of tobacco duty to support health policy on smoking, while taking account of the impact on tobacco smuggling. **Budget**

2009 announces that on 22 April 2009 tobacco duty rates will increase by 2 per cent. This will add 7 pence to a packet of 20 cigarettes.

Gambling duty

5.112 The Government announces the following changes to gambling duties:

- to simplify the regime, **participation fees for bingo will no longer be subject to VAT and bingo duty will rise to 22 per cent on 27 April 2009**; and
- **Amusement Machine Licence Duty (AMLD) will increase on 22 April 2009.** On 1 June 2009 AMLD categories will be recalibrated to reflect regulatory changes. The Government will also consult on moving the taxation of gaming machines onto a gross profits tax basis.

Inheritance tax reliefs

5.113 The Government is **extending the inheritance tax agricultural property and woodlands reliefs to the European Economic Area from 22 April 2009.**

False self-employment

5.114 The Government remains committed to addressing false self-employment in the construction industry. **The Government will consult with a view to future legislation to ensure that construction workers and those they work for are taxed appropriately.** The Government will work with the construction industry to ensure that any legislation is effectively targeted and the industry retains a flexible labour supply.

Foreign Exchange

5.115 The Government is aware of certain structured arrangements (often described as overhedging or underhedging) which, although not normally undertaken for tax avoidance, involve fragmenting transactions across group companies to ensure the Exchequer bears the full economic risk to the group. The Government believes that the economic risks should be shared between the Exchequer and business as Parliament intended. **HMRC will publish a Technical Note in the summer setting out these issues and potential approaches in more detail.**

Furnished holiday lettings

5.116 **Budget 2009 announces the repeal of the Furnished Holiday Lettings (FHL) rules from April 2010.** Until the repeal takes effect, the FHL rules will be extended to those with qualifying furnished holiday lettings elsewhere in the European Economic Area.

Dividend tax credit

5.117 As announced in Budget 2008, the non-payable personal dividend tax credit will be extended to investors with a 10 per cent or greater shareholding in a non-UK resident company. This will be subject to anti-avoidance provisions which are designed to limit burdens for investors while preventing abuse. The Government will continue to monitor this area, and will take immediate action if any avoidance activity is nevertheless identified. **Budget 2009 also announces that the non-payable credit will be extended to all dividends from offshore funds from 22 April 2009, except for distributions from offshore funds with more than 60 per cent of interest bearing assets, which will be taxed as interest.**

Offshore funds

5.118 Budget 2009 announces changes to the offshore funds tax regime from 1 December 2009 by:

- **removing tax barriers impacting the development of offshore funds and legislating for a new definition of an offshore fund,** following extensive consultation; and
- **changing the tax treatment of investors in some contract-based offshore funds.** The treatment for capital gains tax will be aligned with that of overseas unit trusts to reduce administrative burdens for UK investors. The Government will also discuss with industry how to make similar changes to the tax treatment of chargeable gains for investors subject to corporation tax.

6 IMPROVING PUBLIC SERVICES

Since 1997, record levels of investment matched by reform have enabled the Government to deliver real and lasting improvements in Britain's public services.

The Government's short-term focus is on supporting employment and jobs through the recession. **Budget 2009 announces new spending measures, including additional funding for Jobcentre Plus to avoid the problems associated with long-term unemployment that took hold in previous recessions; and that the September Guarantee of a place in education and training to every 16 and 17 year old who wants one will be met in full, an extra 54,500 student places in the next academic year.**

At the same time, the Government is determined to do more to prepare Britain for the economic recovery, building the wealth and jobs of the future. **Budget 2009 announces:**

- **a new £750 million Strategic Investment Fund to support advanced industrial projects of strategic importance,** £250 million of this will be earmarked for low-carbon investment;
- **£500 million of additional spending as part of an overall £1.4 billion package of targeted support to boost Britain's low-carbon sectors;** and
- **a further £600 million to increase housing supply,** including through an extension to the shared equity scheme Homebuy Direct and additional social housing investment.

The Government will continue to invest in front-line public services alongside a stronger drive on value for money. **Budget 2009 announces:**

- **£5 billion recoverable value for money savings in 2010-11, raising the 2007 Comprehensive Spending Review target from £30 billion to £35 billion,** whilst maintaining in full the allocations planned for key front-line services;
- **plans to increase the Government's target on relocating posts out of London to 24,000 by 2010;**
- **in the next Spending Review period, additional efficiencies to help support the economy and front-line services drawn from procurement, back office and IT, and property running costs,** rising to £9 billion of additional efficiency savings by 2013-14; and
- **new incentives and mechanisms with the aim of realising up to £16 billion of property and other asset sales** in the three years from 2011-12, with proceeds used to supplement capital budgets.

Building on these reforms, **Budget 2009 sets assumptions for spending growth from 2011-12 to 2013-14 which allow continued investment in public services whilst ensuring sustainable public finances in the medium term:** with current spending growing by an average 0.7 per cent in real terms and public sector net investment moving to 1¼ per cent of GDP by 2013-14.

DELIVERING EFFICIENT AND EFFECTIVE PUBLIC SERVICES

Improvements in public services

6.1 Over the last decade, increased investment and reform have together enabled the Government to achieve major improvements across front-line public services. For example:

- in 2008, over 65 per cent of 15 year olds achieved 5 or more good GCSEs or equivalent, up from 45 per cent in 1997;
- the proportion of the UK working age population with no qualifications has fallen from 17.1 per cent in 1997 to 10.9 per cent in 2008;

- punctuality and reliability on the rail network continues to improve ahead of industry plans and now stands at an average of 90 per cent. Average kilometres travelled per passenger on the rail network has also increased by 52 per cent since 1997;
- the National Health Service (NHS) will meet its ambition of a 20 per cent reduction in mortality rates of cancer patients aged under 75 by 2010, and has already achieved its 2010 target of a 40 per cent reduction in mortality rates of heart disease patients under 75;
- in 1997, over 280,000 patients were waiting over six months for an in-patient appointment. Virtually no-one now waits longer than 18 weeks from being referred by their general practitioner (GP) until the start of their treatment;
- 73.5 per cent of GP practices now have extended opening hours, over-achieving the target of 50 per cent by the end of 2008; and
- crime has reduced by 35 per cent since 1995, bringing the chances of being a victim of crime to its lowest recorded level.

6.2 Public services are also playing a vital role in supporting Britain's long-term growth and competitiveness, and increased investment over the last ten years has strengthened the ability of the British economy to respond to the current challenges. For example, investment in higher education and adult skills has ensured that businesses have access to the skilled workers they need to respond rapidly to new market opportunities. Investment in the science base has helped make Britain one of the best places in the world for science, research and innovation. Rising investment in the transport network has resulted in reduced journey times from London to other key cities including Paris, Brussels, Glasgow, Liverpool and Manchester.

Investment in priorities

6.3 In the ten years after 1997, total public spending increased by 42 per cent in real terms, compared to an increase of 15 per cent in the previous decade. Together with ambitious targets for efficiency savings, this has enabled the Government to deliver record levels of investment in key priority areas such as health, education and transport, meaning that public services are well placed to respond to the increased demands placed on them in the current economic climate. Since 1997:

- total spending on the NHS has more than doubled in real terms from £35 billion to £89 billion;
- total spending on education is today 60 per cent higher, and as a proportion of GDP has risen from 4.8 per cent to 5.5 per cent;
- total spending on public order and safety has increased by almost 50 per cent in real terms;
- total spending on transport has increased by over 70 per cent in real terms, from £8.7 billion to £20.7 billion; and
- total spending in real terms on Further and Higher Education (including support for students) has increased by 53 per cent and 23 per cent respectively.

Long term capital investment

6.4 The Government has also made significant investments in capital infrastructure, reversing a legacy of under-funding. Public sector net investment as a share of GDP has increased significantly from 0.6 per cent in 1997-98 to 2.1 per cent in 2007-08, and is forecast to be 3.1 per cent by 2009-10, the highest for over 30 years. As a result:

- total capital investment in the NHS has risen from £0.8 billion in 1998-99 to £3.6 billion in 2007-08, annual average real growth of 10 per cent;
- total capital investment in housing and community amenities has risen from £2.7 billion in 1998-99 to £9.1 billion in 2007-08, annual average real growth of 12 per cent;
- total capital investment in education has increased from £1.7 billion in 1998-99 to just over £6.9 billion in 2007-08, annual average real growth of 14 per cent;
- total capital investment in transport has risen from £2.9 billion in 1998-99 to £11.1 billion in 2007-08, annual average real growth of 13 per cent; and
- total capital investment by local authorities has risen from £6.7 billion in 1998-99 to £18.3 billion in 2007-08, annual average real growth of 8 per cent.

6.5 Box 6.1 sets out examples of capital projects that have been delivered over the last five years, helping to lay the foundations for economic growth and productivity.

Box 6.1: Capital investment over the last five years

The Government's increased investment has delivered substantial improvements in public sector infrastructure, for example:

- 140 new schools and 581 existing schools completely rebuilt;
- 292 substantially refurbished schools and a further 511 schools with at least 50 per cent of their space refurbished, resulting in improved spaces for teaching and learning;
- over 2,500 new children's centres, providing high quality early learning, health advice and child care;
- 61 major hospital schemes and over 400 smaller NHS capital schemes, providing first class facilities for both primary and secondary care;
- almost 400 major improvements to Further Education colleges, providing enhanced facilities for teaching and learning;
- 229,000 new affordable homes, including 127,000 social rented homes;
- 176,000 more homes better protected from the risk of flooding and coastal erosion;
- the AIRWAVE radio system for all police forces in England, Scotland and Wales, and most UK ports now having infrastructure to detect the import of radiological materials;
- a high speed rail link from St. Pancras to the South East and the West Coast Mainline upgrade;
- the widening of the M1 and M25 and lengthening of the M6, delivering reduced congestion and journey times;
- 6,900 new prison places in a more efficient and modernised prison system; and
- delivery of new Mastiff and Jackal vehicles for operations in Afghanistan and Iraq.

Public service reform

6.6 Alongside this increased investment, the Government has also put in place reforms to deliver public services that represent value for money for taxpayers and meet the needs of its citizens more effectively, including:

- cross-departmental Public Service Agreements (PSAs) introduced as part of the performance management framework, to set clear priorities for delivering better outcomes for citizens;
- demanding minimum standards and enhanced inspectorates to tackle poor performance across services;
- greater diversity of provision and increased competition between service providers, thereby shifting the balance of power to service users and giving them greater choice; and
- an increased focus on the role of the third sector, encouraging community-driven responses to new needs and promoting volunteering and civic participation to help foster strong local communities and reduce social exclusion.

6.7 In 2008, the Government published *Excellence & Fairness: Achieving World Class Public Services*,[1] which set out its vision for further public service improvement. Since then, changes in the global economy have made achieving world-class public services even more important and in March 2009, the Government set out details of how these principles would be put into practice in *Working Together – Public Services on your Side*[2] (see Box 6.2).

[1] *Excellence & Fairness: Achieving World Class Public Services*, Cabinet Office, June 2008.
[2] *Working Together – Public Services on your Side*, HM Government, March 2009.

Box 6.2: Working Together – Public Services on your Side

Three principles of public services underpin *Working Together – Public Services on your Side:*

Empowering citizens – Excellent public services put people first, investing power in the hands of citizens and communities. This means closely matching rights with responsibilities through services that:

- **are personalised:** for example, Jobcentre Plus will study how best to offer front-line advisers greater flexibility to develop more personalised back-to-work support for customers on benefits;
- **provide more choice and control for citizens:** for example, by offering free health checks on the NHS for those aged 40 to 74; and
- **reflect the information revolution:** with, for example, crime maps that are now accessible through a single portal – DirectGov.

New Professionalism – Public services that are personalised to the different needs, capabilities and ambitions of individuals and local communities have front-line professionals with the space, the skills and the power to respond. This means making public services more sensitive to local places and unlocking the creativity of people on the front line through:

- **new freedoms for local communities and service leaders** to join up and tailor services and economic strategies across local areas, including a further six Multi Area Agreements in the coming year;
- **new freedoms for professionals** to lead, run and personalise services such as developing the options around lead professionals co-ordinating several different agencies to reduce re-offending;
- **plans to boost skills and attract talent:** such as a six month fast track into teacher training for successful skilled graduates; and
- **professionals leading innovation and efficiency:** such as the Prime Minister's Commission on the Future of Nursing and Midwifery, consulting widely on the best way for the NHS to make the most of its talented nursing professionals.

Strategic Leadership – The global recession has highlighted that effective governments must be able to adjust quickly and innovate in the face of new challenges. The Government will:

- **set standards and entitlements – and then stand back:** such as by focusing on just 30 high level outcomes, rather than micro-management;
- **improve productivity:** through involving front-line professionals at every stage of the policy-making process and delivering £35 billion of value for money savings over the 2007 Comprehensive Spending Review period; and
- **drive innovation:** as demonstrated by the new National Endowment for Science, Technology and the Arts Public Services Innovation Laboratory.

SUPPORTING THE ECONOMY THROUGH THE GLOBAL DOWNTURN

6.8 The immediate priority for the Government is to support the economy, providing targeted support to individuals and businesses most affected by the global shocks, whilst creating the conditions for future growth once the economy emerges from the downturn. As set out in Chapter 2, the Government will respond to the current economic challenges in the short term by pursuing a fiscal strategy that supports economic growth.

Support for families and businesses

6.9 The 2008 Pre-Budget Report announced a number of public spending measures to support those individuals and businesses who are most affected by the economic downturn. Since then, the Government has announced further measures, confirming its commitment to providing targeted support. As set out in Chapters 4 and 5, these include:

- the Homeowner Mortgage Support Scheme, which allows some of an eligible borrower's interest payments to be deferred for up to two years (where this is appropriate to their individual circumstances, and subject to suitable independent debt advice), with the Government guaranteeing a proportion of the deferred interest;
- an extra £1.3 billion of funding for Jobcentre Plus to ensure that those out of work and looking for a job get the support they need to move rapidly back to work. Currently, a quarter of individuals find work within one month and over half of them find work within three months;
- a £295 million package of support for up to 500,000 individuals who have been claiming Jobseeker's Allowance for six months, including "Golden Hellos" for employers to encourage recruitment;
- £140 million to support a further 35,000 apprenticeships in 2009-10. At least 21,000 will be in the public sector;
- increased provision for those facing redundancy through the expansion of the Rapid Response Service (RRS) to cover short term as well as long term redundancies. As a result, the RRS has helped over 1,500 firms;
- the Enterprise Finance Guarantee scheme to provide additional help for small and medium enterprises facing credit constraints. Since the launch of the scheme, nearly £290 million of eligible applications from over 2,500 small businesses have been assessed, are being processed, or have been granted, helping firms by providing a 75 per cent guarantee to participating banks on small and medium enterprise loans; and
- the Working Capital Scheme, which has signed £1 billion of guarantees with banks for their working capital lending portfolios totalling £2 billion, freeing up capital to enable banks to provide additional lending to businesses. The additional lending delivered as a result of the Working Capital Scheme will contribute to the lending agreements agreed by banks from 1 March 2009.

6.10 In order to mitigate the risk of a deeper and more prolonged downturn, **Budget 2009 announces a number of additional targeted spending measures, including:**

- **a further employment package, including £1.7 billion of additional funding for the Department for Work and Pensions to ensure Jobcentre Plus and Flexible New Deal programmes have the capacity to respond to rising unemployment.** The package will also include £1.2 billion of support for those aged between 18 and 24 who have been claiming Jobseeker's Allowance for 12 months, by offering them a job, training or a work placement lasting at least six months. Further details can be found in Chapter 5;
- **more help for homeowners, including an expansion in the provision of HomeBuy Direct, the shared equity scheme that helps first-time buyers, and an extension in the eligibility criteria for the Mortgage Rescue Scheme to cover households in negative equity.** Further details can be found in Chapter 5;

- **that the September Guarantee of a place in education and training to every 16 and 17 year old who wants one will be met in full.** There will be additional investment of £251 million in 2009-10 and £404 million in 2010-11, covering an extra 54,500 student places in the next academic year. Unit costs for post-16 learners will be subject to a 1 per cent efficiency assumption in 2010-11. Total spend for 16-19 education in 2009-10 will be £6.8 billion;
- **a 'top-up' trade credit insurance scheme to help UK businesses maintain their finances.** The Government will offer to match private sector trade credit insurance provision if insurers reduce cover to any UK business. Further details can be found in Chapter 4;
- **a vehicle scrappage scheme that will enable consumers who scrap vehicles older than ten years to replace them with a brand new vehicle at a discount of £2,000, co-funded with industry.** Further details can be found in Chapter 4; and
- **£270 million to allow the Social Fund to continue to provide interest free loans for vulnerable people and an additional payment made alongside the Winter Fuel Payment for 2009-10 to provide extra support for pensioners.** Further details can be found in Chapter 5.

Capital fiscal stimulus

6.11 Capital investment plays an important role in boosting aggregate demand during the economic downturn, whilst also laying the foundation for economic growth as the economy recovers. The 2008 Pre-Budget Report announced the Government's commitment to providing timely, targeted and temporary support to the economy by bringing forward £3 billion of capital spending from 2010-11 into 2008-09 and 2009-10. These additional investments are already supporting a number of industries and employing people across the country.

Housing and regeneration

6.12 A total of £775 million of housing and regeneration investment is being brought forward from 2010-11 into 2008-09 and 2009-10. In 2008-09, £130 million allowed the refurbishment of an additional 13,000 homes through the Decent Homes programme and £20 million funded nine community infrastructure projects. In 2009-10, the housing fiscal stimulus will include a further £120 million to bring an estimated 12,000 properties up to the Decent Homes standard; £180 million to be spent on critical regeneration through the Homes and Communities Agency and the Regional Development Agencies (RDAs); and £150 million to fund additional investment in homes for social rent which, combined with £400 million brought forward in the September housing package for 2008-09 and 2009-10, will deliver 7,500 new social rented homes earlier than planned. A further £50 million is earmarked for Armed Forces accommodation, meaning that an additional 600 service men and women and their families will benefit from rebuilt and upgraded accommodation this year.

Transport

6.13 The 2008 Pre-Budget Report announced that £700 million of transport spending would be brought forward from 2010-11 into 2009-10. £400 million of this will be used by the Highways Agency to accelerate high value schemes on the strategic roads network. This includes £100 million to dual the A46 from Newark to Widmerpool, with £300 million to advance the managed motorway works on the M1 and M6 and to accelerate specific asset renewal work and technology improvements across the network. Furthermore, the Department for Transport is procuring around 200 new diesel carriages to boost rail capacity more quickly than would otherwise be possible.

Schools 6.14 Over £800 million will be brought forward from 2010-11 into 2009-10 in the priority schools capital programmes. More than 100 local authorities can now invest in their priority capital programmes one year earlier; and all head teachers in England are recieving an advance of their devolved formula capital to invest in smaller projects as they see fit, from building new classrooms or science laboratories to fitting out new gyms or improving ICT facilities.

Health 6.15 The 2008 Pre-Budget Report announced that £100 million would be brought forward from 2010-11 into 2009-10 to advance the upgrading of 600 GP surgeries to training practices, targeting funding to those areas that historically have had a lower provision of doctors. The targeted areas have now been identified, with allocations to Primary Care Trusts (PCTs) from May 2009 and work at GP practices due to commence by early summer 2009.

Further and Higher Education 6.16 The 2008 Pre-Budget Report brought forward £442 million in total from 2010-11 to 2008-09 and 2009-10 to accelerate the Learning and Skills Council's (LSC) Building Colleges for the Future programme, to support Higher Education (HE) building projects and to bring forward the development of scientific research facilities and improvements to university research infrastructure. In 2008-09, over 100 Further Education (FE) college building projects were completed as a result of nearly £550 million of investment, of which £110 million had been brought forward as part of the fiscal stimulus. Building on this, **Budget 2009 announces an additional £300 million of capital funding for investment in Further Education colleges in the 2007 Comprehensive Spending Review (CSR) period. This will enable the Learning and Skills Council to fund a limited number of further projects through the Building Colleges for the Future programme starting in 2009-10,** based on prioritisation criteria to be agreed with the LSC and the sector.

6.17 Of the £442 million brought forward in the 2008 Pre-Budget Report for FE, HE and science, £200 million will fund the acceleration of HE building projects in 2009-10. The Higher Education Funding Council for England has announced 97 projects so far, including £3.5 million for a new Centre for Optometry at Manchester University; £11 million for a new building at the University of Oxford to house the Department for Earth Sciences; and £5.4 million to improve the teaching rooms and the IT facilities at Kings College London. Due to the design of these institutions, they will also contribute to the UK's carbon reduction targets.

Warm Front 6.18 The 2008 Pre-Budget Report announced that £50 million of investment in the Warm Front programme, which supplies insulation and heating measures to vulnerable households, would be brought forward from 2010-11 into 2009-10, and that the programme would also receive £100 million of additional funding in 2008-09 and 2009-10. As a result, 35,000 additional households have already received assistance, saving them up to £300 in energy bills every year.

Flood defences 6.19 The 2008 Pre-Budget Report announced that £20 million would be brought forward from 2010-11 into 2009-10 to improve flood defences. This is on track to help deliver earlier protection for 27,000 households in vulnerable areas of the country.

Support for PFI projects

Infrastructure debt-financing unit 6.20 The Government remains strongly supportive of the value that private finance can bring to infrastructure procurement. In March 2009, the Government announced a public sector infrastructure debt-financing unit to provide temporary support for Private Finance Initiative (PFI) projects until market conditions improve, ensuring that vital projects in areas such as schools, waste and housing can proceed as planned. Projects in procurement with a total capital value of around £13 billion will be the immediate beneficiaries. The unit has recently reached financial close on its first project, lending £120 million alongside the European Investment Bank and commercial lenders to the Greater Manchester Waste

Development Authority's PFI project, ensuring that the £635 million construction programme can still go ahead.

Building Schools for the Future

6.21 The Government remains committed to delivering educational transformation through the Building Schools for the Future (BSF) programme, where PFI is expected to contribute around one third of the total investment over the course of the 2007 CSR period. Following the consultation last year on the future delivery of BSF, the Government has decided to move from the "wave" based model used to date, so that local authorities who are currently discussing new BSF projects with Partnerships for Schools can join the programme on a rolling basis, in line with available resources and only if Partnership for Schools assesses that they are ready.

Total capital investment in 2008-09

6.22 The Government continues to make significant progress against its commitment to invest in Britain's infrastructure. As a result of the capital fiscal stimulus and departmental capital spending plans set out in the 2007 CSR, total public sector net investment as a percentage of GDP is estimated to be 2.6 per cent in 2008-09, helping provide an important boost to the economy during the downturn. Box 6.3 outlines some of the projects that were delivered in the last financial year.

Box 6.3: Capital investment in 2008-09

As a result of the Government's continued drive on capital investment:

- the National Affordable Housing Programme delivered over 47,000 new homes, including 27,500 social rented homes and 19,500 Low Cost Home Ownership units. An estimated 112,000 existing homes have been brought up to the Decent Homes standard;
- the Warm Front programme implemented energy efficiency and heating measures in more than 234,000 households;
- flood and coastal erosion management reduced flood risk to 20,000 households;
- the buildings and environment of over 100 Further Education institutions were improved;
- 34 schools were built and a further 8 remodelled with another 105 schools currently under construction. 14 new academies were opened with a further 71 under construction or receiving capital investment;
- the M6 Carlisle to Guardsmill extension and the M1 Junction 6A to Junction 10 widening were completed, helping to reduce congestion and improve journey time reliability;
- 38 new primary care facilities were opened to the public;
- 48 new hospital redevelopments and new builds (including 10 major schemes) were opened in 2008-09. The NHS has now achieved its target of 100 new hospitals by 2010, two years ahead of schedule;
- HMS Daring, the first of the new Type 45 destroyers, was transferred to the Royal Navy; and
- the fifth and sixth C17 Air Transport Aircraft were delivered to the Royal Air Force.

PREPARING THE ECONOMY FOR THE UPTURN

6.23 Alongside temporary spending measures to support the economy in the short term, the Government is determined to take action to help the economy to emerge stronger and faster from the downturn, supporting jobs and ensuring that the country is better able to

compete in the global economy of the future. **Budget 2009 announces a number of spending measures that will create the conditions for future growth including:**

- **a new £750 million Strategic Investment Fund, ensuring that the UK remains well positioned to emerge from the downturn in a globally competitive position.** £250 million of this will be earmarked for low-carbon investment. Further details can be found in Chapter 4;
- **a further £500 million to boost Britain's low-carbon sectors and lay the foundations for green growth, as part of an overall £1.4 billion package.** This will support investment in energy and resource efficiency and low-carbon energy generation by business, public sector and households over the next two years; and support low-carbon industries and green manufacturing in the UK. In addition, and subject to consultation, **Budget 2009 announces a £525 million uplift in investment support over the period 2011 to 2014, through the Renewables Obligation, for offshore wind projects reaching financial close in the next two years.** Further details can be found in Chapter 7; and
- **£600 million to stimulate housing development in the short term and boost capacity in the house building industry in the long term, which will deliver up to 10,000 homes in England within the next two years.** The fund comprises gap-equity funding for upfront infrastructure, an expansion in the provision of HomeBuy Direct, increased funding for affordable housing and funding for local authorities to deliver socal housing. Further details can be found in Chapter 5.

Changes to the PSA framework

6.24 In order to ensure that these and other spending measures are delivered quickly and effectively, to limit the adverse effects of the economic downturn and to prepare the economy for the upturn, the Government has reshaped its PSAs to better reflect its economic priorities. The PSA framework now includes an additional overarching objective: "Help people and businesses come through the downturn sooner and stronger, supporting long-term economic growth and prosperity." This objective will be achieved through the delivery of commitments from the National Economic Council to help people and businesses come through the downturn sooner and stronger, including packages on repossessions, apprenticeships, business access to finance and help for the unemployed; and PSAs on economic performance and productivity, skills, employment, housing, business success, transport, science and innovation. The Government remains committed to improvements in public service delivery as set out in the 30 PSAs introduced in the 2007 CSR.

A RELENTLESS FOCUS ON VALUE FOR MONEY

6.25 The Government is commited to increase investment in important public service priorities over the next few years. Alongside this investment, Budget 2009 announces further measures to improve efficiency and cut down on waste.

Over delivery of the 2004 SR Gershon efficiency target

6.26 Since 1997, the Government has made significant progress towards delivering more efficient and effective public services that represent value for money for the taxpayer. For example, in the 2004 Spending Review, the Government set stretching efficiency targets for departments to deliver by March 2008, as recommended by Sir Peter Gershon. The Government has over-delivered against its original target by more than 20 per cent, achieving efficiency savings of over £26.5 billion. The Government has also achieved over 86,700 civil service workforce reductions, significantly over-delivering against its target of 70,600 workforce

reductions, releasing resources that have allowed the Government to invest in more front-line professionals such as doctors, teachers and police officers. Following Sir Michael Lyons' Independent Report into *Public Sector Relocation*,[3] in 2004 the Government also agreed to relocate 20,000 posts out of London and the South East by March 2010. Having already moved more than 19,000 of these posts, **Budget 2009 announces plans to increase the target to 24,000 posts by 2010-11, and the Office of Government Commerce will work with departments to review the level of ambition and relocations in the medium term.**

2007 CSR value for money targets

6.27 The 2007 CSR set a new value for money target worth an additional £30 billion of savings by the end of 2010-11 and also imposed more challenging criteria, with all savings cash-releasing and reported net of costs. Programmes to meet this target are already driving real change and efficiency within departments. Table 6.1 at the end of this chapter outlines a number of key initiatives that departments are undertaking in order to meet their CSR value for money targets.

6.28 Budget 2008 announced the next stage in the Government's rolling programme of value for money improvements, setting up the Operational Efficiency Programme and the Public Value Programme to capitalise on best practice and leading thinking in the private and public sectors. These programmes have explored how further efficiency savings can be achieved in the medium term, recognising that considered analysis and adequate lead times are key to unlocking a more significant level of savings in the future.

The Operational Efficiency Programme

6.29 The Operational Efficiency Programme (OEP) has harnessed private and public sector expertise to examine opportunities for further efficiency savings in five cross-cutting areas: back office and IT, collaborative procurement, asset management, property and local incentives and empowerment. An experienced external advisor has led each of the five areas reviewed by the OEP and the detailed final recommendations are published alongside Budget 2009 in *Operational Efficiency Programme: Final Report*.[4] **The Government accepts the recommendations of the OEP in full and all departments will be working to implement and deliver the additional value for money savings identified through the Programme.**

6.30 Where appropriate, the advisors have quantified the level of savings that the Government could achieve if their recommendations were implemented. These estimated savings are at a high level and are indicative, given limited management information and current market uncertainty, but include savings that could be made both during and beyond the 2007 CSR period. In total, the efficiency savings identified amount to £15 billion a year compared to 2007-08. Some of these savings are already underway. It is estimated that nearly £6 billion per year of these savings can be delivered by 2010-11 as part of plans for the Government's existing efficiency target. It is estimated that, in the next Spending Review period, additional savings can be achieved, rising to around £9 billion per year in 2013-14.

Back office and IT operations

6.31 Dr Martin Read, former Chief Executive of Logica, has found that compared to 2007-08 spend of around £18 billion, £4 billion of savings a year are possible by improving the efficiency of back office operations such as Human Resources and Finance. He has recommended widespread benchmarking and targeted performance reviews across the public sector to drive out inefficiencies, such as the current 300 per cent variation in the per employee cost of Human Resources. Compared to 2007-08 spend of around £16 billion a year on IT, Dr Martin Read has also identified an estimated £3.2 billion a year of savings by strengthening the

[3] *Well Placed to Deliver? Independent Review of Public Sector Relocation*, Sir Michael Lyons, March 2004.
[4] *Operational Efficiency Programme: Final Report*, HM Treasury, April 2009.

assurance, governance and scrutiny of IT projects, and using benchmarking to drive up performance and improve IT procurement.

Collaborative procurement

6.32 Martin Jay, Chairman of Invensys, has found that compared to 2007-08 spending of £89 billion, £6.1 billion of savings a year are possible by harnessing the public sector's collective buying power (plus £1.6 billion of savings on IT, which are included in the figure in paragraph 6.31). He has recommended a series of actions including extending the goods and services that the public sector seeks to buy collaboratively and maximising the use of the Professional Buying Organisations.

Asset management and sales

6.33 Gerry Grimstone, Chairman of Standard Life, has concluded that there is significant potential for the Government to realise greater value from its asset base through applying a more commercial approach. Progress on the studies into specific assets launched at the 2008 Pre-Budget Report is reported in *Operational Efficiency Programme: Final Report*. Gerry Grimstone, working with departments and the Shareholder Executive, has also identified a number of further assets that will be the subject of a second wave of studies. These are also set out in *Operational Efficiency Programme: Final Report*, and progress will be reported in the 2009 Pre-Budget Report.

Property

6.34 Lord Carter of Coles has found that compared to 2007-08 running costs of approximately £25 billion a year, savings of up to £1.5 billion a year by 2013-14 are achievable (plus £0.5 billion of savings on procurement of Facilities Management, which are included in the figures in paragraph 6.32), rising to a total of around £5 billion a year by the end of a 10-year period. He has also estimated that a total of around £20 billion of disposal proceeds (excluding council house sales) could be achieved over an initial 10-year period by better management and rationalisation of the public sector's property estate. He has therefore recommended a series of mechanisms and incentives, including the creation of a central property function to provide assistance and expertise and oversee the efficiency and rationalisation agenda for property across the whole public sector.

Local incentives

6.35 The local incentives and empowerment workstrand, led by Sir Michael Bichard, Executive Director of the Institute for Government, has examined how to provide the incentives for greater collaboration and innovation on the front line, with systematic front-line engagement alongside a reduction in burdens to create the space for progress. **As a first step, the Government will launch the 'Total Place' initiative, looking at public spending and local leadership in 13 local areas to identify how collaboration and prioritisation can lead to greater efficiency and value for money.** The areas taking part in 'Total Place' are: Birmingham; Bradford (with appropriate links to the city-region pilot); Coventry; Croydon; Dorset, Poole and Bournemouth; Durham; Leicester and Leicestershire; Lewisham; Luton and Central Bedfordshire; Kent; Manchester city-region; South Tyneside, Gateshead and Sunderland; and Worcestershire. The Government will report on the interim findings of this work in the 2009 Pre-Budget Report.

Performance management and accountability

6.36 To ensure delivery of the potential savings identified by the OEP, **the Government will strengthen existing accountability mechanisms in several ways: by establishing a Value for Money Review Group; considering the role of Non-Executive Board members in respect of value for money; designating a Minister responsible for championing value for money within each department; and establishing a key leadership role for the Ministerial Committee on Public Services and Public Expenditure (PSX).**

The Public Value Programme

Progress on PVP reforms

6.37 Budget 2008 also launched the Public Value Programme (PVP), to look at transformational policy options in major areas of public spending. **Budget 2009 announces that the Government will:**

- **deliver billions of pounds per year of cash savings and quality improvements by 2013-14 through improving the capability and planning capacity of NHS commissioners and extending the success of the NHS tariff pricing system into new areas,** most notably community services and mental health;
- **roll out new metrics to improve utilisation of the NHS estate, reducing the need for new hospital space and saving up to £100 million per year of estate costs by 2013-14.** The Department of Health will monitor the resulting NHS estate performance improvement;
- **work with schools to ensure the most cost effective use of teaching assistants to enhance educational performance;**
- ensure that, as set out in the *New Opportunities White Paper*,[5] Activity Agreement pilots will focus on the most vulnerable, hardest to reach young people not in education, employment or training and will be developed with improved cost effectiveness. **The cross-government review of the rationale, design and level of financial support for young people in the context of full participation, will build on the analysis of the value for money and effectiveness of the current leaver support scheme;**
- deliver new efficiencies in the Highways Agency, working to double its performance against its value for money target by 2010-11 through **improved cost management of major schemes and the re-tendering of routine and winter maintenance contracts;**
- **implement the Chartered Institute of Public Finance and Accountancy (CIPFA) recommendations to improve the way local authorities account for highway maintenance.** CIPFA's report identified the scope for at least 5 per cent savings through better asset plans. Local authorities are also working with the Highways Agency to improve collaborative procurement;
- **work with the RDAs as they reprioritise their investments to maximise the impact of the Single Pot on regional economies, learning the lessons from the recent independent evaluation of RDAs, announced to Parliament on 31 March 2009.** A strengthened Sponsorship Framework will drive up value for money in RDAs by embedding evaluation, strengthening public reporting and confirming a reshaped Independent Performance Assessment;
- **reprioritise regeneration investment where there are opportunities for transforming the economic prospects of areas with lower economic performance** by targeting market failures, making decisions at appropriate spatial levels and better coordinating funding and delivery, as will be set out in the new Regeneration Framework which will be published shortly;
- **ensure that over the next three years, the National Offender Management Service will run a competition for the management of five existing prisons and that all new-build prisons will be built and managed by the private sector;** and

[5] *New Opportunities: Fair chances for the future*, HM Government, January 2009.

- **develop proposals to increase the value for money of the Warm Front programme, and consider further the best approaches for delivering energy efficiency and heating measures to low-income households as part of the development of the Heat and Energy Saving Strategy.**

New 2010-11 value for money target

6.38 The majority of savings identified by the OEP and PVP will have their greatest impact in the next Spending Review period. However, the results of the programmes make clear that some savings will be achievable in 2010-11. The 2008 Pre-Budget Report announced that, on the back of the initial findings of the OEP and PVP and the over-delivery of the 2004 Gershon target, the Government would increase its £30 billion 2007 CSR value for money target to £35 billion, delivering an additional £5 billion of recoverable value for money savings in 2010-11. **Budget 2009 publishes a departmental breakdown of the new target (table 6.1 at the end of this chapter), which is underpinned by new measures to improve value for money in each department.**

6.39 The Government has been able to deliver these efficiency savings throughout the public sector whilst also continuing to increase investment in public service priorities. The vast majority of the savings delivered over the CSR period will be recycled back into departments' budgets, allowing them to continue to deliver improvements in service quality. £5 billion of savings will be recovered from 2010-11 budgets to support the fiscal consolidation necessary in the medium term.

6.40 This is being done alongside maintaining the allocation plans for key front-line public services:

- funding to the NHS front line through PCT allocations in 2009-10 and 2010-11 will continue to rise to £80 billion and £84 billion respectively, in line with the 5.5 per cent nominal growth in each year, announced in December 2008;
- funding to schools will continue to rise by 3.8 per cent in 2009-10 and 4.3 per cent in 2010-11; and
- both the 2010-11 local authority formula grant and the police grant will remain as announced in the local government finance settlement and the police and community safety settlement. As a sign of their commitment to improving efficiency, local government and the police will both deliver a further 1 per cent of efficiency savings beyond the level of savings committed to at the 2007 CSR, with all savings recycled back to front-line services.

6.41 The devolved administrations' budgets have been adjusted in line with the application of the Barnett formula, as set out in the 2008 Pre-Budget Report.

Public sector pay

6.42 Public sector workers are at the heart of delivering world-class public services and supporting long-term economic growth, prosperity and fairness. Public sector pay policy needs to be set in the context of wider developments across the economy, where it is clear that the weaker private sector labour market has increased the relative attractiveness of the public sector as an employer. In setting public sector pay the Government will continue to balance a number of objectives: recruiting and retaining a high quality workforce; affordability and value for money for taxpayers; and consistency with achieving the Bank of England's inflation target. In this context, continued public sector pay restraint will be important to support front-line service delivery.

6.43 Senior staff have an important role to play in showing leadership in exercising pay restraint. In March 2009, the Government announced that pay awards for key senior public

sector groups for 2009-10 would be limited to 1.5 per cent. This covers senior civil servants, judges, very senior managers in the NHS and chief executives of Non-Departmental Public Bodies (NDPBs). More generally, pay for NDPB chief executives will be considered alongside, and by the same principles, as the pay remit of their organisations. **When vacancies from NDPB chief executives arise, the Government will undertake a first principles review of remuneration packages to ensure that these reflect the current labour market conditions.** The Government has also decided to accept in full the recommendations of the Pay Review Bodies for 2009-10 pay uplifts for the armed forces (2.8 per cent) and doctors and dentists (1.5 per cent). Bonuses for senior staff across the public sector must be scrutinised to ensure value for money for the taxpayer, emphasising that there are no rewards for failure.

A sustainable medium term path for public spending

6.44 Over the medium term, the Government is determined to continue to improve and invest in public services, whilst also ensuring a sustainable path for the public finances. Budget 2009 sets out future spending plans for the period from 2011-12 onwards and details of the action the Government is taking to ensure that front-line public service priorities will continue to improve in the years ahead.

Value for money in the next SR

6.45 The OEP, PVP and other value for money reforms have shown the progress that can be made in driving down costs and improving value for money both within and across the public sector, but there is clearly scope to do more. **Budget 2009 announces that, in addition to ongoing efficiencies that departments are expected to deliver, the Government will drive out additional efficiencies identified for 2011-12 and beyond:**

- **by 2013-14, £9 billion a year of additional savings identified by the OEP across procurement, back office and IT, and property running costs;** and
- **following the recommendations of the OEP advisors, new incentives and mechanisms will be put in place to realise up to £16 billion of property and other asset sales in the three years from 2011-12,** freeing up additional resources on top of capital budgets to fund investment priorities.

6.46 **Budget 2009 also announces that the PVP will be expanded to ensure demanding value for money reviews are conducted right across departmental budgets, delivering even greater efficiency savings in the next Spending Review period. The expanded PVP will cover a minimum of 50 per cent of each department's budget and with a particular focus on areas of spend that impact across departmental boundaries.** Building on past successes, this programme will draw on the best expertise and ideas of those working at every level in the public sector:

- Value for Money Innovation Panels, made up of senior figures, will challenge the level of ambition across major areas of spend, to release significant levels of savings in the future;
- Public Sector Innovators from best-in-class sectors, will work in partnership with other public sector organisations to share best practice and drive out opportunities for further savings; and
- front line value for money partners from throughout the delivery chain will be integrated within departmental programmes to innovate and bring forward their own ideas for improvements.

6.47 Lower inflation will make it easier to deliver savings as departments have had an additional boost to their spending power in 2009-10 and 2010-11 as a result of lower prices.

6.48 The same rigorous approach must also be applied to the management of public spending, such as social security and tax credits, that is managed outside of departmental budgets. So building on the reforms set out in the December 2008 Welfare Reform White Paper *Raising expectations and increasing support; reforming welfare for the future*,[6] the Government will do more to ensure the working age benefits system is fair, affordable over the long term and actively encourages people away from dependency and into work.

Public service pensions

6.49 To manage the increasing pension costs associated with rising longevity, public service pensions are also being reformed:

- new arrangements for the Teachers scheme and the Civil Service scheme came into force in January 2007 and July 2007 respectively, and new NHS and Local Government Pension Schemes have been operating since April 2008;
- mechanisms, such as cost sharing and a cap on employer contributions, have been put in place to ensure future sustainability and affordability; and
- in the three central government schemes, the normal pension age has been increased from 60 to 65 for new entrants and, in the local government scheme, arrangements have been made to phase out a rule that has enabled some staff to take a pension before they reach the scheme's normal pension age of 65 without a reduction for early payment.

Future spending assumptions

6.50 Building on all these reforms, **Budget 2009 sets new assumptions for spending growth in the period from 2011-12 onwards, which will ensure continued investment and improvements in front-line public services whilst ensuring sustainable public finances in the medium term:**

- **current spending will grow by an average of 0.7 per cent a year in real terms between 2011-12 and 2013-14,** with additional efficiency savings allowing the Government to focus resources on front-line public service priorities. With lower inflation, public spending will continue to be higher in real terms than as set out in the 2008 Pre-Budget Report; and
- **public sector net investment will move to 1¼ per cent of GDP by 2013-14,** with proceeds from additional assets and property sales available to supplement capital budgets.

6.51 This means that over the five years from 2008-09 to 2013-14, current spending will grow in real terms by an average of 2.6 per cent, and public sector net investment by 2013-14 will still be twice as high as in 1997-98. By releasing additional efficiency savings through the OEP and expanded PVP, the Government will be able to continue to invest in, and improve, its front-line public service priorities in the years ahead.

[6] *Raising expectations and increasing support: reforming welfare for the future*, Department for Work and Pensions, December 2008.

Table 6.1: Departmental breakdown of the new £35 billion 2007 CSR value for money target

Departments have been able to find additional efficiency savings in 2010-11 whilst still continuing with planned substantial increases for key front-line public services. For example:

- The Department of Health will be able to make additional savings while continuing to increase allocations to PCT's by 5.5 per cent, as announced in December 2008;
- The Department for Children, Schools and Families will be able to make additional savings while continuing to increase allocations to schools by 4.3 per cent;
- The Department for Communities and Local Government will be able to make additional savings while keeping the 2010-11 local authority formula grant as announced in the local government finance settlement, rising by 2.5 per cent;
- The Home Office will be able to make additional savings while keeping the 2010-11 police grant as announced in the police and community safety settlement, rising by 2.7 per cent;
- The Department for Innovation, Universities and Skills will be able to make additional savings while continuing to increase the science budget by 6 per cent; and
- The Department for International Development will be able to make additional savings while its budget increases at an annual average real growth rate of 11.4 per cent over the 2007 CSR period. The Government also remains on track to deliver £9.1 billion of Overseas Development Aid by 2010-11 as set out in the 2007 CSR.

Department	Contribution to the new £35bn 2007 CSR Target	Examples of value for money savings include:
Department for Children, Schools and Families (DCSF)	**£5.14 billion (including £650m of additional savings in 2010-11)**	£307 million of savings in schools through applying a one per cent efficiency saving against cost pressures to free up resources to support more personalised learning. Schools are continuing to improve educational outcomes while achieving efficiencies, including through improving their financial management, capability and skills; 3 per cent efficiencies in the programme expenditure of Non-Departmental Public Bodies (NDPBs); £650 million additional savings without adversely affecting the quality of key services, including through further efficiencies across NDPBs and DCSF; and Economies of scale arising from the growth in post-16 learner numbers over the next two years, which will mean that learning places can be delivered with greater efficiency after this year.
Department of Health (DH)	**£10.5 billion (including £2.3bn of additional savings in 2010-11)**	£500 million per annum released through reductions in average length of stay in hospital, reducing waste in valuable hospital bed space and costs that occur when patients are kept in hospital longer than necessary, while improving patient experience and clinical outcomes; £550 million per annum through the new Pharmaceutical Price Regulation Scheme, which controls the prices of branded prescription medicines to the NHS thereby protecting it from excessive prices, while ensuring patients receive innovative new drugs more quickly; £500 million per annum through improved capability and planning capacity in commissioning processes, and improved quality at lower costs through the new tariff pricing system and extension of the tariff into community services and mental health; and £100 million per annum delivered by further improving collaborative procurement through the new Commercial Operating Model, and by improving efficiency in back office functions by building on the success of NHS Shared Business Services.

Table 6.1: continued

Department	Contribution to the new £35bn 2007 CSR Target	Examples of value for money savings include:
Department for Transport (DfT)	**£1.96 billion (including £200m of additional savings in 2010-11)**	£144 million from the Highways Agency, including £50 million of efficiencies on major road schemes through value engineering processes and additional savings through better technology and maintenance procurement, helping to support continued investment in economically important transport infrastructure projects; £538 million from Network Rail as a result of the Office of Rail Regulation setting strict efficiency targets, reducing the grant which the department pays Network Rail, delivering greater value for money from public investment in the operation, maintenance and renewal of rail infrastructure; £140 million from increased efficiency in the ongoing retendering of Highways Agency maintenance contracts, which in 2008-09 have been generating at least 15 per cent savings; and £7 million of savings from the Driver and Vehicle Licensing Agency (DVLA) through a more focussed approach to Vehicle Excise Duty evasion, helping to ensure fairness for the taxpayer.
Department for Innovation, University and Skills (DIUS)	**£1.94 billion (including £400m of additional savings in 2010-11)**	£118 million through increasing the effectiveness of research activities funded by the Research Councils by reducing administration costs and refocusing spend on new research priorities; £50 million of savings from improved procurement and better estates management in the Higher Education sector; £400 million of savings through a renewed efficiency drive in Further and Higher Education: the use of benchmarking data; greater contestability, particularly in commissioning new programmes and services; reduced expenditure through lower than previously expected rates of inflation and the strategic reprioritisation and re-phasing of programmes; and An additional £106 million of savings delivered by the Research Councils within the science and research budget to be re-invested within that budget to support key areas of economic potential.
Department for Communities and Local Government (CLG)	**£987 million (including £100m of additional savings in 2010-11)**	£110 million from continuing modernisation of the Fire and Rescue Service Authorities through revision of shift patterns, crewing arrangements and Human Resource savings; £65 million of savings through more effective use of funds to tackle the problems of the most difficult housing estates, focusing on supporting local authorities in their work with communities, local and regional partners; £43 million by reducing overheads and ending the lease on a London premises; and £20 million through a more focused Housing and Planning Delivery Grant, supporting local authorities to deliver more housing and to build planning capacity.
Local Government	**£5.50 billion (including £600m of additional recyclable savings in 2010-11)**	Savings from individual local authorities and groups of local authorities across a wide range of functions, for example: £160 million of savings estimated across all of the programmes of the South East Regional Improvement and Efficiency Partnership, including through the development of an ambitious construction framework to reduce construction costs; £70 million through collaborative procurement in the Yorkshire and Humber Regional Improvement and Efficiency Partnership to support local authorities to adopt a collaborative approach to framework agreements and term contracts and to link into existing national and regional contracts; £68 million from local authorities in the North West of England as a result of more efficient procurement activity, including through an e-procurement portal, which supports local authorities to find the best available deals; and £26 million estimated in one year across all of Essex County Council's services, including through the transformation of back office functions and the introduction of a supplier relationship management programme, therefore unlocking benefits by promoting a joint approach to continuous improvement and innovation.
Home Office (HO)	**£1.69 billion (including £150m of additional savings and a further £130m of additional recyclable savings in 2010-11)**	£1 billion per annum in partnership with the Police Service through front-line productivity improvements (e.g. Operation Quest, which has resulted in 15 per cent improvements in officer response times and significant increases in customer satisfaction in its initial roll out), and the use of technology to save police time (more than 40,000 extra mobile data devices for officer use); £150 million efficiencies in the UK Border Agency, including by streamlining the processing of asylum and migration applications and using new technology, such as iris and facial recognition technology, to provide a speedier service to legitimate travellers at the border; £60 million a year from improved commercial activity, including by leveraging spend and collaboration, process and price savings, mitigation of risk in the supplier base and a review of major programmes and projects; and £50 million worth of improvements in the effectiveness of corporate functions (finance, Human Resources and estates), including the realisation of the full benefits of shared services.
Ministry of Justice (MoJ)	**£1.08 billion (including £70m of additional savings in 2010-11)**	£120 million of efficiencies from the Prison Service's shared service centre, providing back office shared services for 128 prisons and other Government departments; £82 million savings in the National Offender Management Service through initiatives such as clustering (merging services between prisons in close proximity) and core day standardisation (bringing greater consistency and predictability to prison operations) and allowing prison staff arrangements to be re-profiled; £82 million from streamlining administrative processes in the Courts Service; and £33 million through 'The Way Ahead', a reform programme designed to deliver a sustainable legal aid system by moving away from fees based on the number of hours worked, to a fixed and graduated fee scheme based on cases. The reform programme also set the scene for introducing competitive and market-based system for legal aid procurement, thereby helping efficient providers prosper.

Table 6.1: continued

Department	Contribution to the new £35bn 2007 CSR Target	Examples of value for money savings include:
Law Officers' Departments (LODs)*	**£94 million (including £15m of additional savings in 2010-11)**	£16 million from optimising the use of an expanded cadre of Crown Prosecution Service (CPS) employed Associate Prosecutors and Crown Advocates to bring down the costs of prosecution; £24 million by streamlining and improving common business processes in CPS Areas across the country and by working more efficiently with the courts to reduce the number of adjournments in court and time spent on case preparation; £8 million from combining the Revenue and Customs Prosecution Office and the CPS to create one enhanced prosecuting organisation, optimising economies of scale and rationalising service delivery; and £37 million through the reform of corporate services including pursuing shared service solutions, collaborative procurement and maximising the potential gains from investment in IT.
Ministry of Defence (MOD)	**£3.15 billion (including £450m of additional recyclable savings in 2010-11)**	£200 million through the Performance, Agility, Confidence and Efficiency (PACE) programme delivering more effective military capability to Armed Forces, with £100 million already delivered; £170 million from the Nuclear Weapons Capability Sustainment Programme, which aims to sustain key workforce skills, modernise core research and manufacturing facilities and provide extra support infrastructure; £100 million more from extending the Civilian Costs Programme which will reduce support costs across the department; and An additional £6 million through continued pressure for efficiency on the Shared Services centres created in MOD in recent years.
Foreign and Commonwealth Office (FCO)	**£164 million (including £20m of additional savings in 2010-11)**	£18 million of savings from the British Council by moving to web based service provision and focusing on key priorities; £6.6 million via the Europe Zero Based Review by focusing on key priorities, downgrading posts and reducing back office activity; £12.5 million of efficiencies through better procurement and a reduction in the costs of goods and services purchased during the 2007 CSR period; and £9.5 million of IT efficiencies through three main drivers: the FCO's Telecommunications Network, Communications Centre and Programme Management. For example, £6 million per annum will be generated as a result of contract negotiations with FCO's existing telecoms supplier.
Department for International Development (DFID)	**£647 million (including £155m of additional savings in 2010-11)**	£110 million of savings generated by shifting more resources to countries where UK aid will have the greatest impact, helping to lift an estimated additional 100,000 people out of poverty; £6 million from efficiency savings in the back office and through the implementation of IT systems for programme and financial management; £5 million from more effective, focussed central communications work and more efficient use of web and social media networks; and £10 million savings from strengthened partnerships on research and analytical work, and improved procurement and management of policy and research contracts.
Department of Energy and Climate Change (DECC)	**£279 million (including £20m of additional savings in 2010-11)**	£125 million through improved financial incentives in contracts with site management companies to deliver efficiencies in decommissioning work across the Nuclear Decommissioning Agency sites; £15 million from reducing administration costs by focussing on priority areas where DECC can have the greatest impact; £52 million through improved procurement of commodities and third-party services, including the use of framework contracts for procurement of consultancy and technical work; and £20 million through greater improvements in the management of contracts, maximising income from assets and reduction in back office costs.
Department for Business, Enterprise and Regulatory Reform (BERR)	**£148 million (including £27m of additional savings in 2010-11)**	£5 million savings from delivering capital investment in assisted areas through the Selective Finance for Investment in England scheme, which focuses on higher value projects and provides better value for money through higher levels of additionality than the previous Regional Selective Assistance scheme; £1.4 million savings from the Competition Commission Council's fundamental review of the Competition Commission including through reducing burdens on business, making more effective use of staff and Members, improving team working and improving outcomes; £3 million from administration budgets, including efficiencies in BERR's corporate centre and back office functions and from savings in UK Trade and Investment's ICT costs as it rolls out its new digital strategy; and £12 million from improved delivery of fair markets policies including changes to the funding model for the Financial Reporting Council, savings associated with creation of Consumer Focus from its predecessor consumer bodies and improved value for money through implementation of dispute resolution regulations by Acas.
Department for Environment, Food and Rural Affairs (Defra)	**£381 million (including £75m of additional savings in 2010-11)**	£50 million by streamlining the Environment Agency's delivery of Flood and Coastal Erosion Risk management at the same time as funding is increased over the 2007 CSR period; £44 million on more efficient animal disease surveillance through a more risk-based approach to monitoring and enforcement and by sharing costs with industry; £10 million from rationalising Defra's estate, particularly in London, enabled by greater use of hot-desking and portable IT solutions; and £6 million through the re-procurement of facilities management services for Defra and its Agencies.

Table 6.1: continued

Department	Contribution to the new £35bn 2007 CSR Target	Examples of value for money savings include:
Department for Culture, Media and Sport (DCMS)	**£168 million (including £20m of additional savings in 2010-11)**	£33 million through driving value for money in NDPBs. For example, the Museums, Libraries and Archives Council have relocated outside of London, delivering savings in rental and service charges and staff costs of £290,000 per year; £4 million from greater efficiencies in DCMS's corporate centre. This will be secured through a reduction in administration expenditure, including savings on accommodation and staff costs; and £20 million of savings through driving further efficiencies including across DCMS's central and NDPBs' back office and lower priority programmes. This includes £3 million from S4C and £4 million from the Arts Council England.
Department for Work and Pensions (DWP)	**£1.4 billion (including £120m of additional recyclable savings in 2010-11)**	£15 million through DWP's Shared Services organisation, which provides internal services such as Human Resources to the department; Approximately £300 million through increases in staff productivity. This has been made possible by changes brought about by the Business Strategy and other front-line process improvements. These have improved both the way the department does business and the service offered to customers; £28 million through the Information Flows Programme which is delivering real improvements to the administration of Housing Benefit and Council Tax Benefit, thereby improving customer services by providing online access to relevant information about benefits administered by DWP; and £30 million from the modernisation of DWP's estate and improving overall workspace utilisation.
Chancellor's Departments – HM Revenue and Customs (HMRC) and HM Treasury	**£788 million (£754m from HM Revenue and Customs, including £80m of additional recyclable savings in 2010-11, and £35m from HM Treasury, including £5m of additional savings in 2010-11)**	£13.5 million from spending on HM Treasury procurement contracts by 2010-11, establishing a benchmarking process across procurement activities to deliver measurable value for money improvements in major contracts, especially in ICT and consultancy and from third party spend on consultancy and advice; Over £50 million of efficiencies through the Carter Programme, implementing new, enhanced, online services for Self Assessment, PAYE, VAT and Corporation Tax and measures to encourage online filing. Over two thirds of Self Assessment returns were filed online using the new service in 2008-09 - a 50 per cent increase on the previous year; £70 million through rationalising and developing a more strategically located estate to meet customer service and operational requirements. HMRC aims to reduce the size of its estate by one third and has carried out 60 closure projects in 2008-09. £18 million has been saved so far in 2008-09; and £60 million from greater efficiencies in HMRC central "Head Office" and corporate service areas.
Cabinet Office	**£45 million (including £10m of additional savings in 2010-11)**	£14.7 million in procurement efficiencies, for example by further utilising OGC Buying Solutions frameworks; £20.1 million by rationalising departmental administration. This initiative covers both the administration of the grants awarded by the department as well as its own internal administration; Around £5 million by implementing a Shared Service for finance, human resources and procurement; and £14 million of savings achieved by reducing expenditure on consultancy. Further savings will be achieved incorporating a centralised approach to the commissioning of consultants.
Northern Ireland Office	**£125 million (including £17m of additional savings in 2010-11)**	£29 million of efficiencies in the Northern Ireland Prison Service including through a permanent upfront reduction in Main Grade Officer headcount by 150 posts; £4 million of administration savings per annum over the next three years. As of December 2008, £3 million of savings had been delivered; and £74 million from increased efficiencies in the Police Service of Northern Ireland.

* ***Law Officers' Departments include**: Crown Prosecution Service (CPS), Serious Fraud Office (SFO), Treasury Solicitors Department (TSOL), Revenue and Customs Prosecutions Office (RCPO), Attorney General's Office (AGO), Her Majesty's Crown Prosecution Service Inspectorate (HMCPSI), National Fraud Strategic Authority (NFSA)*

7 Building a low-carbon recovery

The UK has led the world in taking a strategic and long-term approach to the problem of climate change. Existing policies are already enabling £50 billion of low-carbon investment over the three years to 2011, and helping to support 900,000 jobs. Budget 2009 builds on these foundations and provides over £1.4 billion of extra targeted support in the low-carbon sector. Together with announcements made since last autumn, measures announced today will enable an additional £10.4 billion of low-carbon sector and energy investment over three years, securing new jobs and new business, and placing the UK at the forefront of a worldwide low-carbon recovery.

To strengthen the long-term policy framework and give UK industry the confidence to invest in low-carbon technologies, **Budget 2009 sets the world's first carbon budgets**, as required by the new Climate Change Act. These set a legally binding 34 per cent reduction in emissions by 2020, a new level of ambition for UK climate policy.

Saving energy is the easiest way to cut carbon emissions, saving households and businesses money on bills. Building on the one million homes insulated last year, Budget 2009 announces an additional **£375 million to support energy and resource efficiency in businesses, public buildings and households over the next two years, and £70 million for decentralised small-scale and community low-carbon energy**. Together, these measures will support employment, and save 380,000 tCO_2 and around £60 million in energy bills each year.

Meeting carbon budgets will require a transformation of the way the UK meets its energy needs. The Government's existing framework will enable a ten-fold increase in renewable investment by 2020. To protect investment and jobs in low-carbon energy, and to strengthen the long-term framework for a low-carbon energy future, Budget 2009 announces:

- **£405 million to support low-carbon industries and advanced green manufacturing**, to help make the UK a worldwide leader;
- **that UK renewable and energy projects stand to benefit from up to £4 billion of new capital from the European Investment Bank**, removing blockages in project financing;
- **an uplift in support for offshore wind investments that reach financial close between now and 2011 through the Renewables Obligation**. This is expected to support £9 billion of investment and power up to 2.8 million homes;
- **extending support for combined heat and power through climate change levy exemptions**, helping bring forward £2.5 billion of investment and 3 GW of capacity by 2015, and supporting employment; and
- **a new funding mechanism to support up to four carbon capture and storage demonstration projects, and £90 million to fund detailed preparatory studies**.

To support the public finances, while also driving the move to a low-carbon and resource-efficient economy, Budget 2009 announces:

- **an increase in fuel duty of 2 pence per litre on 1 September 2009, and of 1 penny per litre in real terms each year from 2010 to 2013**. This will contribute to medium-term fiscal consolidation, and save 2 $MtCO_2$ per year by 2013-14; and
- **a continued increase in the standard rate of landfill tax by £8 per tonne on 1 April each year from 2011 to 2013**, to reduce landfill in a sustainable way by encouraging further investment into alternative waste management options.

7.1 Climate change is one of the greatest global economic and environmental challenges. The recent international scientific congress in Copenhagen concluded that the risks of climate change were worsening, with increasing probabilities of abrupt or irreversible climate shifts. In a warmer world, changes to the climate system are likely to lead to serious food and water shortages, sea level rises threatening coastal cities and low-lying areas, and large-scale movements of population.

7.2 To avoid the most dangerous effects, global emissions need to peak in the coming decade and then reduce to at least half their current levels by 2050. The Government's strategy for action is to act internationally to build a coordinated response at the global level, while delivering ambitious cuts in carbon emissions at home to demonstrate leadership and meet the UK's commitments. Through the new Climate Change Act the world's first carbon budgets will put the UK on track to meet an 80 per cent reduction in emissions by 2050. Existing policies are already enabling £50 billion of investment in the low-carbon sector over the three years to 2011 (Box 7.1).

Box 7.1: £50 billion of low-carbon investment

Tackling climate change requires substantial levels of investment across all sectors of the economy. The Government's policy framework is enabling £50 billion of investment over the period of the Comprehensive Spending Review (2008-11). This figure brings together government spending, fiscal support and private investment driven by government regulation in energy efficiency, renewable energy and public transport. The estimated breakdown for the full three-year period is set out by theme below:

- **Energy efficiency (£8.9 billion)** – measures to help households, businesses and the public sector use less energy, made up of Carbon Emissions Reduction Target, the Community Energy Saving Programme, Warm Front, Decent Homes, the Energy Savings Trust, smart metering for SMEs and public sector sites, reduced VAT for energy savings materials, Landlords Energy Savings Allowance, incentives for thermal insulation in industrial installations, and the value of climate change levy exemptions;
- **Renewables support (£6 billion)** – helping to deliver a ten-fold increase in renewable energy to meet the UK 2020 renewables target, including through private sector investment in renewables and the Renewables Obligation;
- **Technology support (£1.7 billion)** – developing and deploying new low-carbon technologies, including through the domestic Environmental Transformation Fund, Research Councils, Technology Strategy Board, Carbon Trust, Energy Technologies Institute and enhanced capital allowances;
- Reducing greenhouse gas emissions from **waste (£2.4 billion)** including PFI, business and local authority waste reduction programmes;
- **Transmission and electricity distribution infrastructure (£7.6 billion)** including work to link low-carbon power generators to the National Grid; and
- **Public transport and low-carbon and electric vehicles (£23.2 billion)** including spending on rail and public transport, as well as spending on ultra-low carbon vehicles.

7.3 Budget 2009 builds on this framework to provide over £1.4 billion of targeted support during the downturn to families, businesses and low-carbon industries, while creating the right incentives to transform the UK's energy and transport infrastructure for the long term (Box 7.2). These policies build on the *Low-Carbon Industrial Strategy: A Vision*,[1] launched in March 2009, and the Government's wider industrial strategy set out in *Building Britain's Future:*

[1] *Low-Carbon Industrial Strategy: A Vision*, HM Government, March 2009.

New Industry, New Jobs.[2] They will place the UK at the forefront of a worldwide low-carbon economic recovery, providing an opportunity to create new jobs and business in sectors of the future through low-carbon growth. By 2015, the low-carbon and environmental sector in the UK is expected to grow by £45 billion, taking its total worth to £150 billion. By then, the sector could employ 1.3 million, up by 400,000 from today.[3]

Box 7.2: Targeting low-carbon and energy investment

Budget 2009 announces over £1.4 billion additional targeted support for the low-carbon sector over the forecast period. This comprises:

- £525 million support to offshore wind through reform of the Renewables Obligation;
- £375 million for energy and resource efficiency in business, public buildings and households,[a] including £10 million for waste infrastructure;
- £405 million to support the development of a world-leading low-carbon and advanced green manufacturing sector in the UK;
- £60 million to fund engineering and design studies for carbon capture and storage;[b]
- £70 million to support decentralised small-scale and community low-carbon energy.

The measures announced by the Government since September 2008, including in the Pre-Budget Report and this Budget, will enable a further £10.4 billion of low-carbon and energy investment over the next three years. In addition to the measures outlined above, and taking into account the impact of the Renewables Obligation reform only in 2011-12, this comprises:

- up to £2.3 billion of lending which could be enabled, including from the European Investment Bank (EIB), to support investment in the automotive sector which contributes towards meeting environmental and energy efficiency targets;
- up to £4 billion from the EIB for UK renewable and energy projects;
- £1.1 billion in additional Warm Front funding, and increased energy efficiency obligations on energy suppliers, as announced in September 2008;
- £1 billion of investment in combined heat and power facilities supported by the extension of the climate change levy exemption;
- £535 million in green stimulus measures announced in the 2008 Pre-Budget Report;
- £250 million to bring forward ultra-low carbon vehicles announced in January 2009, with further details set out in April 2009; and
- £120 million to ensure delivery of the Greater Manchester waste PFI project.

Employment in environmental sectors could be further boosted by the funds being allocated to local authorities and other partners to provide jobs, as set out in Chapter 5.

[a] This includes £100 million of new funding to deliver energy efficient housing as set out in Chapter 5.
[b] A further £30 million is being found within existing environment budgets.

[2] *Building Britain's Future: New Industry, New Jobs*, HM Government, April 2009.
[3] *Low Carbon and Environmental Goods and Services: an industry analysis*, Innovas Solutions Ltd, March 2009.

REACHING A GLOBAL DEAL

Copenhagen 2009

7.4 As set out above, only a fully global response can deal with the challenge of climate change. The Government is committed to achieving a new ambitious global agreement. At Copenhagen later this year, the international community will negotiate the successor to the Kyoto Protocol. All major economies must now reduce or slow the growth of their emissions, including the advanced developing countries. This can be supported by international finance, especially by broadening and deepening the global carbon market, and by multilateral public funding, such as Climate Investment Funds. The international community must also support the most vulnerable countries to adapt to the impacts of climate change, some of which are already unavoidable.

London Summit

7.5 At the London Summit earlier this month, G20 Leaders reaffirmed their commitment to reach a global agreement on climate change in Copenhagen. They agreed to build an inclusive, green and sustainable recovery, and encouraged the World Bank and the other Multilateral Development Banks to play a strong role in providing investment for low-carbon development. Countries will now identify and work together on further measures to tackle climate change, including through discussions on international financing arrangements.

The EU 2020 Climate and Energy Package

7.6 In order to lead the effort to achieve a global deal, the EU committed at the December 2008 European Council to cut emissions by 20 per cent, or by 30 per cent as part of an international agreement. The UK was instrumental in the negotiation of this package, which sets the framework for a strengthened EU Emissions Trading Scheme (EU ETS), binding targets for Member States to reduce emissions, and a target for 20 per cent of the EU's energy to come from renewable sources by 2020.

EU Emissions Trading Scheme

7.7 The EU ETS remains fundamental to the delivery of carbon savings as well as to the establishment of a carbon price. It covers around 40 per cent of EU greenhouse gas emissions, making it the largest carbon market in the world. From 2012, the scheme will also include aviation, capping carbon emissions from this sector, while enabling cuts to be made in the most cost-effective way.

7.8 The revisions to the EU ETS agreed in December will make the scheme more environmentally ambitious. A central, EU-wide cap will ensure an annual reduction in emissions up to 2020, and will support the broadening and deepening of carbon markets as part of coordinated action towards a global deal.

Box 7.3: Auctioning carbon allowances

The UK was the first EU Member State to auction carbon allowances under Phase II of the EU ETS, holding two successful auctions and raising over £100 million. Auction revenue helps support public spending, including investment in public transport and energy efficiency. These auctions have helped secure London as the global centre of the carbon market, and demonstrate the Government's commitment to a robust, long-term carbon price.

In line with broader commitments to fair, stable and efficient financial markets, the Government is introducing legislation and new measures to improve the efficiency and accessibility of UK carbon auctions, including:

- a performance fee to compensate auction intermediaries for the services provided on behalf of the Government and to encourage wider participation;
- a bidding facility ensuring preferential access to carbon allowances for smaller firms; and
- measures to reduce legal risks and transaction costs for bidders.

A reliable auctioning system will become even more important to the stability and liquidity of the market as auctioning levels increase substantially in Phase III of the scheme.

INCREASING UK AMBITION – CARBON BUDGETS

7.9 The Government is committed to ensuring that the UK remains a world leader in its domestic response to climate change. The UK Climate Change Act is the first of its kind anywhere in the world, setting not only a long-term target for emissions reductions but also a legally binding trajectory towards this target. The Act requires the Government to set carbon budgets, fixing binding limits on greenhouse gas emissions over five-year periods. Carbon budgets put the transition to a low-carbon economy at the heart of economic decision-making. By providing the private sector with a clear and credible long-term framework, carbon budgets strengthen the signals needed to bring forward investment in the low-carbon sector.

First three carbon budgets

7.10 The Climate Change Act established an independent Committee on Climate Change (CCC) to advise the Government on the level of carbon budgets and potential for reducing emissions in the UK. The Committee's first report was published on 1 December 2008.[4] **Budget 2009 announces that the Government will set the UK's first three carbon budgets at levels leading to a 34 per cent reduction in greenhouse gas emissions with respect to 1990 levels by 2020.**[5] This represents a step change in UK ambition on climate change, consistent with the CCC's advice, and puts the UK on track to meet an 80 per cent reduction in emissions by 2050. The Government will increase the level of ambition of carbon budgets once a satisfactory global deal on climate change is reached.

7.11 The UK is on track to meet its carbon budgets, with emissions expected to fall by around one-third by 2020 since 1990 (Chart 7.1). While there is some uncertainty in predicting the exact path of future emissions, the latest Government modelling shows that UK emissions should be lower than required for the first and second budget periods, and well within the range of uncertainty for the third budget period. In the summer, as required by the Climate Change Act, the Government will publish an energy and climate change strategy, setting out the policies that will deliver these budgets, and continuing progress towards 2050 goals. The strategy will strengthen the long-term policy framework, taking account of recent consultations on heat and energy saving, renewable energy and zero-carbon homes.

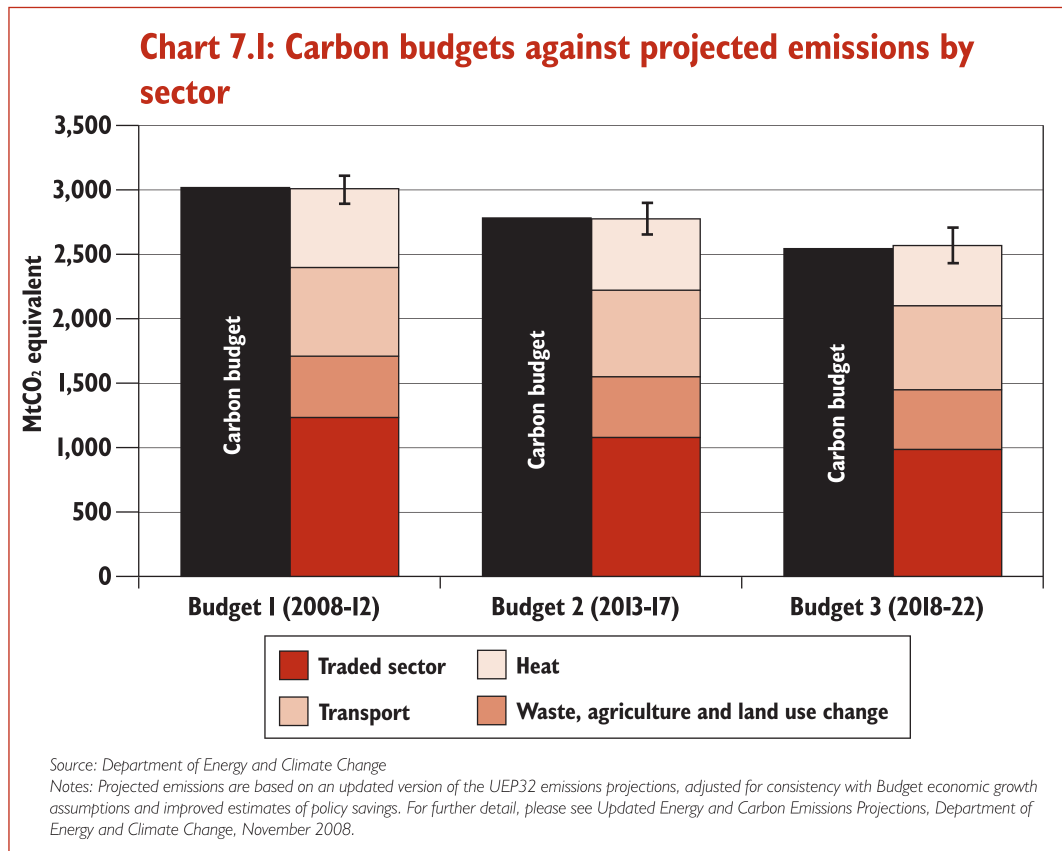
[4] *Building a low-carbon economy: the UK's contribution to tackling climate change*, Committee on Climate Change, December 2008.

[5] As required by the Climate Change Act 2008, an order setting the carbon budgets will be laid before Parliament today for approval. *Building a low-carbon economy: implementing the Climate Change Act 2008*, HM Treasury, HM Government, April 2009.

Carbon budgets and a global deal

7.12 The Climate Change Act allows the Government to meet its carbon budgets through the purchase of carbon credits corresponding to overseas emissions reductions. **The Government aims to meet the first three carbon budgets without purchase of overseas credits outside of the EU ETS, reserving possible credit purchase as a fallback option, as recommended by the CCC.** Under a global deal, the Government would expect purchase of credits to form an important part of the additional effort needed to meet more challenging carbon budgets. This commitment to planned credit purchase will contribute to the Government's efforts to secure a global climate deal and position the UK to influence development and reform of the international carbon market.

Chart 7.1: Carbon budgets against projected emissions by sector



Source: Department of Energy and Climate Change
Notes: Projected emissions are based on an updated version of the UEP32 emissions projections, adjusted for consistency with Budget economic growth assumptions and improved estimates of policy savings. For further detail, please see Updated Energy and Carbon Emissions Projections, Department of Energy and Climate Change, November 2008.

TARGETED SUPPORT FOR FAMILIES AND BUSINESS THROUGH THE DOWNTURN

7.13 The Government is committed to ensuring the long-term environmental ambitions set out by carbon budgets are not jeopardised by short-term economic conditions. Investment in low-carbon sectors also provides an opportunity to accelerate the transition towards a low-carbon economy by putting spare capacity in the economy to productive uses, creating and sustaining jobs, while saving families and businesses money on their energy bills through energy efficiency.

7.14 The 2008 Pre-Budget Report announced that the Government would bring forward £535 million of new and accelerated capital spending on energy efficiency, transport and adaptation measures (Box 7.4). Budget 2009 builds on this package with further targeted support to boost energy efficiency and low-carbon energy.

Box 7.4: Delivering the 2008 Pre-Budget Report green stimulus

As part of the 2008 Pre-Budget Report fiscal stimulus, the Government is providing £535 million of accelerated capital spending and additional resources over 2008-09 and 2009-10 to promote environmental objectives and support low-carbon growth. Delivery is well underway:

- 234,000 households were assisted by the Warm Front programme in 2008-09, including 35,000 helped by £50 million of new money provided in the Pre-Budget Report. This money is expected to reduce emissions by around 40,000 tCO_2 per year;
- the Department for Transport is procuring 200 new diesel carriages to boost rail capacity more quickly than would otherwise be possible. Bids from prospective suppliers have been received and are currently being considered by the Department. The carriages are expected to enter service by 2012. Rail journeys are substantially more carbon-efficient per passenger kilometre than cars and normal buses; and
- investment has been brought forward to sustain and accelerate the Decent Homes programme in 2008-09, including the provision of energy efficiency and heating measures in social housing.

Activity on Warm Front in 2009-10 is expected to provide early additional help to 49,000 households. Investment is also being brought forward to 2009-10 for Decent Homes, flood defences and the British Waterways canal network.

Reducing energy bills and carbon emissions

7.15 Improving energy efficiency is the most cost-effective way to reduce carbon emissions, while also saving money on bills, and freeing resources for investment elsewhere. However, households and businesses often hold off investing in energy efficiency because they may not have adequate information about the benefits or they are unable to afford upfront costs. Government action can help overcome these barriers, for example by providing advice, information and discounts to support households to install energy-saving products, as well as targeted public spending to help vulnerable and low-income households.

7.16 As part of these policies, the Government is implementing a major £6.9 billion Home Energy Saving Programme to retrofit the existing housing stock, including the £1 billion package of new measures announced last September. As a result of this package, and the work of energy suppliers, the insulation industry and householders themselves, more than one million houses are estimated to have been insulated over the past year, saving each household up to £250 a year on their energy bills.[6] The Government is now consulting on how to further increase energy efficiency through a new heat and energy saving strategy, with the aim of retrofitting the entire housing stock by 2030 and reducing emissions from existing buildings to approaching zero by 2050.[7]

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[6] For an average three-bedroom semi-detached house installing both cavity wall and full loft insulation.

[7] *Heat and Energy Saving Strategy Consultation*, HM Government, February 2009.

Energy efficiency

7.17 To make further progress against the Government's ambitions, Budget 2009 announces a substantial package of new spending, totalling £365 million for energy efficiency across the economy.[8] These measures will reduce carbon emissions, save money, and also help employment:

- **£100 million extra to improve the insulation for 150,000 homes in the social sector** through the Decent Homes programme in England, saving each household on average £120 a year, and 120,000 tonnes of carbon dioxide (tCO_2) per year;
- **£100 million, as part of the new housing package, for the construction of new homes at higher energy efficiency standards** as set out in Chapter 5;
- **£100 million of new funding for low-cost loans**, delivered through the Carbon Trust in England, helping around 3,500 small and medium-sized businesses to make £23 million savings on bills, and leading to savings of up to 140,000 tCO_2 per year; and
- **£65 million of new funding for loans to install energy efficiency measures in public buildings**, delivered through the Carbon Trust Salix Scheme in England, supporting around 3,000 projects in schools, hospitals and other public sector institutions. This will help save £18 million a year and 100,000 tCO_2 per year.

Small-scale renewable and community energy

7.18 The UK target to generate 15 per cent of energy from renewable sources by 2020 will need more energy to be generated and supplied by small-scale renewable energy technologies (such as solar power and heat pumps) and community heating schemes, where heat is generated centrally and transmitted via pipes. These can be a cost-effective way of generating low-carbon energy. Budget 2009 announces further measures to support decentralised small-scale renewable and community energy:

- **an additional £45 million for small-scale renewable electricity and heat technologies, primarily through the Low-Carbon Buildings Programme**. This will help to bring forward around 13,000 installations, and prepare the renewable supply chain to benefit from future opportunities when feed-in tariffs and the renewable heat incentive are introduced in 2010 and 2011 respectively; and
- **£25 million in funding for low-carbon community heating schemes**, allowing at least 10 communities to benefit from cleaner, locally produced energy. This will help deliver savings of 20,000 tCO_2 and support employment.

Energy prices

7.19 A competitive and efficient energy market has an important role to play in keeping energy prices low. The Government has committed to ensure that consumers benefit from lower prices and that their interests, particularly those of the vulnerable, are protected. In particular, the Government wants consumers to benefit from the significant falls in wholesale energy prices from their peaks in 2008. The Pre-Budget Report announced that Ofgem would produce quarterly reports on retail energy prices to ensure transparency over the extent to which suppliers are passing on price reductions to consumers. The first of these reports was published on 2 March 2009.[9] All of the six major supply companies have now announced some price reductions.

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[8] This UK-wide figure includes consequential funding for the devolved administrations. It will be for the devolved administrations to determine their own priorities. In addition a further £10 million of new grants for businesses will be provided for waste infrastructure (see paragraph 7.62).

[9] *Ofgem Quarterly Wholesale/Retail Price Report*. Ofgem, March 2009.

7.20 The Government also supports strong regulation in this area. Ofgem has concluded that existing powers are insufficient to prevent abuse of market power, and is now consulting on options to deal with this issue. In addition, Ofgem is consulting on licence changes to prevent unfair price discrimination and to help consumers engage more effectively in the market. The Government stands ready to consult on legislation to tackle unfair pricing differentials between different methods of payment for energy if there is not a speedy and satisfactory resolution of these issues.

OPPORTUNITIES FOR NEW LOW-CARBON INDUSTRY AND JOBS

7.21 The transition to a low-carbon economy will mean a transformation of the economy, requiring new services, technologies and industries. Such a change will provide an opportunity to invest for growth in these sectors, creating new openings for business, and the development of highly skilled jobs in the UK.

7.22 The Government wants to make the UK a world leader in the low-carbon and environmental sector, which is worth £3 trillion globally. By 2015 the sector could be worth £150 billion in the UK alone, and employ around 1.3 million people. The existing £50 billion of low-carbon investment, enabled by Government policies, has helped establish the UK's innovation and manufacturing base in these areas. Budget 2009 builds on this to provide further support for a low-carbon economy. The Government will publish further details on the low-carbon industrial strategy tomorrow. Employment in environmental sectors could be further boosted by the funds being allocated to local authorities and other partners to provide jobs, as set out in Chapter 5.

Building a low-carbon energy future

7.23 The UK will need investment in new generation capacity of up to 35 GW, almost half of current capacity, over the next two decades to replace ageing power stations and meet growing electricity demand.[10] To ensure this new investment supports low-carbon energy, the UK has put in place a long-term policy framework, including the EU ETS, which places a firm cap on emissions from the power sector, and the Renewables Obligation, which requires electricity suppliers to source an increasing percentage of electricity from renewable sources. This will help to drive a ten-fold increase in renewable electricity over the next ten years to meet the UK's renewable energy targets.[11] The UK has already trebled electricity from renewable sources and become the world leader in offshore wind. Five more offshore wind farms are currently under construction so in 2009 the UK will have doubled its capacity.

7.24 Falls in carbon and energy prices, tight finance conditions and exchange rate fluctuation create risks for renewables and other infrastructure investment. Delays or failures of particular projects could also impact on the supply chain or on confidence in the sector overall. The Government is therefore acting to help protect investment in energy and renewables projects.

7.25 Action to support the economy as a whole through the downturn will help the energy sector. For example, recapitalisation of the banks and other macro policy initiatives, such as the Asset Purchase Facility and first-year allowances announced in this Budget, should help support energy investment.

[10] *Meeting the Energy Challenge: A White Paper on Energy*, Department of Trade and Industry, May 2007.
[11] *UK Renewable Energy Strategy Consultation*, Department for Business, Enterprise and Regulatory Reform, June 2008.

Renewables financing

7.26 The UK is already the world-leader in offshore wind. To ensure that investors are able to secure an appropriate level of return in the current economic climate, and that the UK remains an attractive destination for wind investment, **Budget 2009 announces a banding review with the intention of increasing the banding of Renewables Obligation Certificates (ROCs) from 1.5 to 2.0 for offshore wind projects meeting specified completion criteria if they place new orders in 2009-10, and then 1.75 in 2010-11**. This is expected to provide £525 million support from 2011 to 2014, protecting 3 GW of proposed investment over the next two years, enough to power an estimated 2.8 million homes.

7.27 Energy projects seeking bank lending can experience difficulties in raising the necessary finance in current conditions. **Budget 2009 announces that UK renewable and energy projects stand to benefit from up to £4 billion of new capital from the European Investment Bank (EIB)** through direct lending to energy projects and intermediated lending to banks. The Government is bringing together the EIB, banks and developers to ensure this new framework lending and other products deliver rapid and sustained investment for UK renewable energy. The Government believes that this initiative can bring forward £1 billion of consented small and medium-sized UK renewables projects to deployment.

Investing in the UK low-carbon sector

7.28 As set out in *Building Britain's Future: New Industry, New Jobs*, a thriving low-carbon industry will need investment in technology development, infrastructure and supply chains. **Budget 2009 announces that the Government will allocate £405 million to support the development of a world-leading low-carbon energy and advanced green manufacturing sector in the UK.**[12] The funding will support the development and deployment of low-carbon technologies such as wind and marine energy (for example through building facilities to test prototype models), and will help attract and protect investment in the UK's low-carbon supply chain. Funding will be delivered through existing programmes such as the Environmental Transformation Fund and as part of the Strategic Investment Fund, as set out in Chapter 4. These measures will help establish the UK as a market leader in renewables technology and advanced green manufacturing.

7.29 This funding should allow the UK to develop expertise in particular low-carbon sectors such as offshore wind and marine power in which it has an advantage, through strength of natural resources, combined with technology, engineering and finance skills.

Strengthening the framework for energy investment

7.30 As the economy recovers, a range of low-carbon energy sources will be needed to meet the associated increase in energy demand. In addition to policies to support the low-carbon sector through the downturn, Budget 2009 strengthens the long-term policy framework to enable the UK to meet future carbon budgets at a lower cost, and at the same time improve the UK's security of energy supply.

Carbon capture and storage

7.31 The deployment of carbon capture and storage (CCS) will be key to the move towards a low carbon energy supply. CCS is the process of capturing carbon dioxide from fossil fuels and storing it instead of releasing it into the atmosphere. CCS could reduce carbon dioxide emissions from fossil fuel power stations by 90 per cent.

7.32 The Government has been instrumental in driving forward proposals in the EU to provide funding for CCS projects, leading to agreement at the European Council in December 2008 to allocate 300 million allowances from the EU ETS to part fund up to 12 CCS demonstrations worth around €9 billion. The UK is also one of the first countries in the world to be developing detailed regulatory arrangements for the storage of carbon dioxide, under the Energy Act 2008.

[12] £250 million through BERR and £155 million through DECC.

7.33 The increasing urgency of the climate change challenge and lessons learned from the competition to date mean that the Government now considers a new and more ambitious policy on CCS is appropriate. **Budget 2009 announces that it is the Government's intention to put in place a mechanism to deliver up to four CCS demonstration projects, including both pre- and post-combustion coal projects.**

7.34 Subject to receiving suitable bids and being able to reach appropriate terms, it remains the Government's intention to proceed with the current competition to contract award. As with any long-term procurement, final funding approval for this will depend on decisions taken at the next Spending Review.

7.35 To maintain momentum in bringing forward CCS, **Budget 2009 announces that £90 million is being allocated to fund companies in the current competition to undertake detailed preparatory studies for CCS**, with £60 million of this transferred from existing transport budgets. These studies will reduce technological risk for CCS projects and give greater clarity on costs. They will also ensure that preparations for construction start at the earliest possible date. It would be a requirement of funding that information from the studies is made available to promote global understanding of CCS.

Combined heat and power

7.36 Combined heat and power (CHP) delivers significant carbon emissions reductions within the UK. In recognition of this, the Government has put in place a range of regulatory and fiscal measures to encourage CHP investment, including support through the EU ETS. The Government's long-term strategy to support this sector will be set out in the heat and energy saving strategy, later in 2009.

7.37 However, in order to provide certainty to bring forward future investment, **the Government today announces that it will extend the climate change levy exemption for indirect sales of CHP electricity to 2023, subject to State aid approval. The Government will also commit to continuing other existing levy exemptions for CHP**. These measures will bring forward future investment in CHP of around £2.5 billion, which will increase electrical generating capacity by 3 GW by 2015, and promote employment opportunities in the sector. By 2020, these measures have the potential to deliver around 7 GW of new CHP electrical generating capacity, and reduce emissions by 3.2 million tonnes of carbon dioxide ($MtCO_2$). **Budget 2009 can also announce that climate change levy rates will remain at the current levels in 2010-11.**

Nuclear

7.38 The Government recognises that nuclear is a secure form of low-carbon energy generation with an important role to play alongside renewables and CCS. The Office for Nuclear Development has been established to help give potential developers clarity about the steps they need to take in order to bring forward new nuclear. The recent acquisition of British Energy by one of the world's leading nuclear operators demonstrates that the Government is succeeding in establishing the UK as one of the most attractive locations for new nuclear investment.

North Sea infrastructure and cushion gas

7.39 To maximise the potential of existing infrastructure, **Budget 2009 announces reforms to remove fiscal barriers to projects that reuse North Sea oil and gas infrastructure for other activities**, potentially benefiting gas storage, CCS, and wind energy projects. In addition, to provide industry with the certainty needed to bring forward gas storage projects, which will increase security of supply and help smooth energy price fluctuations, **Budget 2009 confirms that cushion gas is eligible for plant and machinery capital allowances.**

A SUSTAINABLE FUTURE FOR TRANSPORT

7.40 Transport plays an important role in the economy, but it can also have adverse environmental impacts. Road transport alone currently accounts for around one-fifth of total UK greenhouse gas emissions. The Government is committed to moving towards a low-carbon transport system, through supporting the development of green technologies and providing the right signals to encourage efficiency.

7.41 The Government has therefore been a strong proponent of tougher vehicle emissions standards. Significant progress has been made here since the Pre-Budget Report. In December 2008, the EU agreed to set binding targets on the carbon dioxide emissions from new cars, including a long-term target – as championed by the UK – of 95g CO_2 per km by 2020. This is one of the most ambitious targets in the world, and should save 7.6 $MtCO_2$ per year in 2020 in the UK.

7.42 Budget 2009 builds on this to move further towards a low-carbon transport system and help meet carbon budgets, introducing new measures to:

- encourage investment in the development and take-up of vehicles with lower carbon emissions, including ultra-low carbon vehicles; and
- support the public finances while promoting environmental ambitions, using fuel duty and Vehicle Excise Duty (VED) to help create the right incentives to reduce emissions.

7.43 The Government is also taking forward temporary measures to support the transport sector during the downturn. Chapter 4 sets out the details of a car scrappage scheme. Its primary purpose is to provide a boost to new car sales to help the industry in the current downturn. The scheme will encourage replacement of ageing vehicles by newer models with generally lower emissions, and is expected to have a neutral or modestly positive environmental impact.

Supporting the development of low-carbon vehicles

7.44 Improvements to vehicle technology have a critical role to play in moving to a low-carbon transport system. The way in which vehicles are built and powered needs to change. In the short term through improvements to existing technologies, and in the longer term through new, cleaner technology.

Ultra-low carbon vehicles

7.45 The Government is committed to supporting the shift to ultra-low carbon vehicles, including early electric and plug-in hybrid cars. In addition to direct funding, the Government is also providing support through the tax system, with electric vehicles paying no fuel duty or VED. To further support this transformation, £250 million of funding was announced in January 2009, and in April *Ultra-Low Carbon Vehicles in the UK* [13] announced that:

- up to £20 million will be available to support the roll-out of charging infrastructure needed to grow the market for ultra-low carbon cars. Cities and regions, in conjunction with the private sector, will be able to bid for this seed funding; and
- the majority of the £250 million will be used to reduce up-front costs of early electric and plug-in hybrid cars by between £2,000 and £5,000. The Government will begin discussions with the automotive and finance industries, as well as other key stakeholders, to explore how best to deliver this incentive from 2011.

[13] *Ultra-Low Carbon Vehicles in the UK*, DfT, BERR, DIUS, April 2009.

Box 7.4: Ultra-low carbon vehicles in the UK

The Government's ambition for the road transport sector is two-fold: to reduce the environmental impact of transport and for UK business to benefit from this transformation. To meet this dual challenge, the Government will work with the private sector to bring forward emerging new, cleaner technology including electric and plug-in hybrid cars.

Kilometre for kilometre, an electric vehicle powered with electricity generated from the current UK grid can emit up to 40 per cent less carbon than a conventional petrol vehicle. Electric vehicles will also improve local air quality as they have zero emissions at the tail pipe.

The main car manufacturers are already working to bring electric vehicles to the market. However, there are considerable challenges to overcome before large-scale take-up of ultra-low carbon vehicles can be achieved. Despite significantly lower running costs, these vehicles will initially be more expensive than conventional vehicles due to the battery costs. This is why the Government is committed to supporting the uptake of these early vehicles and helping consumers to access this technology.

A network of charging infrastructure is also necessary to ensure that drivers can recharge their vehicles. This is already emerging, with charging points starting to be installed around the country: 100 charging points are expected in London by the end of May 2009 alone. Although around 60 per cent of journeys by car are under 25 miles, charging points will be needed for longer journeys and for those drivers who cannot recharge at home. The Government is committed to supporting the targeted roll-out of this infrastructure to support this new technology.

Demonstration projects to showcase and trial these new and emerging technologies are already underway. For example, a competition run through the Technology Strategy Board will put over 200 ultra-low carbon vehicles on the road within 18 months. The Government is also showing public sector leadership in its procurement decisions, including through the Low Carbon Vehicle Procurement Programme, which focuses on vans. This aggregates the demand for electric and low-carbon vans from the entire public sector: manufacturers will receive larger orders and the public sector participants are insulated from the additional costs.

EIB European Clean Transport Facility

7.46 In the Pre-Budget Report, the Government called on the EIB to double its financial support for the next generation of greener cars by making available €8 billion over the next two years. The EIB announced a doubling of its Clean Transport Facility last December, and UK-based manufacturers will benefit from this.

Automotive Assistance Programme

7.47 Chapter 4 also sets out the further support provided for the car industry via the UK Automotive Assistance Programme. This will offer guarantees on EIB and other lending to ensure continued new green investment. To be eligible, projects need to deliver investment that secures jobs, skills or technology, and contribute towards meeting environmental and energy efficiency targets, for example reducing carbon emissions or achieving higher environmental protection standards.

Light commercial vehicles

7.48 Following the introduction of binding EU targets for new car CO_2 emissions, the European Commission is developing a similar proposal for van emissions. Light commercial vehicles account for around 15 per cent of road transport emissions. The Government will engage with the Commission as they take forward this work. Building on progress already made in protecting the environment, the Government will continue to work with business to investigate opportunities to encourage the use of ultra-low carbon light commercial vehicles.

Bus industry support

7.49 To improve the environmental performance of buses, the Government is reforming the Bus Service Operators Grant (BSOG) as announced in the 2008 Pre-Budget Report. **Budget 2009 confirms that operators will now only receive an increase in their rate of BSOG if they achieve fuel efficiency improvements**. Furthermore, with effect from this month, operators will receive per-kilometre payments for the low-carbon buses that they operate to incentivise their introduction.

A long-term framework for transport tax

7.50 Transport taxes support the public finances while also playing a significant role in incentivising fuel-efficient driving and reducing emissions. As part of the Government's plans for securing medium-term fiscal consolidation, the Government will use transport taxes to ensure that the burden of taxation falls in such a way as to support the transition to a low-carbon economy.

Fuel duty

7.51 As announced in Budget 2007 and confirmed in the 2008 Pre-Budget Report, main fuel duty rates rose by 1.84 pence per litre on 1 April this year. To support fiscal consolidation, **Budget 2009 announces that main fuel duty will increase by 2 pence per litre on 1 September 2009 and by 1 penny per litre in real terms on 1 April each year from 2010 to 2013**. This will save 2 $MtCO_2$ per year by 2013-14. Rebated oils duty will rise in proportion to main fuel duty increases on the same dates. Details of road fuel gas rates in these years are set out in Chapter A.

Vehicle excise duty

7.52 The 2008 Pre-Budget Report set out reforms to vehicle excise duty (VED) for cars registered from 1 March 2001 onwards, to incentivise the purchase and manufacture of lower-carbon cars. Budget 2009 confirms these reforms, which include:

- from May 2009, an increase in the number of VED bands from seven to thirteen. This will provide a greater incentive for drivers to choose a lower-carbon version of car within their preferred class;
- from April 2010, the Government will further separate out the thirteen different bands, in order to strengthen the environmental signal; and
- from April 2010, differential First-Year Rates of VED for new vehicles will be introduced. These will provide a stronger signal to consumers at the point of purchase.

7.53 To ensure that new VED rates and bands are clearly understood by motorists, the Department for Transport has worked with the Low Carbon Vehicle Partnership to update the fuel economy label for new vehicles, and is continuing to work with industry to develop a fuel economy label for the second-hand car market.

7.54 **Budget 2009 also announces changes to the VED rules on refunds, six-month licences and imported vehicles** during the first year of vehicle licensing, from April 2010, as a consequence of the introduction of First-Year Rates, as well as general changes to the treatment of imported vehicles. Details are set out in Chapter A.

Taxation of business travel

7.55 Company car tax (CCT) was reformed in 2002 and is now based on carbon emissions, encouraging the take-up of more fuel-efficient cars in company fleets. In recognition of advancing vehicle technologies, **Budget 2009 announces that, with effect from 6 April 2011:**

- **the basic threshold for the 15 per cent band of CCT will be reduced by 5g CO_2 per km**, so that this band applies to cars emitting between 121 and 129g CO_2 per km. The percentage of list price subject to tax will continue to increase by 1 percentage point with every 5g per km increase in CO_2 emissions, to a maximum of 35 per cent;
- **the cap on car list prices used to calculate the taxable benefit arising from company cars will be abolished**, so that drivers of expensive cars will be subject to a fair level of tax; and

- to ensure that CCT continues to reward the final carbon emissions of vehicles and is technology neutral as new low-emitting vehicles are developed, **discounts currently available for early uptake Euro 4-standard diesel cars, higher-emitting hybrid cars and alternative fuel company cars will be abolished**. Hybrid cars emitting 120g CO_2 per km or less will continue to fall within the 10 per cent band of CCT and electric cars will continue to be subject to the 9 per cent band, the lowest for any type of company car.

7.56 Since April 2008, there has been a 10 per cent band for cars emitting 120g CO_2 per km or less but by 2012, as new technology develops and the EU targets for carbon dioxide from cars come into force, the Government expects many more vehicles to fall within this category. To continue to provide an incentive to purchase the lowest emitting vehicles on the market, the Government intends to remove this category in 2012 and instead extend the system of CCT bands so that they increase by 1 percentage point with every 5g CO_2 per km increase in emissions, from 10 per cent. Details of specific rates and thresholds for 2012 will be announced in future Budgets. The Government is also considering the case for abolishing the diesel supplement in company car tax for diesel cars that comply with the future Euro 6 emissions and air quality standards.

Heavy goods vehicles and road freight

7.57 **Budget 2009 confirms that VED rates for heavy goods vehicles will be frozen in 2009-10**, to support the UK haulage industry. The Euro V vehicle emissions standard for new heavy goods vehicles will become mandatory on 1 October 2009. As a result, Reduced Pollution Certificates (RPCs) for vehicles achieving early compliance with this standard will no longer be available for new vehicles from that date. **The Government will introduce measures to incentivise the choice of Euro VI vehicles**, once the full details of the standard have been established by the European Commission. As outlined in Chapter 4 the Government is also introducing a temporary increase in capital allowances for new investment in 2009-10. Haulage operators can benefit from the first-year allowance of 40 per cent for new investment.

7.58 Government policies also aim to support the road haulage industry to increase safety and environmental performance. Recent examples of this commitment include:

- the Graduated Fixed Penalty and Deposit Scheme, which came into force on 1 April 2009. This allows authorities to enforce road traffic law against all offenders with on-the-spot fines, even if they reside outside of the UK;
- £24 million of enforcement funding, announced in April 2008, which has already delivered 120 additional enforcement staff, who will carry out 108,000 extra checks annually; and
- the 2008 increase in funding for the Freight Best Practice programme – which helps the industry to improve operational efficiency and reduce fuel consumption – and the extension of the scheme to Scotland in November 2008 and Northern Ireland in December 2008.

NATURAL RESOURCES

7.59 Each year, households and businesses generate around 100 million tonnes of waste. Two-thirds of this waste currently ends up in landfill, leading to increased emissions of methane, a powerful greenhouse gas, and loss of material that could be put to more productive uses through re-use and recycling.

7.60 The Government is committed to promoting sustainable waste management practices that will help to protect the natural environment and also deliver carbon savings. Over the period from 1990 to 2007, emissions in the waste sector have declined by nearly 45 per cent. Budget 2009 takes further steps to strengthen the environmental signals already in place.

Landfill tax

7.61 Landfill tax remains a cornerstone of waste management policy in the UK. By increasing the costs of sending waste to landfill, the tax encourages use of, and investment in, sustainable alternative treatment options, such as sorting machinery, recycling and anaerobic digestion. **Budget 2009 announces that the standard rate of landfill tax will continue to increase by £8 per tonne on 1 April each year from 2011 to 2013**, so that the tax continues to incentivise investment in more sustainable alternatives to reduce reliance on landfill, delivering emissions savings equivalent to 0.7 $MtCO_2$ per year. **Budget 2009 also announces that the lower rate applying to inactive wastes will be frozen at £2.50 per tonne for 2010-11.**

Waste infrastructure

7.62 Continued investment in waste infrastructure will ensure local authorities have the capacity to divert biodegradable waste from landfill. The Government is taking steps to ensure that waste investment is not hindered by the lack of access to capital or tightening in the credit markets:

- the Government plans to commit more than £2 billion of Private Finance Initiative credits, to allow investment in waste handling projects. The Treasury Infrastructure Finance Unit (TIFU) launched in March 2009 will support projects that are struggling to raise debt finance at acceptable terms to ensure this investment is not slowed by current conditions in the credit markets. A £120 million loan from the TIFU has already helped the Greater Manchester Waste Delivery Authority reach financial close on its £635 million programme of construction, supporting new green jobs and leading to diversion of over 700,000 tonnes of waste from landfill each year from 2013; and
- in addition, **Budget 2009 announces £10 million of new grants for businesses in 2009-10** to deliver anaerobic digestion and in-vessel composting infrastructure. This will provide capacity to remove 316,000 tonnes of waste each year from landfill, reducing local government and business waste disposal costs.

7.63 At the same time, the Government is taking steps to ensure that the legislation and administrative arrangements underpinning landfill tax remain robust. **The Government is legislating in Finance Bill 2009 to protect revenue following the Waste Recycling Group judgment last summer**. This legislation, from 1 September 2009, will ensure that certain specified uses of material on a landfill site will be subject to tax and will remove redundant provisions. **Today the Government is also launching a consultation on reforms to modernise landfill tax legislation in the longer term.**

7.64 In addition, the Government is assessing the case for introducing further restrictions on the landfilling of biodegradable wastes and recyclable materials. Targeted restrictions on landfill could be a cost-effective means of achieving carbon and energy savings from waste. Defra and devolved administrations have commissioned further research on the options for such restrictions in the UK, including the costs, benefits and practical implications. The Government aims to consult on these options by the end of this year.

Landfill communities fund

7.65 The landfill communities fund invests in projects that aim to improve communities around a landfill site. Earlier this year, contributions from landfill site operators to the fund reached £1 billion, benefiting over 24,000 projects over the past 12 years. To ensure the fund continues to benefit local communities affected by the disamenities of landfill, **the Government today announces that the maximum amount that operators can claim against their annual landfill tax liability will remain unchanged at six per cent**. This should result in a £2 million increase to bring the value of the fund to £72 million of credit claimable for 2009-10.

Carrier bags **7.66** Budget 2008 announced that the Government would introduce legislation to impose a charge on single-use carrier bags if there was not sufficient progress on a voluntary basis. The Government has taken powers to do this in the Climate Change Act. In December, the Government and the British Retail Consortium agreed a 50 per cent cut in the number of carrier bags given out by spring 2009. Recent figures show that retailers have exceeded a previous voluntary target. Since 2007 retailers have delivered a 40 per cent reduction in the environmental impact of carrier bags. In the longer term, the Government and retailers have a shared aspiration to achieve a 70 per cent reduction in the number of carrier bags handed out.

Aggregates levy **7.67** The aggregates levy was established to make the price of aggregates better reflect the environmental costs of quarrying, encouraging the use of recycled aggregates and alternative materials. The levy has been a significant factor in reducing sales of virgin aggregates in England by around 18 million tonnes between 2001 and 2005, with an estimated increase in the use of recycled aggregate of nearly six million tonnes. As announced in Budget 2008, the levy was increased from £1.95 per tonne to £2.00 per tonne from 1 April 2009 to maintain its environmental effectiveness. **The aggregates levy will be frozen at £2.00 per tonne in 2010-11** to ease pressure on the sector facing difficulties under the downturn of the construction market.

Adaptation

7.68 The Government is committed to preparing the UK for the challenges posed by the impacts of a changing climate and the increased incidence of extreme weather events such as heat waves, storms and floods. In the summer, the Government will release new UK Climate Projections showing how temperatures, rainfall patterns and sea levels could change in the coming decades. Understanding these changes is central to helping businesses and the public sector adapt to the changing climate.

Floods **7.69** Flooding is one of the most significant risks of climate change facing the UK. The Government has provided substantial uplifts in spending reviews to fund flood defences and adaptation measures. £20 million of investment will be brought forward to 2009-10, delivering earlier protection for 27,000 homes. The draft Floods and Water Bill, published on 21 April 2009, will deliver improved management of flood risk and streamline current legislation.

Water **7.70** Similarly, making more efficient use of water resources is key to adapting to future changes in the climate. It will become increasingly important to find ways to allocate, treat and use water more efficiently. The Government therefore welcomes the final report of the independent *Cave Review: Competition and Innovation in Water Markets*,[14] published today, which aims to ensure more competitive prices, more choice and better service for business customers, as well more efficient and sustainable use of water. More detail is provided in Chapter 4.

[14] *Cave Review: Competition and Innovation in Water Markets*, Defra, April 2009.

Table 7.1: The environmental impacts of measures in Budget 2009[1]

Total sector savings in 2020 and measures by sector[2]	Environmental impact[3]
Introduction of carbon budgets which set legally binding five-year limits on greenhouse gas emissions from the UK economy	Carbon budgets will require a 34 per cent reduction in greenhouse gas emissions with respect to 1990 levels by 2020.
Power Sector and Heavy Industry (EU ETS) – 99 $MtCO_2$[4]	
Mechanism to meet demonstration costs of carbon capture and storage (CCS) projects and funding for companies that undertake preparatory studies	CCS has the potential to reduce CO_2 emissions from power stations by up to 90 per cent. Demonstration of CCS on each 300 MW of post-combustion coal will deliver savings of 1 $MtCO_2$ per year by 2020. In addition, demonstration of CCS on each 450 MW pre-combustion coal will deliver savings of 1.2 $MtCO_2$ per year by 2020. These will contribute to achievement of the EU ETS cap.
European Investment Bank: up to £4 billion lending which could be enabled	This package will ensure that planned investment in energy and low-carbon projects continues to happen, contributing to achievement of the EU ETS cap.
Extension of climate change levy exemptions for combined heat and power (CHP)	These measures will have the potential to deliver around 7 GW of new CHP electrical generation capacity by 2020, saving 3.2 $MtCO_2$. Most of these savings will be covered by the EU ETS cap.
Increasing support for offshore wind under the Renewables Obligation	Designed to protect 3 GW of planned investment over the next 2 years, contributing to achievement of the UK's renewable energy target in the electricity sector.
£405 million in funding to provide support for low-carbon technology and manufacturing	This measure will help accelerate the development of low-carbon technologies and attract inward investment in low-carbon energy manufacturing to the UK, thereby ensuring the UK is a low-carbon technology and manufacturing hub and contributing to achievement of the EU ETS cap in the future.
Renewables – 21.5 $MtCO_2$[5]	
Providing £45 million for small scale renewable electricity and heat, primarily through the Low Carbon Buildings Programme	Expected lifetime savings are around 0.3 $MtCO_2$ in heat and 0.1 $MtCO_2$ in electricity. This will contribute to the savings expected from the achievement of the UK renewable energy target in the electricity and heat sectors.
Business and Public Sector Energy Saving - 1.6 $MtCO_2$[6]	
£100 million in funding for loans to SMEs for energy efficiency measures	Reduced energy use through energy efficiency measures. Estimated savings are 0.14 $MtCO_2$ in 2011-12. Some savings will be covered by the EU ETS cap.
£65 million in funding for loans to public sector for energy efficiency measures	Reduced energy use through energy efficiency measures. Expected savings are 0.1 $MtCO_2$ in 2010-11. Some savings will be covered by the ETS cap and the Carbon Reduction Commitment.
Maintaining Climate Change Levy (CCL) rates	CCL is estimated to reduce energy demand in the business and public sector by nearly 15 per cent per year in 2010.
Household Energy Saving – 7.9 $MtCO_2$[7]	
£100 million in funding to provide cavity wall insulation for social housing	Reduced energy use as a result of improved insulation. Expected savings will be 0.12 $MtCO_2$ per year in 2011-12. Some savings will be covered by the EU ETS cap.
£25 million in funding to provide support for community heating schemes	More energy efficient/low-carbon heating systems will save 0.02 $MtCO_2$ per year in 2010-11.
£100 million for new energy efficient housing	Reduction in carbon emissions compared to current building regulations.
Transport – 7.6 $MtCO_2$[8]	
Increases in fuel duty of 2 ppl in September 2009 and 1 ppl above inflation in each year from 2010 to 2013	Fuel duty increases are expected to result in emissions savings of 2 $MtCO_2$ per year by 2013-14.
Reforms to Vehicle Excise Duty (VED) including increase in bands in 2009 and introduction of First-Year Rates in 2010	VED reforms are estimated to result in a cumulative saving of around 1 $MtCO_2$ by 2020. This assessment only includes impacts in the new car market but the measure will also apply in the second-hand market. The reforms will help deliver the savings from the EU Regulation on new car CO_2 emissions.
Lower CO_2 emissions thresholds in Company Car Tax (CCT)	Strengthening the incentive in CCT for businesses to own the lowest-emitting cars will reward manufacturers of the cleanest vehicles, helping them to meet new EU car emissions standards.
£250 million funding for ultra-low carbon cars (£20 million to cover infrastructure and the remainder to fund consumer incentives of £2,000 – £5,000 per car)	Funding will help bring forward new, cleaner technology, including electric and plug-in hybrid cars. Electric vehicles powered with electricity generated from the current UK grid can emit up to 40 per cent less carbon than a conventional petrol vehicle.
Reforms to Bus Service Operators Grant (BSOG)	BSOG reforms cut the link between fuel used and subsidy paid and will pay 6p per km for low-carbon buses, which use less fuel. This will incentivise the uptake of low-carbon buses in the future.
Car scrappage scheme, primarily aimed at supporting industry	Scheme expected to have a neutral or modestly positive environmental impact.
Lending could be enabled for the automotive sector through EIB and other funding as part of the Automotive Assistance Programme (AAP)	The primary aim of the AAP is to ensure continued new green investment which is vital to ensure that the auto industry emerges from the current downturn with the skills and technology base needed to be competitive in the global automotive market.
Natural Resources	
Standard rate of landfill tax to increase by £8 per tonne on 1 April each year from 2011 until 2013	Landfill tax is expected to save up to 0.7 $MtCO_2e$ each year by 2013-14.
£10 million in funding to help divert waste from landfill in 2009-10	Funding will help deliver anaerobic digestion and in-vessel composting infrastructure that will remove 316,000 tonnes of biodegradable waste from landfill each year.

[1] The UK-wide figures for spending include consequential funding for the devolved administrations. It will be for the devolved administrations to determine their own priorities.

[2] Savings in 2020 are based on an updated version of the UEP32 emissions projections, adjusted for consistency with Budget economic growth assumptions and improved estimates of policy savings. Savings are relative to a pre-Energy White Paper baseline projection which reflects the impact of the Climate Change Programme policy package, and does not include a carbon price. For further detail of the UEP32 please see Updated Energy and Carbon Emissions Projections, DECC, November 2008.

[3] All CO_2 savings come from Government modelling.

[4] Based on the UK's share of the EU ETS cap, including domestic aviation. Savings from the EU ETS are supported by many other Government policies including the Supplier Obligation, Carbon Reduction Commitment, products policy and the Renewable Energy Strategy, which contribute to achievement of the EU ETS cap.

[5] Savings come from renewable heat and transport emissions reductions outside the EU ETS cap. Savings based on meeting an ambitious 15 per cent renewable energy target for the UK, comprising 32 per cent in the electricity sector, 14 per cent in the heat sector and 10 per cent in the transport sector from biofuels.

[6] Savings outside the EU ETS cap include the Carbon Reduction Commitment, business smart metering, Energy Performance of Buildings Directive, products policy and carbon neutral government.

[7] Savings outside the EU ETS cap include the Supplier Obligation, Zero-Carbon Homes, Energy Performance of Buildings Directive, products policy and better billing. A further supplier obligation will replace the Carbon Emissions Reduction Target (CERT) when it comes to an end in 2011, and the level of ambition is committed to be equal to that under CERT. Savings assume rate of new house building will be in line with the Government's projected house building estimates to 2016.

[8] Updated central estimate of savings from the EU Regulation on new car CO_2 emissions, including savings from a long-term new car CO_2 target of 95g CO_2 per km by 2020.

Financial Statement and Budget Report

A

Budget policy decisions

A.1 The Economic and Fiscal Strategy Report (EFSR) explains how the measures and other decisions announced in Budget 2009 build on those already introduced to advance the Government's long-term goals. This chapter of the Financial Statement and Budget Report (FSBR) brings together in summary form all the measures and decisions that affect the Budget arithmetic that have been announced since Budget 2008 and gives their estimated effect on government revenues and spending to 2011-12. The chapter also includes a summary of the changes to the main rates and allowances for the personal tax and benefit system, the business tax system, value added tax (VAT), environmental taxes, and other indirect taxes.

A.2 The appendices to this chapter provide additional information on Budget measures:

- Appendix A1 provides details of tax changes and other policy decisions which were announced in Budget 2008 or earlier, but which take effect from or after April 2009;
- Appendix A2 explains in detail how the effects of the Budget measures on Government revenues are calculated; and
- Appendix A3 provides estimates of the costs to the Government of some of the main tax allowances and reliefs.

A.3 In the text of this chapter, the number or letter in brackets after each measure refers to the line in Tables A1 and A2 where its costs or yield is shown. The symbol '-' indicates that the proposal has no Exchequer effect until at least 2012-13. The symbol '*' indicates that the effect is negligible, amounting to less than £3 million a year.

Budget policy decisions

A.4 Table A1 summarises the Budget 2009 measures that affect Government revenues and spending. These include tax measures, National Insurance contributions (NICs) measures, measures that affect Annually Managed Expenditure (AME), and additions to Departmental Expenditure Limits (DEL). Measures that are financed from existing DEL provisions are not included.

Table A1: Budget 2009 policy decisions

		(+ve is an Exchequer yield)			£ million
		2009-10	2010-11	2011-12	2009-10
		indexed	indexed	indexed	non-indexed
Supporting Business					
1	Business rates: deferral of payments	-700	+335	+320	600
2	First-year capital allowances: one year increase to 40%	-1,640	-190	+380	-1,640
3	Loss carry back: further temporary extension	-55	-195	-45	-55
4	Car scrappage	-300	0	0	-300
5	Strategic Investment Fund	-400	-350	0	-400
6	Lloyd's UK dividend exemption	-10	-10	-10	-10
7	Loan relationships: late paid interest to connected companies	-5	-15	-5	-5
8	North Sea fiscal regime: incentives for investment	0	-5	-10	0
9	Residence and domicile: consequential changes	-5	-5	-5	-5
10	VAT Package: refund scheme	*	-5	-5	*
11	Agricultural property and woodlands relief: extension	-5	-5	-5	-5
12	Building Colleges for the Future	-200	0	0	-200
Helping People Fairly					
13	DWP additional employment funding	-590	-1,080	0	-590
14	Employment: guarantee for young people [1]	-300	-900	-	-300
15	Increase in Statutory Redundancy Pay	-15	-25	-	-15
16	Age related payments to pensioner households	-600	0	0	-600
17	Increase ISA limits	-5	-20	-60	-5
18	Increase Pension Credit capital disregards	-60	-130	-	-60
19	Working Tax Credit run-ons: extension	-5	-10	-	-5
20	Child Trust Fund: extra payments for disabled children	0	-15	-	0
21	Increase Child Element of Child Tax Credit	0	-140	-	0
22	Housing Benefit/Council Tax Benefit overpayments: remove double subsidy provision	0	+10	-	0
23	Housing Benefit/Council Tax Benefit: earnings disregard	0	-5	-	0
24	Housing Benefit: managing gains from Local Housing Allowance	0	+145	-	0
25	Increase Social Fund	-125	-145	0	-125
26	Support for Mortgage Interest	-135	0	0	-135
27	SDLT holiday for residential homes: extension to 31 December 2009	-90	0	0	-90
28	Support for housing supply	-420	-180	0	-420
29	Local Authority guideline rent increases in 2009-10	-10	-10	0	-10
30	Repeal furnished holiday lettings rules	0	-15	+20	0
31	Reduced VAT rate for children's car seat bases	*	-5	-5	*
32	Financial assistance for charities	-20	0	0	-20
33	Armed forces accommodation	-50	+25	-	-50
Preparing for a green recovery					
34	Support for low carbon technologies	-160	-65	0	-160
35	Support for energy and resource efficiency	-220	-55	0	-220
36	Landfill tax reform	+30	+70	+70	+30
37	Landfill tax rates	-5	-25	+80	-5
38	Enhanced capital allowances	+10	+15	+15	+10
39	Company car tax rates	0	0	+85	0
40	Vehicle excise duty	0	-5	-5	0
41	VAT: Revalorisation of fuel scale charges	0	0	0	-10

Table A1: Budget 2009 policy decisions (continued)

		(+ve is an Exchequer yield)			£ million
		2009-10	2010-11	2011-12	2009-10
		indexed	indexed	indexed	non-indexed
Ensuring sustainability of the public finances					
42	Fuel duty: increases	+600	+1,250	+1,750	+1,575
43	Income Tax: full withdrawal of personal allowance from £100,000 [2]	0	+100	+180	0
44	Income Tax: increase additional rate to 50% from £150,000 and increase trust rate to 50% from 2010-11 [3]	0	+1,130	+1,810	0
45	Pensions Tax: restrict tax relief to 20% above £150,000 [4]	0	0	+200	0
46	Tobacco: 2% increase in specific duty	+60	+60	+60	+60
47	Gambling participation fees: removal of VAT	-50	-55	-60	-50
48	Gaming duty on casino card rooms	+5	+5	+5	+5
49	Bingo duty: increase rate to 22%	+35	+35	+35	+35
50	Amusement machine licence duty: increase rates	+20	+15	+15	+20
Protecting Revenue					
51	Foreign exchange: targeted anti-avoidance rule	+20	+20	+20	+20
52	Corporate intangible assets regime: countering abuse	+70	+130	+110	+70
53	Review of Alcohol Fraud Strategy	+20	+10	+10	+70
54	Manufactured overseas dividends: avoidance	0	0	+50	0
55	Double tax relief: avoidance	+100	+100	+200	+100
56	Living accommodation benefit charge: avoidance	+45	+45	+55	+45
57	Publishing names of serious tax defaulters	0	+20	+60	0
58	Accountability of senior accounting officers	0	+40	+50	0
59	Review of powers: debt management	+5	+5	-135	+5
TOTAL POLICY DECISIONS:		-5,160	-100	+5,230	-2,845
ADDITIONAL ITEMS					
60	Reserve: support for military operations	-1,900	0	0	-1,900
61	Reprofile addition to 2008-09 DEL reserve	-500	-500	0	-500
Memo: reset AME margin		-1,000	-2,000	-	

- Included within the current spending growth assumption for 2011-12 onwards.

** Negligible*

[1] *Gross costs are £1.4 billion over 2009-10 and 2010-11. The figures in the table are net of associated savings.*

[2] *This modifies the yield published at PBR 2008 for the staged restriction of the personal allowance. The total yield in 2012-13 from the removal of the personal allowance will be £1.5 billion.*

[3] *This measure is in addition to the yield published at PBR 2008 for the 45% additional rate commencing from 2011-12. The total yield in 2012-13 from the 50% additional rate will be £2.4 billion.*

[4] *Yield increases due to lagged effect of self-assessment. For 2012-13, the yield is £3.1 billion.*

A.5 Table A2 summarises the impact on government revenues and spending of other measures introduced since Budget 2008, including those measures announced at the 2008 Pre-Budget Report.

Table A2: Other measures announced since Budget 2008

			(+ve is an Exchequer yield)			£ million
			2009-10 indexed	2010-11 indexed	2011-12 indexed	2009-10 non-indexed
		Supporting the economy and ensuring sustainability of public finances				
a	+	VAT rate reduction	-7,800	0	0	-7,800
b	+	Alcohol duties: increase in rates	+575	+570	+610	+715
c	+	Tobacco duties: increase in rates	+350	+360	+365	+350
d	+	Capital spending brought forward	-2,545	+2,910	0	-2,545
e	+	Indexation of income tax rates, allowances and thresholds and PBR changes to personal allowance and basic rate limit	-3,740	-3,870	-3,370	-6,000
f	+	Freeze basic rate limit in 2011-12	0	0	+90	0
g	+	Restrict personal allowance by half from £100,000 and to zero from £140,000 from 2010-11	0	+790	+1,220	0
h	+	Additional higher income tax rate of 45% above £150,000 and raise trust rate to 45% from 2011-1	0	0	+710	0
i	+	Align the NICs primary threshold with personal allowance in 2011-12	0	0	-1,690	0
j	+	Increase main employee NICs rate by 0.5% from 2011-12	0	0	+1,960	0
k	+	Increase additional employee NICs rate by 0.5% from 2011-12	0	0	+400	0
l	+	Increase employer NICs rate by 0.5% from 2011-12	0	0	+2,460	0
m	+	Increase main self-employed rate of NICs by 0.5% from 2011-12	0	0	+160	0
n	+	Increase additional self-employed NICs rate by 0.5% from 2011-12	0	0	+60	0
o	+	September housing package: spending measures	-665	+865	0	-665
p	+	SDLT holiday for residential homes	-130	0	0	-130
q	+	Public spending: additional value for money savings	0	+5,000	+5,000	0
		Supporting business				
r	+	Foreign profits	-150	-150	-350	-150
s	+	Loss carry back: temporary extension	-175	-20	+15	-175
t	+	Small Companies Rate of corporation tax: defer increase to April 2010	-10	-310	-90	0
u	+	Rates on empty property: temporary exemption	-185	+10	0	-185
v	+	Backdated business rates bills	-85	+20	+20	-85
w	+	Income shifting: defer action	-25	-260	-200	-25
x	+	Insurance claims equalisation reserves	-35	-35	-35	-35
		Helping people fairly				
y	+	Child benefit: bring forward uprating from April 2009 to January 2009	0	0	0	-460
z	+	Standard uprating of Tax Credit rates and thresholds and bringing forward CTC increase from April 2010 to April 2009	-200	0	0	-1,800
aa	+	Uprating of Child Benefit and Guardian's allowance	0	0	0	-560
ab		Welfare reform White Paper	+15	-50		+15
ac		Employment summit: benefit savings	+30	+30		+30
ad	+	DWP JobCentre Plus funding	-400	-400	0	-400
ae	+	Uprating of pension credit above indexation	-260	-300	-310	-560
af	+	Freeze pension lifetime and annual allowance from 2011-12 for 5 years	+100	+200	+400	+100
ag	+	Local Housing Allowance: cap benefit at 5 bedroom rate	+5	+15	+15	+5
ah	+	Index housing benefit disregard in tax credits	-5	-5	-5	-5
ai	+	Support for mortgage interest	-15	0	0	-15
aj	+	Class 3 NICs: Pensions Bill amendment	+230	+10	+10	+260
ak	+	Uprating of NICs rates and thresholds	0	0	0	-1,360
al	+	Further support for debt advice	-10	-5	0	-10
		Protecting revenues				
am	+	Change of Accounting Practice Regulations	+10	+15	+15	+10
an		Interest Relief Exploitation	+50	0	0	+50
ao	+	Enhance tax avoidance disclosure regime	+10	+15	+10	+10
		Delivering on environmental goals				
ap	+	Air passenger duty [2]	-70	-190	-120	+100
aq	+	Vehicle excise duty [3]	-475	-495	-520	+140
ar	+	Additional spending on Warm Front	-50	0	0	-50
as	+	Capital allowances: business cars	+5	+5	0	-5
		TOTAL POLICY DECISIONS	**-15,650**	**+4,725**	**+6,830**	**-21,235**
		Memo: Resetting AME margin	-2,000	-2,000		-2,000
at	+	Memo: Support for PFI projects [4]	-1,000	-1,000	0	-1,000

+ Announced in the 2008 Pre-Budget Report

[1] Yield increases due to lagged effects of self-assesment. For 2012-13 onwards, yield is £1630 million / £1580 million.

[2] The APD costings are measured against a baseline that assumes the introduction of aviation duty as announced in Budget 2008. As the Budget 2009 air passenger duty rates result in a lower exchequer yield, the resulting costings are negative.

[3] The VED costings are measured against a baseline that assumes the rates announced in Budget 2008. As the Budget 2009 rates result in a lower exchequer yield, the resulting costings are negative.

[4] Costings for PFI over 2009-10 and 2010-11 are estimates of the anticipated net PSND impact from the expected drawdown of loan facilities over these years from transactions reaching financial close over 2009-10. These figures may be revised at subsequent fiscal events to reflect changes in expected market conditions for the financing of PFI projects.

PERSONAL TAX, SUPPORT AND BENEFITS

Income Tax

Bands, rates and personal allowances

A.6 As announced on 13 May 2008, the personal allowance was increased by £600 to £6,035 in 2008-09. As part of this, the basic rate limit was reduced by £1,200. The increase to the personal allowance has been made permanent in 2009-10, with a further increase of £130 above indexation. This extra support will be maintained for 2010-11. (e)

A.7 As announced at the 2008 Pre-Budget Report, the basic rate limit will be held at its 2010-11 value in 2011-12. (f)

A.8 In 2010-11, the income tax personal allowance will be restricted for those with incomes over £100,000 at a rate of £1 of allowance lost for every £2 of income over that level until completely withdrawn. This replaces the two-stage withdrawal at the 2008 Pre-Budget Report. (43)(g)

A.9 A new additional rate of income tax of 50 per cent (and 42.5 per cent for dividend income) will be introduced in 2010-11 for those with incomes above £150,000. The tax rate applicable to trusts will also rise to 50 per cent. This replaces the 45 per cent additional rate announced at the 2008 Pre-Budget Report. (44)(h)

Table A3: Bands of taxable income

2008-09	£ a year	2009-10	£ a year
Basic[1,2] rate (20 per cent)	0 - 34,800	Basic[1,2] rate (20 per cent)	0-37,400
Higher[2] rate (40 per cent)	over 34,800	Higher[2] rate (40 per cent)	over 37,400

[1] *From 2008-09 the general rule is that all income above personal allowances is taxable at the main rates of tax: the basic rate and the higher rate. There is a 10p starting rate for savings income only. The starting rate limit for savings is £2,320 for 2008-9 and will be £2,440 for 2009-10 . If an individual's non-savings taxable income exceeds the starting rate limit, then the 10p starting rate for savings will not be available for savings income.*

[2] *The rates applicable to dividends are 10 per cent for dividend income up to the basic rate limit and 32.5 per cent above that.*

Table A4: Income tax allowances

	£ per year		
	2008-09	2009-10	Increase
Personal allowance			
age under 65	6,035	6,475	440
age 65-74	9,030	9,490	460
age 75 and over	9,180	9,640	460
Married couple's allowance[1]			
aged less than 75 and born before 6 April 1935	6,535	-[3]	-[3]
age 75 and over	6,625	6,965	340
minumum amount[2]	2,540	2,670	130
Income limit for age-related allowances	21,800	22,900	1,100
Blind person's allowance	1,800	1,890	90

[1] *Tax relief for this allowance is restricted to 10 per cent.*

[2] *This is also the maximum relief for maintenance payments where at least one of the parties is born before 6 April 1935.*

[3] *All claimants to married couple's allowanace (MCA) or if their claim is based on the age of their spouse or civil partner will be at least 75 years of age at some point during the tax year and therefore entitled to the highest level of MCA.*

Effects on the Scottish Parliament's tax varying powers – statement regarding Section 76 of the Scotland Act 1998

A.10 A 1 penny change in the Scottish variable rate could be worth approximately plus or minus £350 million in 2009-10 and plus or minus £360 in 2010-11. These figures do not include an estimate of the behavioural impacts of invoking the Scottish variable rate. In HM Treasury's view, an amendment to the Scottish Parliament's tax varying powers is not required as a result of these changes.

National Insurance contributions

NICs rates

A.11 As announced at the 2008 Pre-Budget Report, the National Insurance contributions thresholds, limits and flat rates were increased in line with indexation for 2009-10, except for the Class 1 Upper Earnings Limit, Class 4 Upper Profits Limit and the weekly rate of Class 3 National Insurance contributions. (ak)

A.12 As announced at the 2008 Pre-Budget Report, from 6 April 2011, the employee, employer and self-employed rates, including the additional rates, of National Insurance contributions will increase by 0.5 per cent. (j)(k)(l)(m)(n)

Primary NICs threshold

A.13 As announced at the 2008 Pre-Budget Report, from 6 April 2011, the primary threshold for National Insurance contributions will be aligned with the weekly equivalent of the income tax personal allowance. (i)

Class 3 NICs

A.14 As announced at the 2008 Pre-Budget Report, the Class 3 National Insurance contributions rate is £12.05 a week from 6 April 2009. (aj)

Table A5: Class 1 National Insurance contribution rates 2009-10

Earnings[1] £ per week	Employee (primary) NIC rate[2] per cent	Employer (secondary) NIC rate[3] per cent
Below £95 (LEL)	0	0
£95 to £110 (PT/ST)[4]	0	0
£110 to £844 (UEL)	11	12.8
Above £844	1	12.8

[1] The limits are defined as LEL - lower earnings limit; PT - primary threshold; ST - secondary threshold; and UEL - upper earnings limit.

[2] The contracted-out rebate for primary contributions in 2009-10 is 1.6 per cent of earnings between the LEL and the upper accrual point (UAP) of £770 for contracted-out salary-related schemes (COSRS) and contracted-out money purchase schemes (COMPS).

[3] The contracted-out rebate for secondary contributions is 3.7 per cent of earnings between the LEL and UAP for COSRS and 1.4 per cent for COMPS. For COMPS, an additional age-related rebate is paid direct to the scheme following the end of the tax year. For appropriate personal pensions, the employee and employer pay NICs at the standard, not contracted-out rate. An age and earnings related rebate is paid direct to the personal pension provider following the end of the tax year.

[4] No NICs are actually payable but a notional Class 1 NIC will be deemed to have been paid in respect of earnings between LEL and PT to protect benefit entitlement.

Table A6: Self-employed National Insurance contribution rates 2009-10

Annual profits[1] £ per year	Self-employed NICs Class 2 £ per week	Class 4 per cent
Below £5,075 (SEE)[2]	£0.00	0
£5,075 to £5,715 (LPL)	£2.40	0
£5,715 to £43,875 (UPL)	£2.40	8
Above £43,875	£2.40	1

[1] *The limits are defined as SEE - small earnings exception; LPL - lower profits limit and UPL - upper profits limit.*

[2] *The self-employed may apply for exception from paying Class 2 contributions if their earnings are less than, or expected to be less than, the level of the small earnings exception.*

Tax Credits, benefits and personal taxes

Working Tax Credit

A.15 As announced at the 2008 Pre-Budget Report, from 6 April 2009, all elements of the Working Tax Credit (WTC), with the exception of the childcare element, were increased in line with indexation. The disregard for WTC in Housing Benefit was also increased in line with indexation. (z)(ah)

Working Tax Credit run-on

A.16 From 31 July 2009, the current 4-week run-on of entitlement to WTC when people become unemployed will be extended to cover households which would lose their entitlement to WTC because of a move to part-time working. (19)

A.17 The Government will amend the law to make clear that from 31 July 2009 the current 4-week run-on of entitlement to WTC also covers the childcare element, including for couples when only one partner stops working. (19)

Child Tax Credit

A.18 As announced at the 2008 Pre-Budget Report, from 6 April 2009, the child element of the Child Tax Credit was increased by £75 above earnings. All other elements of the Child Tax Credit, except the family and baby elements, were increased in line with indexation. From April 2010, the child element of the Child Tax Credit will increase by an additional £20 above indexation. (z)(21)

Table A7: Working and Child Tax Credit rates and thresholds

	£ per year		
	2008-09	2009-10	Increase
Working Tax Credit			
Basic Element	1,800	1,890	90
Couple and lone parent element	1,770	1,860	90
30 hour element	735	775	40
Disabled worker element	2,405	2,530	125
Severe disability element	1,020	1,075	55
50 plus element, 16–29 hours	1,235	1,300	65
50 plus element, 30+ hours	1,840	1,935	95
Childcare element			
maximum eliglible cost for one child	£175 per week	£175 per week	-
maximum eligible cost for two or more children	£300 per week	£300 per week	-
per cent of eligible costs covered	*80%*	*80%*	-
Child Tax Credit			
Family element	545	545	-
Family element, baby addition	545	545	-
Child element	2,085	2,235	150
Disabled child element	2,540	2,670	130
Severely disabled child element	1,020	1,075	55
Income thresholds and withdrawal rates			
First income threshold	6,420	6,420	-
First withdrawal rate (per cent)	*39%*	*39%*	-
Second income threshold	50,000	50,000	-
Second withdrawal rate (per cent)	*6.67%*	*6.67%*	-
First threshold for those entitled to Child Tax Credit only	15,575	16,040	465
Income disregard	25,000	25,000	-

Child benefit

A.19 As announced at the 2008 Pre-Budget Report, from 5 January 2009, Child Benefit increased to £20 per week for the first child and to £13.20 per week for subsequent children, bringing forward the commitment in Budget 2008 to make these increases from 6 April 2009. (y)

Guardian's Allowance

A.20 As announced at the 2008 Pre-Budget Report, from 6 April 2009, Guardian's Allowance was increased in line with indexation. (aa)

National Insurance credits for families

A.21 From April 2011, grandparents and other family members will be able to gain National Insurance credits toward the basic State Pension for caring for their grandchildren or members of their family aged 12 or younger, for 20 hours a week or more. (-)

Pension Credit

A.22 As announced at the 2008 Pre-Budget Report, from 6 April 2009, the standard minimum income guarantee in Pension Credit increased above indexation to £130 a week for a single pensioner and to £198.45 a week for a pensioner couple. (ae)

A.23 The Government will launch a campaign that includes contacting all Pension Credit recipients to help pensioners to claim back tax they have overpaid from the last six years.

Capital disregard for pension credit

A.24 From November 2009 the capital disregard for pension credit and pensioner related Housing and Council Tax Benefit will increase from £6,000 to £10,000. (18)

Pension tax relief

A.25 Higher rate pension tax relief will be tapered down to 20 per cent for those with incomes £150,000 and over from 2011-12. Anti-forestalling provisions will be introduced with effect from 22 April 2009. (45)

Pension lifetime and annual allowances

A.26 As announced at the 2008 Pre-Budget Report, the lifetime allowance will be maintained at the 2010-11 level of £1.8 million for a further five years, up to and including 2015-16. The annual allowance will also be held constant at £255,000 over the same period. (af)

Additional payment to pensioner households

A.27 As announced at the 2008 Pre-Budget Report, a £60 payment was paid to each pensioner, and other recipients of the Christmas Bonus, between January and March 2009. An additional £100 will be paid to households with someone aged over 80 and an additional £50 to households with someone aged over 60 alongside the Winter Fuel Payment in winter 2009-10. (16)

Local Housing Allowance

A.28 As announced at the 2008 Pre-Budget Report, from 6 April 2009 the maximum amount of Local Housing Allowance that a household can receive is at the 5 bedroom rate. From April 2010 there will no longer be scope for anyone to receive more in the Local Housing Allowance than they have to pay in rent. (24) (ag)

Support for Mortgage Interest

A.29 As announced on 2 September 2008, as a temporary measure, the waiting period for Support for Mortgage Interest (SMI) has been reduced for new working age claimants from 39 to 13 weeks from 5 January 2009. A two-year time limit to SMI support for Jobseeker's Allowance (JSA) claimants has also been introduced. (ai)

A.30 As announced at the 2008 Pre-Budget Report, from 5 January 2009, the eligibility for SMI has been increased by raising the Capital Limit to £200,000 for new claimants of working age. (ai)

A.31 The 2008 Pre-Budget Report announced that the Standard Interest Rate (SIR) used to calculate SMI would be maintained at the existing 6.08 per cent for six months from December 2008. The SIR will now be maintained at 6.08 per cent for an additional six months, until 31 December 2009. (26) (ai)

Treatment of Housing Benefit and Council Tax Benefit overpayments

A.32 From April 2010, the rules on how Housing Benefit and Council Tax Benefit overpayments that result from customers changing address within the same local authority area will be treated for Housing Benefit and Council Tax Benefit subsidy purposes, will be rationalised so there is no longer double payment. (22)

A.33 From 2010-11, the Government will change the earnings limit in Housing Benefit and Council Tax Benefit for those undertaking permitted work on Incapacity Benefit and Severe Disablement Allowance, so that these are the same as for those on income-related Employment Support Allowance. (23)

Guideline rents

A.34 As announced on 6 March 2009, the average Local Authority guideline rent increase for 2009-10 will be halved from 6.2 per cent to 3.1 per cent. (29)

ISA limits

A.35 With effect from 6 October 2009, Individual Savings Accounts (ISA) limits will rise to £10,200, up to £5,100 of which can be saved in cash, for those aged 50 and over. The ISA limits will rise to these levels for all individuals with effect from 6 April 2010. (17)

Saving Gateway

A.36 As announced at Budget 2008, the Saving Gateway will be introduced nationally in 2010. As announced at the 2008 Pre-Budget Report the Government will contribute 50 pence for each pound saved in the scheme. The Saving Gateway Accounts Bill, which is currently before Parliament, has been amended to extend eligibility to recipients of Carer's Allowance. (-)

The Child Trust Fund

A.37 The Government will contribute £100 per year to the Child Trust Fund account of disabled children, with severely disabled children receiving £200. Children who receive Disability Living Allowance at any point in a tax year will receive these contributions. Payments will commence from April 2010 onwards. (20)

Financial Services Compensation Scheme

A.38 Legislation will be introduced, with effect from 6 October 2008, to ensure that people compensated under the Financial Services Compensation Scheme receive the tax treatment they would have received under normal circumstances. (*)

Residence and domicile

A.39 Following consultation, the Government will legislate a number of minor changes to the tax rules for non-domiciled UK residents to reduce their administrative complexity. The changes will include some anti-avoidance provisions. This will not change the underlying reforms made in Finance Act 2008. (9)

Personal dividend taxation

A.40 As announced in Budget 2008, from 22 April 2009 the non-payable dividend tax credit will be extended to investors with a 10 per cent or greater shareholding in a non-UK resident company, except where the source country does not levy a tax on corporate profits similar to corporation tax. It will now also be extended to dividends from offshore funds, except those with more than 60 per cent of their investments in interest bearing assets. Distributions from these funds will instead be taxed as interest. (-)

Furnished holiday lettings

A.41 From 6 April 2010, the furnished holiday lettings (FHL) rules will be repealed. Until the repeal takes effect, the FHL rules will be regarded as extending to those with qualifying furnished holiday lettings elsewhere in the European Economic Area. (30)

Additional funding for Jobcentre Plus and Flexible New Deal Programmes

A.42 An additional £1.7 billion is provided over 2009-10 and 2010-11 to ensure Jobcentre Plus continues to deliver the Jobseekers Allowance (JSA) regime to a larger volume of claimants and to implement the Flexible New Deal, as described in the EFSR. This is in addition to the £1.3 billion[1] provided to DWP at the 2008 Pre-Budget Report. (13)(ad)

Supporting youth employment

A.43 There will be a new guarantee of 6 months of work or training for everyone under the age of 25 who has been on JSA for 12 months, with an additional £1.2 billion of Government funding to support new places, with jobs coming online from October 2009. (14)

Six month offer

A.44 As announced on 12 January 2009, from 6 April 2009, £150 million was made available for 2009-10 and 2010-11 for measures to support those unemployed for between 6 and 12 months. (ac)

Statutory redundancy pay

A.45 Subject to an affirmative order being approved by Parliament, statutory redundancy pay will increase to £380 per week. (15)

Welfare Reform White Paper

A.46 The December 2008 Welfare Reform White Paper, *"Raising expectations and increasing support: reforming welfare for the future"*, announced reforms that will require more benefit claimants to take up the employment support available to them. (ab)

Support for debt advice

A.47 As announced at the 2008 Pre-Budget Report, £15.85 million was committed to expand access to free and impartial debt advice. (al)

Increasing the social fund

A.48 There will be additional investment in the Social Fund of £125 million in 2009-10 and £145 million in 2010-11. (25)

[1] £800 million was funded via 2008 Pre-Budget Report additions, with the remainder from Department of Work and Pension (DWP) End Year Flexibility (EYF).

Housing supply **A.49** An additional £600 million[2] is provided in 2009-10 and 2010-11 for housing supply, as described in more detail in the EFSR. This is in addition to resources announced in September 2008 and at the 2008 Pre-Budget Report (see Box 5.4 in Chapter 5) to support the housing market. (28)(o)

TAXES ON CHARGEABLE GAINS, INHERITANCE TAX, ASSETS AND PROPERTY

Capital gains tax **A.50** From 6 April 2009 the capital gains tax annual exempt amount increased in line with statutory indexation to £10,100. (-)

Stamp duty land tax **A.51** Following an announcement on 2 September 2008 that stamp duty land tax (SDLT) would not apply on residential property of £175,000 or less for a period of one year, the SDLT holiday will now be extended to 31 December 2009. (27)(p)

A.52 With effect from Royal Assent to Finance Bill 2009, there will be an extension to the favourable SDLT treatment for land acquisitions by, and purchases made through shared ownership schemes to profit-making Registered Providers of social housing, where the schemes are assisted by public subsidy. (-)

A.53 With effect from 22 April 2009 changes will be made to legislation enabling the SDLT relief for leasehold enfranchisement to operate as intended to ensure that a purchase of a freehold by multiple leaseholders is not charged at a higher rate of SDLT than each leaseholder would pay if individually purchasing part of the freehold. (*)

Real Estate Investment Trusts **A.54** With effect from 22 April 2009, minor amendments to UK-REITs legislation will ensure that it works as intended. (-)

Inheritance tax reliefs **A.55** The inheritance tax agricultural property and woodlands reliefs will be extended to the European Economic Area from 22 April 2009. Property qualifying for these extended inheritance tax reliefs will also qualify for capital gains tax hold over relief. (11)

BUSINESS, FINANCIAL SERVICES AND CHARITIES

Corporation tax rate **A.56** The main rate of corporation tax will remain unchanged for financial year 2010-11 at 28 per cent on profits of companies other than ring fence profits, and 30 per cent on ring fence profits. (-)

First-year allowance **A.57** A first-year capital allowance of 40 per cent for one year, with effect April 2009, will be introduced. Firms investing over £50,000 in qualifying plant and machinery in 2009-10 will benefit from a higher rate of tax relief on investment. (2)

Small companies' rate **A.58** As announced at the 2008 Pre-Budget Report, the planned increase in the small companies' rate of corporation tax is being deferred for one year; and the rate will remain at 21 per cent for the financial year 2009-10. (t)

Business rates **A.59** As announced on 31 March 2009, businesses will be able to spread the payment of the 2009-10 inflation up-rating of business rates over three years. This will include measures to allow those affected by the end of the 2005 transitional relief scheme also to spread the increase in their bills over 3 years. (1)

A.60 As announced at the 2008 Pre-Budget Report, certain businesses facing significant backdated business rates bills issued before 31 March 2010 can pay over 8 years interest-free. (v)

[2] This includes all Barnett consequentials.

Empty property rate relief

A.61 As announced at the 2008 Pre-Budget Report, from 1 April 2009, the threshold at which business rates is charged on empty property in England has been temporarily increased from £2,200 to £15,000 until 31 March 2010. (u)

Loss carry-back

A.62 Trading loss carry-back for businesses will be extended from one to three years for losses up to £50,000, for two years from 24 November 2008 for companies and tax years 2008-09 and 2009-10 for unincorporated businesses, extending the 2008 Pre-Budget Report announcement. (3)(s)

Foreign profits

A.63 The 2008 Pre-Budget Report announced reforms to the taxation of foreign profits. From 1 July 2009 an exemption from tax for foreign dividends received by all companies will be introduced along with a limited restriction to the interest deduction rules for accounting periods beginning on or after 1 January 2010. Consequential changes to the controlled foreign companies (CFC) rules and replacement of the Treasury Consent rules with a post-transaction reporting requirement will be introduced from 1 July 2009. (r)

Foreign currency share proceeds hedging

A.64 As announced on 10 March 2009, any gains or losses on derivative contracts entered into on or after 10 March 2009 and, subject to a transitional rule, derivative contracts entered into on or after 1 January 2009 and still operating on 10 March 2009 for the purpose of hedging the exchange exposure on share proceeds from a rights issue, are to be disregarded for tax purposes. (-)

Foreign denominated losses

A.65 As announced on 18 December 2008 losses incurred in a foreign currency will be allowed to be carried forward or back in that currency, effective for accounting periods beginning on or after 29 December 2007, but with an election to opt for the change to apply to future losses only in accounting periods beginning on or after Royal Assent to Finance Bill 2009. (*)

Offshore funds

A.66 Legislation will be introduced in Finance Bill 2009 to provide a new definition of an offshore fund effective from 1 December 2009. (*)

A.67 Legislation will also be introduced, effective from 1 December 2009, to align the capital gains tax (CGT) treatment of investors in contract based off-shore funds with that of overseas unit trusts. (-)

Double taxation rules

A.68 Corporation tax double taxation relief rules have been amended retrospectively, from 1 April 2008, to ensure that the rules apply as intended. (-)

Income shifting

A.69 At the 2008 Pre-Budget Report action on income shifting was deferred and, consequently, no legislation will be brought forward in the Finance Bill. The Government will keep this issue under review. (w)

Mutual societies

A.70 A measure will be introduced to enable the removal of tax barriers to transfers of business between mutual societies with effect to transfers on or after 22 April 2009. (-)

Asset Protection Scheme

A.71 A measure will be introduced to ensure arrangements under the Asset Protection Scheme, and any other arrangements designated as similar by HM Treasury, are effective in tax law and do not in themselves give rise to a new tax relief entitlement. The legislation will apply to arrangements entered into on or after 22 April 2009. (-)

Islamic finance

A.72 As announced at the 2008 Pre-Budget Report, with effect from Royal Assent to Finance Bill 2009, relief from stamp duty land tax for land transactions forming part of arrangements for issuing alternative finance investment bonds will be introduced, with the aim of achieving consistency with their conventional equivalents. (*)

A.73 With effect from Royal Assent to Finance Bill 2009, relief from tax on capital gains for land transactions forming part of arrangements for issuing alternative finance investment bonds will be introduced, with the aim of achieving consistency with their conventional equivalents. (-)

Lloyd's claims equalisation reserves

A.74 As announced at the 2008 Pre-Budget Report, investors in the Lloyd's insurance market will be able to benefit from relief for claims equalisation, in a broadly similar way to general insurance companies. Commencement will apply retrospectively for results treated as declared in 2008 (originating in Lloyd's year of account 2005). (x)

Lloyd's UK Dividend exemption

A.75 Dividends and other distributions received from UK companies on or after 1 July 2009 by corporate members of the Lloyd's insurance market will be exempt from tax, to align the tax treatment with that of general insurance companies. (6)

Life insurance

A.76 Following consultation, measures dealing with additions to the long-term insurance fund and value shifting attributable to the transfer of business will be introduced with effect from 22 April 2009. Clarification of the rules applying to financing-arrangement-funded transfers to shareholders will apply retrospectively from 1 January 2008; and will also apply to foreign business assets for accounting periods beginning on or after 1 January 2009 and ending on or after 22 April 2009. (-)

Tax Elected Funds

A.77 From 1 September 2009, a new tax regime for UK Authorised Investment Funds will be introduced to enable them to market themselves more competitively. (*)

Property Authorised Investment Funds

A.78 As announced at the 2008 Pre-Budget Report, amendments were made to legislation for Property Authorised Investment Funds, effective from 1 January 2009. (-)

Qualified Investor Scheme

A.79 As announced at the 2008 Pre-Budget Report, the rules for the Qualified Investor Scheme were replaced from 1 January 2009. (*)

Investment Trust Companies

A.80 From 1 September 2009, Investment Trust Companies will be able to invest tax-efficiently into interest bearing assets. (*)

Tax charges on stock lending

A.81 As announced at the 2008 Pre-Budget Report, measures will be introduced effective from 1 September 2008, to limit capital gains and stamp tax charges where stock lending arrangements terminate due to insolvency. (-)

Group tax rules

A.82 On 18 December 2008, a change to the tax treatment of certain preference shares was announced. The change is effective for accounting periods beginning on or after 1 January 2008. Companies can elect for the changes to apply only to new share issues. (-)

Corporate gains rules

A.83 From 22 April 2009, the corporate gains rules for notional transfers within a group of companies will be simplified. (-)

Sale of lessors

A.84 Sale of lessors legislation will be changed to prevent it having a negative effect on otherwise innocent transactions where transaction takes place on or after 22 April 2009. (-)

Enterprise Investment Schemes

A.85 Four changes are being introduced to simplify and improve the rules for the Enterprise Investment Scheme. A change governing carry back of relief will apply from 6 April 2009. Other changes will apply from 22 April 2009. (*)

Loan relationships

A.86 With effect for company accounting periods beginning on or after 1 April 2009, the corporation tax rules on the late payment of interest between connected companies are being changed. In future, interest will be deductible under normal corporation tax rules as it accrues, unless the creditor company is located in a tax haven. If this relaxation of the rule is abused, anti avoidance legislation will be introduced. (7)

Change of Accounting Practice Regulations

A.87 As announced at the 2008 Pre Budget Report, with effect from 1 January 2009 an anomaly in the Change of Accounting Practice Regulations has been corrected, to prevent companies suffering double taxation or obtaining double relief as a consequence of a change of accounting practice relating to financial instruments. (am)

North Sea oil taxation

A.88 With effect from 22 April 2009, a new 'Field Allowance', which will act to reduce the initial tax paid by qualifying new developments, will be introduced. (8)

A.89 With effect from 22 April 2009, chargeable gains will be removed from North Sea asset swaps and disposals where gains are reinvested in the North Sea. (8)

A.90 With effect from 30 June 2009, reforms will be made to the petroleum revenue tax (PRT) regime to ensure companies are still able to receive decommissioning relief even where licences have expired. (8)

Strategic Investment Fund

A.91 An additional £750 million is provided over 2009-10 and 2010-11 for a Strategic Investment Fund (SIF). This includes £50 million additional funding for the Technology Strategy Board (TSB) and, £10 million additional funding for UK Trade and Investment, both over 2009-10 and 2010-11. £250 million of the SIF will be earmarked for low carbon projects. (5)

Support for PFI

A.92 As announced on 3 March 2009, the Government will lend to those Private Finance Initiative projects that cannot raise sufficient debt finance. Budget 2009 sets aside £1 billion in 2009-10 and £1 billion in 2010-11 for this measure.[3] (at)

Car scrappage

A.93 An additional £300 million is provided in 2009-10 for a car scrappage scheme. This is in addition to the £400 million announced on 27 January 2009 to support the automotive industry. (4)

Capital funding for FE colleges

A.94 An additional £300 million of capital funding has been allocated to fund investment in further education colleges.[4] (12)

Financial assistance for charities

A.95 A new one-off £20 million Hardship Fund will be introduced in 2009-10 to provide grant support to front-line third sector organisations in England adversely affected by the recession, with demonstrable resource constraints due to cash flow difficulties or increased demand. (32)

VALUE ADDED TAX

Temporary reduction of VAT rate

A.96 As announced at the 2008 Pre-Budget Report, on 1 December 2008 the standard rate of VAT was reduced temporarily to 15 per cent. The rate will return to 17.5 per cent on 1 January 2010. Legislation will be introduced in the Finance Bill to ensure that VAT is paid at the correct rate on supplies made on or after that date. The scope of the legislation was set out in announcements made alongside the 2008 Pre-Budget Report and on 31 March 2009. (a)

A.97 The Finance Bill will clarify the scope of the economic regulator powers that were used to reduce the standard rate of VAT temporarily.

VAT registration threshold

A.98 From 1 May 2009, the VAT registration threshold will be increased from £67,000 to £68,000 and the deregistration threshold from £65,000 to £66,000. (-)

[3] Costings for PFI over 2009-10 and 2010-11 are estimates of the anticipated net PSND impact from the expected drawdown of loan facilities over these years from transactions reaching financial close over 2009-10. These figures may be revised at subsequent fiscal events to reflect changes in expected market conditions for the financing of PFI projects

[4] The £300m figure includes £200m from the scorecard and £100m funded through EYF.

VAT retail schemes **A.99** As announced at the 2008 Pre-Budget Report, from 1 April 2009 the turnover threshold, above which large retailers are required to agree a bespoke VAT accounting scheme, was increased to £130 million. (*)

VAT flat rate scheme **A.100** As announced at the 2008 Pre-Budget Report, from 1 April 2009 the eligibility tests for the VAT flat rate scheme were simplified, making it easier for businesses to join and leave the scheme. In addition, the sectoral rates used in the scheme were amended on 1 December 2008, to take account of the reduction in the standard rate of VAT. (*)

VAT partial exemption **A.101** From 1 April 2009, the standard method used by partly exempt businesses to calculate their VAT recovery has been simplified. (*)

VAT option to tax simplification **A.102** As announced at the 2008 Pre-Budget Report, from 1 May 2009, a new Automatic Permission Condition will be introduced to make it easier for taxpayers to opt to tax otherwise exempt supplies of land and property. Furthermore, from 1 May 2010, two related extra-statutory concessions will be withdrawn. (*)

Cross border VAT **A.103** From 1 January 2010, the VAT treatment of cross border trade will be changed by introducing:

- new place and time of supply rules for certain cross-border supplies of services;
- new reporting requirements for cross-border supplies of both goods and services; and
- new rules to make it easier for businesses to reclaim VAT paid in other EU countries. (10)

VAT on agricultural land **A.104** Following Royal Assent to Finance Bill 2009, changes in the VAT rate or other changes to the VAT status of agricultural land will not be considered rent changes for the purposes of rent review provisions in the Agricultural Holdings Act 1986. (-)

VAT on car seat bases **A.105** From 1 July 2009, the current reduced rate of VAT for children's car seats will be extended to cover children's car seat bases. (31)

ENVIRONMENT AND TRANSPORT

Air passenger duty **A.106** As announced at the 2008 Pre-Budget Report, air passenger duty will be reformed, rather than proceeding with a per plane tax. (ap)

Fuel duty **A.107** On 1 April 2009, the main fuel duty rate increased by 1.84 pence per litre. Also on 1 April 2009, duty on rebated oils rose in proportion to the main fuel duty rate; the duty differential for compressed natural gas was maintained; and the duty differential for liquefied petroleum gas was reduced by 1 penny per litre. On 1 May 2009 the duty rate for light oil other than unleaded petrol will rise by 1.84 pence per litre and the duty rate for aviation gasoline (avgas) will rise by 2.31 pence per litre. (42)

A.108 On 1 September 2009, main fuel duty rates will increase by 2 pence per litre. On the same date, duty on rebated oils and avgas will rise in proportion to the main fuel duty increase, while duty on leaded petrol and on biofuels will increase by 2 pence per litre. Duty on road fuel gases will also increase on 1 September 2009, such that current duty differentials for both compressed natural gas and liquefied petroleum gas are maintained for the rest of 2009-10. (42)

A.109 On 1 April 2010, and on the same date in each year to 2013, main road fuel duty will increase by 1 penny per litre above indexation. On the same dates, rebated oils duty rates will rise in proportion to the main fuel duty increases, and road fuel gas duty rates will rise such that the duty differential for compressed natural gas is maintained at its current level, but the differential for liquefied petroleum gas is reduced by 1 penny per litre each year. (42)

Fuel scale charges

A.110 From 1 May 2009, the VAT fuel scale charges will be revised to reflect updated fuel prices. (41)

Vehicle excise duty for post -2001 cars

A.111 As announced at the 2008 Pre-Budget Report, with effect from 1 May, vehicle excise duty (VED) for cars registered from 1 March 2001 onwards will be reformed, as set out in table 8a. Cars emitting over 225g CO_2 per km, that were registered between 1 March 2001 and 23 March 2006, will be placed into the new band K and stay there in 2010. With effect from 1 April 2010, differential First-Year Rates of VED will apply to new cars. (aq)

A.112 From 1 April 2010, other measures will come into effect including: rebates on the unexpired portion of a first vehicle licence for a new car in bands H to M will only be permitted up to the standard rate for cars in those bands, unless the car has been stolen, written off, or become eligible for a nil licence. In addition, it will also not be permitted to take out a six month licence as the first vehicle licence for a new car in bands H to M. (40)

A.113 From 1 April 2010, cars imported into the UK will only pay the First-Year Rate if they are under six months old or have travelled less than 6,000 km. Wider rules on the licensing of vehicles imported into the UK from 23 March 2006 onwards will also be changed from April 2010. (40)

VED for pre-2001 cars and vans

A.114 With effect from 1 May 2009, as set out in table 8b, the upper and lower rates of VED for cars and light goods vehicles first registered before 1 March 2001 will increase by £5. From 1 April 2010, the lower rate will be frozen, and the upper rate will increase by £15. (40)

VED for post-2001 vans

A.115 With effect from 1 May 2009, the standard and discounted VED rates for light goods vehicles registered after 2001 will increase by £5. From 1 April 2010, the standard rate will increase by £15 and the discounted rate will be frozen. (40)

VED for motorbikes and HGVs

A.116 As announced at 2008 Pre-Budget, Report the VED rates for motorbikes, heavy goods vehicles and all related rates will be frozen in 2009. (aq)

Table A8a: VED bands and rates for cars registered on or after 1 March 2001 (graduated VED)

		2009-10	2010-11	
VED band	CO_2 emissions (g/km)	standard rate (£)[1]	standard rate (£)[1]	first year rate (£)[1]
A	Up to 100	0	0	0
B	101 - 110	35	20	0
C	111 - 120	35	30	0
D	121 - 130	120	90	0
E	131 - 140	120	110	110
F	141 - 150	125	125	125
G	151 - 165	150	155	155
H	166 - 175	175	180	250
I	176 - 185	175	200	300
J	186 - 200	215	235	425
K[2]	201-225	215	245	550
L	226-255	405	425	750
M	Over 255	405	435	950

[1] *Alternative fuel discount: 2009-10, A-I £20, J-M £15; 2010-11 onwards £10 all cars*

[2] *Includes cars emitting over 225g/km registered between 1 March 2001 and 23 March 2006*

Table A8b: VED bands and rates for private and light goods vehicles registered before 1 March 2001 (pre-graduated VED)

Engine size	2009-10 (£)	2010-11 (£)
1549cc and below	125	125
Above 1549cc	190	205

Vehicle registration certificate destruction

A.117 The granting of regulation-making powers in relation to destruction of the vehicle registration certificate will be legislated in this year's Finance Bill. (-)

Tax relief for business expenditure on cars

A.118 As announced on 1 April 2009, new rules for tax relief for business expenditure on cars will apply from 1 April 2009 for corporation tax, or 6 April 2009 for Income Tax. The rate of tax relief for such expenditure will depend on a car's CO_2 emissions. (as)

Company car tax

A.119 With effect from 6 April 2011, the threshold for the 15 per cent band of company car tax (CCT) will be reduced by 5g CO_2 per km, so that it applies to cars emitting between 121 and 129g CO_2 per km. The proportion of a company car's list price that is subject to tax will increase by 1 percentage point with each 5g per km that its CO_2 emissions exceed this threshold, to a maximum of 35 per cent for company cars emitting 225g CO_2 per km and above. (*)

A.120 From 6 April 2011, the £80,000 cap on the list price of company cars will be abolished, and the full list price of all company cars will be used to calculate the level of benefit that is taxable under CCT. (39)

A.121 Reductions in the proportion of company car list price that is subject to taxation currently available to Euro 4 standard diesel cars registered before 1 January 2006, petrol-electric hybrid cars, road fuel gas-powered cars and E85 biofuel-capable cars will be removed from 6 April 2011. (*)

A.122 As announced at the 2008 Pre-Budget Report, from 6 April 2009, disabled company car drivers will be able to use the list price and CO_2 emissions of an equivalent manual car when calculating their company car benefit charge. (-)

Landfill tax

A.123 The standard rate of landfill tax will continue to increase by £8 per tonne each year from 1 April 2010 to 1 April 2013. The lower rate of landfill tax will remain frozen at £2.50 per tonne for 2010-11. (37)

Reform of landfill tax

A.124 Uses of waste on a landfill site for specified purposes will be treated as being subject to taxable disposal from 1 September 2009. (36)

Landfill communities fund

A.125 The percentage cap for landfill communities fund will remain unchanged at 6 per cent for 2009-10. The fund will be worth £72 million during that year. (*)

Climate change levy

A.126 The rates of the climate change levy will be frozen for 2010-11. (-)

A.127 The climate change levy exemption for indirect sales of electricity from combined heat and power (CHP) will be extended to 2023, subject to state aid approval. Other existing levy exemptions for CHP will also continue. (-)

A.128 A restricted entitlement to claim the climate change levy reduced rate, applying to supplies of electricity and liquefied petroleum gas only, will be introduced. The new provision will have effect on and after Royal Assent to Finance Bill 2009. (-)

A.129 A mechanism will be introduced to enable recovery of climate change levy from facilities that fail to meet their target under the climate change agreement scheme. It will apply to certification periods starting on or after 1 April 2009. (-)

A.130 Supplies of solid fuel valued at £15 per tonne or less and made on or after 1 January 2010 will become subject to climate change levy. (*)

Aggregates levy

A.131 The rate of aggregates levy will be frozen at £2 per tonne for 2010-11. (-)

Enhanced capital allowances

A.132 The list of designated energy saving and water-efficient technologies qualifying for 100 per cent first-year capital allowances will be changed during 2009. (38)

Low-carbon sector support

A.133 An additional £500 million[5] is provided over 2009-10 and 2010-11, as part of an overall £1.4 billion package, to boost Britain's low-carbon sectors and lay the foundations for green growth, as described in more detail in the EFSR. This is in addition to £100m provided for Warm Front at the 2008 Pre-Budget Report. (34)(35)(ar)

OTHER INDIRECT TAXES AND DUTIES

Tobacco duties

A.134 As announced at the 2008 Pre-Budget Report, on 24 November 2008, the ad valorem duty rate on cigarettes was increased from 22 per cent to 24 per cent and specific duty rates on all other tobacco products were increased by 4 per cent. (c)

A.135 On 22 April 2009, duties on tobacco will increase by 2 per cent. (46)

[5] This includes all Barnett consequentials.

Table A9: Changes to tobacco duties

	Effect of tax[1] on typical item (increase in pence)	Unit
Cigarettes	7	packet of 20
Cigars	3	packet of 5
Hand-rolling tobacco	7	25g
Pipe tobacco	4	25g

[1] *Tax refers to duty plus VAT.*

Alcohol duty

A.136 As announced at the 2008 Pre-Budget Report, on 1 December 2008, beer, cider and wine duty rates increased by 8 per cent and spirits duty rates increased by 4 per cent. (b)

A.137 On 23 April 2009, alcohol duty rates will increase by 2 per cent.

Table A10: Changes to alcohol duties

	Effect of tax[1] on typical item (increase in pence)	Unit
Beer	1	Pint of beer @ 4.2% abv
Wine	1	175ml glass typical strength
Wine	4	75cl bottle typical strength
Sparkling Wine	5	75cl bottle typical strength
Spirits	13	70cl bottle @ 37.5% abv
Spirits-based RTDs	1	275ml bottle @ 5.4% abv
Cider	1	Litre bottle typical strength
Sparkling Cider	4	75cl bottle typical strength

[1] *Tax refers to duty plus VAT.*

Betting and gaming duties

A.138 On 27 April 2009 participation fees for bingo and player-to-player gaming in casinos will no longer be subject to VAT. Bingo duty will rise to 22 per cent for accounting periods starting on or after 27 April 2009. (47)(49)

A.139 On 27 April 2009 player-to-player gaming in casinos will be brought into the Gaming duty regime. (48)

A.140 On 1 June 2009 the prize limit for bingo duty exemption that may be offered on small scale amusements provided commercially will increase from £50 to £70. (49)

A.141 Gaming duty bands will increase in line with inflation for accounting periods starting on or after 1 April 2009. (-)

A.142 Amusement machine licence duty categories will be recalibrated on 1 June 2009 to reflect regulatory changes. Rates will increase on all categories from 4pm on 22 April 2009. (50)

PROTECTING TAX REVENUES

Tax avoidance disclosure regime

A.143 As announced at the 2008 Pre-Budget Report, regulations have been introduced to simplify and improve the way users of disclosed tax avoidance schemes report a Scheme Reference Number (SRN) to HM Revenue & Customs. These come into effect from 1 April 2009. (ao)

A.144 As announced on 13 November 2008, with effect from announcement, legislation will be introduced to prevent loss of tax through the leasing of plant machinery. (-)

A.145 As announced on 13 November 2008, with effect from announcement, legislation will be introduced to prevent a loss of tax on the sale of a company that is an intermediate lessor of plant or machinery. (-)

A.146 As announced on 13 November 2008, with effect from announcement, legislation will be introduced to prevent avoidance involving businesses leasing films to others under a long funding lease. (-)

UK REITs

A.147 As announced at the 2008 Pre-Budget Report, with effect on and after 22 April 2009, the original objectives of the UK-REITs regime will be restored so that companies are prevented from joining the regime unless at least 75 per cent of their gross income comes from the rental of property to tenants. (-)

Payments of manufactured interest

A.148 As announced on 27 January 2009, legislation will be introduced to ensure the tax treatment of payments of manufactured interest follows the treatment of the payments in company accounts prepared in accordance with generally accepted accounting practice. (-)

Financial products

A.149 With effect from 22 April 2009, legislation will be introduced to prevent avoidance schemes involving use of convertible securities within a group to create accounting asymmetries and creation of artificial losses on loans and derivatives. (-)

Principles based legislation

A.150 Principles based legislation will be introduced with effect from 22 April 2009 to counter financial products avoidance, involving disguised interest and sales of income streams, following extensive consultation. (-)

Interest relief exploitation

A.151 As announced on 19 March 2009, legislation will be introduced to stop individuals exploiting provisions that give relief for interest payments on loans used to invest in partnerships or small companies. Legislation will be effective from 19 March 2009. (an)

Personal tax: avoidance

A.152 As announced on 12 January 2009 and 1 April 2009, with effect from 12 January 2009, measures were introduced to prevent individuals obtaining reliefs available for employment-related liabilities and losses incurred by employees and former employees when the arrangements are designed to avoid tax. (-)

Corporate intangibles

A.153 Legislation will be introduced with effect from 22 April 2009 to confirm that for the purposes of the corporate fixed intangible assets regime goodwill is treated as intended. (52)

Living accommodation benefit charge

A.154 Where an employee or director pays a lease premium for accommodation provided by their employer they will be taxed according to the full market rent on leases entered into on or after 22 April 2009. (56)

Double tax relief avoidance

A.155 Measures will be introduced with effect from 22 April 2009 to stop abuse of the manufactured overseas dividend rules and to clarify the double tax relief rules to counter abusive schemes. (54)(55)

ForEx matching targeted anti-avoidance

A.156 A measure will be introduced with effect from 22 April 2009 to prevent tax avoidance schemes that seek to exploit the foreign exchange tax matching provisions. (51)

Authorised Investment Funds

A.157 As announced at the 2008 Pre-Budget Report, the Authorised Investment Fund regulations have been amended to provide certainty that Authorised Investment Funds cannot be used by financial traders to reduce corporation tax. (-)

Life insurance policies

A.158 As announced on 1 April 2009, legislation will be introduced to close down an avoidance scheme by making it clear that 'income' loss relief cannot be created through the use of certain life insurance policies. (-)

North Sea accelerated decommissioning relief

A.159 Legislation will be introduced, with effect from 22 April 2009, to prevent oil and gas companies claiming tax relief for infrastructure decommissioning costs in advance of the actual decommissioning being undertaken. (-)

Publication of names

A.160 Legislation will be introduced, to be bought into effect by Treasury Order, enabling HM Revenue & Customs to publish the names and details of individuals and companies who are penalised for deliberate defaults on or after 1 April 2010 leading to a loss of tax of more than £25,000. (57)

Tax computation certification

A.161 Legislation will be introduced requiring senior accounting officers of major corporates to certify personally that adequate controls to prepare accurate tax computations are in place. This will have effect on returns due to be made for accounting reference periods beginning on or after Royal Assent to Finance Bill 2009. (58)

Additional information requirements

A.162 HM Revenue & Customs will require those who have incurred a penalty for deliberate understatement of over £5,000 of tax to provide more information about their tax affairs for up to five years to ensure they have proper systems to be able to make a correct tax return. (-)

Offshore disclosure

A.163 HM Revenue & Customs will be seeking the permission of the First Tier Tribunal to issue notices requiring financial institutions to provide information about offshore account holders. A New Disclosure Opportunity (NDO) will run until March 2010 giving holders of offshore accounts an opportunity to disclose, of their own accord, if they have unpaid tax or duties and to settle debts. (-)

Alcohol fraud strategy

A.164 HM Revenue & Customs together with the UK Border Agency are setting out a comprehensive programme of work to target all forms of alcohol fraud and the criminal networks behind it. (53)

Modernising tax administration

Trade debt releases

A.165 As announced at the 2008 Pre-Budget Report and with effect from 22 April 2009, the law relating to trade debt releases will be modified to ensure that releases between connected companies are tax-neutral for both debtor and creditor. (-)

Extra- statutory concessions

A.166 With effect from 1 April 2010, HM Revenue & Customs will withdraw a number of extra-statutory concessions. (*)

Error or mistake relief

A.167 Legislation will be introduced to provide the sole means of reclaiming overpayments of income tax, capital gains tax and corporation tax where there is no other statutory route. The legislation also amends the error or mistake relief rules to provide additional taxpayer safeguards. The measure will have effect for claims made on or after 1 April 2010. (-)

Penalties and interest **A.168** Legislation will be made to allow the introduction of a harmonised interest regime and aligned penalties regimes for late filing, across the taxes and duties administered by HM Revenue & Customs, starting with interest and penalties on late paid PAYE from April 2010. The new provisions will be brought into effect by Treasury Orders from the date specified in the Orders. In all cases where HM Revenue & Customs currently charges and pays out interest, rates across taxes will be harmonised from Royal Assent to Finance Bill 2009. (-)

Compliance checks **A.169** New record keeping requirements, inspection and information powers, and assessing time limits will be introduced to align and simplify the way HM Revenue & Customs checks compliance for the environmental taxes (aggregates levy, climate change levy and landfill tax), insurance premium tax, stamp duty land tax and stamp duty reserve tax, inheritance tax and PRT. Information powers and penalties for failure to comply with these obligations will come into effect on 1 April 2010. New time limits will come into effect on 1 April 2011. (*)

Payment and repayment **A.170** Measures will be introduced, with effect on and after Royal Assent to Finance Bill 2009, to make it easier for taxpayers to pay what they owe on time; and support HM Revenue & Customs in effectively tackling those who pay late. The measures involve payment instalment schemes, powers to trace missing debtors and collection of small debts through PAYE. (59)

OTHER SPENDING MEASURES

Capital spending **A.171** As announced at the 2008 Pre-Budget Report, £3 billion of capital spending from 2010-11 has been brought forward to 2008-09 and 2009-10. (d)

Reprofiling the 2008-09 reserve **A.172** The addition to the 2008-09 reserve announced at the 2008 Pre-Budget Report will be reprofiled into 2009-10 and 2010-11. (61)

Supporting military operations and the Armed Forces **A.173** Additional resources will be provided for military operations in Afghanistan, including additional spending on protected mobility vehicles. £50 million will be brought forward for investment in Armed Forces accommodation providing refurbished or rebuilt accommodation for around 600 service men and women. (33)(60)

2010-11 value for money target **A.174** As announced at the 2008 Pre-Budget Report, the existing cross-Government value for money target for 2010-11 has increased from £30 billion to £35 billion, releasing £5 billion of additional recoverable savings in 2010-11. Budget 2009 sets out how savings will be achieved by individual departments. The Barnett formula will be applied as usual to the devolved administrations' budgets. (q)

APPENDIX A1: MEASURES ANNOUNCED IN BUDGET 2008 OR EARLIER

Table A11: Measures announced in Budget 2008 or earlier which take effect from April 2009 or later

		(+ve is an exchequer yield)			£ million
		2009-10 indexed	2010-11 indexed	2011-12 indexed	2009-10 non-indexed
	Measures announced in Budget 2008 or earlier				
a	Land Remediation Relief - extension to derelict land	-10	-20	-30	-10
b	Income Tax and NICs: raising the higher rate threshold and upper earnings limit	-290	-270	-290	-360
c	Extension of the dividend tax credit	neg	-20	-15	neg
d	VAT: staff hire concession	+250	+250	+250	+250
e	Review of powers: penalties	0	+10	+10	0
f	Tax simplification: increase income tax self assessment payment on account threshold	-90	0	0	-90
g	Removal of Enterprise Zone Allowances	-5	-25	+15	-5
h	Implementing the state second pension White Paper reforms	+290	+300	+340	+290
i	Child Benefit disregard for Housing Benefit and Council Tax Benefit	-180	-350	-360	-180
j	Reassement of work capability of incapacity benefit claimants	0	-10	-10	0
k	Inheritance Tax: increase threshold to £325,000 in 2009-10, £350,000 in 2010-11 and indexation thereafter	+10	-45	-120	-30
l	Biofuels: removal of the duty differential	0	+525	+500	+40
m	Company car tax thresholds	0	+85	+75	0

Land remediation relief

A.175 As announced in Budget 2008, Land Remediation Relief will be available for certain costs incurred in clearing up long-term derelict land from 1 April 2009. (a)

Income tax and NICS

A.176 As announced at Budget 2007, the basic rate limit for income tax was increased by £800 above statutory indexation in 2009-10 to £37,400, and the Class 1 earnings limit and the Upper Profits Limit for National Insurance contributions were aligned with the consequent higher rate income tax threshold of £43,875. (b)

Personal dividend taxation

A.177 As announced in Budget 2008, from 22 April 2009, the non-payable dividend tax credit will be extended to investors with a 10 per cent or greater shareholding in a non-UK resident company, except where the source country does not levy a tax on corporate profits similar to corporation tax. (c)

VAT staff hire concession

As announced in Budget 2008, the staff hire concession, which allowed employment businesses to charge VAT only on the margin of their supplies, was withdrawn with effect from 1 April 2009. (d)

Review of powers: penalties

A.178 As announced in Budget 2008, for return periods ending on or after 1 April 2009, where the filing date is after 1 April 2010, the new penalty regime for incorrect returns introduced in 2007 for income tax, capital gains tax, VAT, PAYE and NICs will be extended across all other taxes and duties. From 1 April 2009, the penalty regime for failure to notify HM Revenue & Customs of a new charge was aligned across all taxes and duties. (e)

Payment on account **A.179** As announced in the 2007 Pre-Budget Report, the payment on account threshold for income tax self-assessment has been doubled from £500 to £1,000 from 6 April 2009. (f)

Removal of Enterprise Zone Allowance **A.180** As announced on 17 December 2007, Enterprise Zone Allowances will be withdrawn from April 2011 as a consequence of the withdrawal of the Industrial Building's Allowance. (g)

Second State Pension **A.181** As announced in the 2007 Pre-Budget Report, the introduction of the Upper Accruals Point for the Second State Pension will take effect from 6 April 2009. (h)

Child Benefit **A.182** As announced in Budget 2008, from 1 October 2009 Child Benefit will be disregarded in calculating income for Housing and Council Tax Benefits. (i)

Incapacity Benefits **A.183** As announced in Budget 2008, starting in April 2010, the eligibility for incapacity benefits (IB) of all existing incapacity beneffits will be reassessed using the new Employment Support Allowance Work Capability Assessment. (j)

Inheritance tax nil-rate band **A.184** As announced in Budget 2006, the inheritance tax nil-rate band increased on 6 April 2009 to £325,000. (k)

Biofuels duty differential **A.185** As announced at Budget 20-08, from 2010-11, the biofuels duty differential will cease, and support for biofuels will be provided wholly by the Renewable Transport Fuel Obligation. (l)

Company car tax **A.186** Budget 2008 announced that, with effect from 5 April 2010, the lower threshold for the 15 per cent CCT band will be lowered so that it applies to drivers of company cars emitting between 121g CO_2 per km and 134g CO_2 per km. (m)

APPENDIX A2: EXPLAINING THE COSTING

A.187 This appendix explains how the fiscal impacts of the Budget and Pre-Budget Report policy decisions are calculated. In the context of these calculations, the net revenue effects for the measures may include amounts for taxes, National Insurance contributions, social security benefits and other charges to the Exchequer, including penalties.

Calculating the costings

A.188 The net Exchequer effect of a Budget measure is generally calculated as the difference between applying the pre-Budget and post-Budget tax and benefit regimes to the levels of total income and spending at factor cost expected after the Budget. The estimates do not therefore include any effect the tax changes themselves may have on overall levels of income and spending, even though these effects may be significant for large changes in the tax system.

A.189 They do, however, take account of other effects on behaviour where they are likely to have a significant and quantifiable effect on the cost or yield and any consequential changes in revenue from related taxes and benefits. These may include estimated changes in the composition or timing of income, spending or other economic determinants. For example, the estimated yield from increasing the excise duty on spirits would include the change in the yield of VAT and other excise duties resulting from the new pattern of spending. The calculation of the expected effect of changes in duty rate on consumer demand for excise goods assumes that any change in duty is passed on in full to consumers. Where the effect of one tax change is affected by implementation of others, the measures are normally costed in the order in which they appear in Tables A1, A2 and A1.1.

A.190 Tables A1, A2 and A1.1 show both the indexed and non-indexed costings of the various measures:

- The indexed costings show the exchequer impacts of the measures against a baseline that assumes allowances, thresholds and specific tax rates will be increased in line with either the appropriate price index, or any pre-commitments (measures announced in previous Budgets or Pre-Budget Reports that are or were due to come into effect). As such they give an indicator of the impact of the decisions made in the appropriate Budget or Pre-Budget Report.

- The non-indexed column shows the revenue effects of the policy options against a baseline that assumes allowances; thresholds and tax rates are left unchanged. The non-indexed column therefore includes the revenue impact of indexation or other pre-commitments.

A.191 Unless allowances, thresholds and specific tax rates have been pre-announced, the indexed baseline assumes the following:

- income tax and National Insurance allowances and thresholds, excluding the additional higher rate and threshold for restricting the personal allowance; the child element and disabled and severely disabled child elements of the Child Tax Credit, the single person, couple, lone parent, 30 hour 50 plus, disabled and severely disabled worker elements of the Working Tax Credit; inheritance tax nil-rate band allowance threshold and the capital gains tax annual exempt amount all increase in line with the change in the Retail Price Index (RPI) in the year to the September prior to the respective Budget;

- The climate change and aggregates levy and the vehicle excise duty, amusement machine licence duty, air passenger duty, fuel, tobacco and alcohol duties all rise in line with the projected annual change in the RPI in the year to the third quarter following the respective Budget; and

- VAT thresholds and gaming duty bands rise in line with the change in the RPI in the year to the December prior to the respective Budget.

A.192 With the exception of business rates, when indexation rates are negative, the indexed baseline assumes allowances, thresholds and specific tax rates are held constant.

A.193 The yields of measures that close tax avoidance loopholes or tackle tax fraud represent the estimated direct Exchequer effect of the measures with the existing level of avoidance activity.

A.194 These estimates are shown on a National Accounts basis. The National Accounts basis aims to recognise tax when the tax liability accrues irrespective of when the tax is received by the Exchequer. However, some taxes are accounted for when the Exchequer actually receives the tax, reflecting the difficulty in determining the period to which the tax liability relates. Examples of such taxes are corporation tax, self-assessment income tax, stamp duty land tax, inheritance tax and capital gains tax. This approach is consistent with other Government publications.

APPENDIX A3: TAX ALLOWANCES AND RELIEFS

A.195 This appendix provides the latest estimates of the revenue cost of some of the main reliefs against tax and National Insurance contributions in 2007-08 and preliminary estimates for 2008-09. The figures are shown on a full-year accruals basis unless otherwise specified. The appendix covers only reliefs with estimated annual costs of at least £50 million are shown. The costs of minor tax reliefs can be found on the HM Revenue & Customs website. More details on individual tax allowances and reliefs can be found in the HM Treasury publication, *Tax ready reckoner and tax reliefs.*

A.196 The full accrual presentation enables the total revenue effect to be shown in a single year for each measure. This presentation differs from that in the earlier tables in Chapter A which adopt the National Accounts basis used in the presentation of UK public finances.

A.197 Some allowances and reliefs are called 'tax expenditures'. This is because they are designed to help or encourage particular individuals, activities or products. So for example the exemption of the first £30,000 of payments on termination of employment helps people being made redundant; the R&D tax credits promote expenditure on research by businesses and the relief for Individual Savings Accounts promotes savings by individuals. Such reliefs are often an alternative to corresponding public expenditure payments that would generate similar effects – i.e. there could be a choice between giving a tax relief as an allowance or deduction against tax, or by an offsetting cash payment.

A.198 Other allowances and reliefs can reasonably be regarded (or partly regarded) as an integral part of the tax structure and have a universal or at least a more wide-ranging coverage. These are called 'structural reliefs' and the personal allowances are a good example. To the extent that income tax is based on ability to pay, it does not seek to collect tax from those with the smallest incomes. But, even with such structural reliefs, the Government has some discretion about the level at which the relief is set.

A.199 The split between structural reliefs and tax expenditures is inevitably broad-brush and the distinction in not always straightforward. Many reliefs combine both structural and discretionary components. Capital allowances, for example, provide relief for depreciation at a commercial rate as well as an element of accelerated relief. It is this latter element that represents additional help provided to business by the Government and is a 'tax expenditure'.

A.200 The figures should only be regarded as broad estimates. The loss of revenue associated with tax reliefs and allowances cannot be directly observed, and so the estimates are often based on simplified assumptions. The cost of a relief also depends on the tax base against which it is measured. Largely because of the difficulties of estimation, the published tables are not comprehensive, but do cover the major reliefs and allowances. This means that figures in Table A3.1 are not directly comparable with those of the main Budget measures shown earlier in this chapter.

A.201 It is important to note that each relief is costed separately. In some cases the combined cost of a number of reliefs will differ significantly from the sum of the figures for the individual reliefs. The figures do not allow for any behavioural changes as a result of the reliefs. In practice, if a relief was withdrawn, taxpayers; behaviour would often alter so that the actual yield from ending the relief would be very different from, and often smaller than, that shown.

Table A3.1 Estimated costs of principal tax expenditures and structural reliefs

	£ million	
	2007-08	2008-09
TAX EXPENDITURES		
Income tax		
Relief for:		
Approved pension schemes	18,900	20,300
Share Incentive Plan	210	150
Approved savings-related share schemes	330	230
Enterprise Management Incentives	190	150
Approved Company Share Option Plans	150	110
Personal Equity Plans	425	N/A
Individual Savings Accounts	2,000	2,000
Venture Capital Trusts	80	60
Enterprise Investment Scheme	180	130
Professional subscriptions	85	80
Rent a room	120	120
Seafarers' Earnings Deduction	110	110
Exemption of:		
First £30,000 of payments on termination of employment	900	900
Interest on National Savings Certificates including index-linked certificates *	170	80
Premium Bond prizes	280	210
Income of charities	1,250	1,350
Foreign service allowance paid to Crown servants abroad	70	70
Personal Tax Credits	4,700	5,500
Employer Supported Childcare exemption	400	500
Student maintenance awards	90	115
Corporation tax		
R&D tax credits	510	580
Income tax and corporation tax		
Discontinued small budget film tax relief	120	neg
Discontinued large budget film tax relief	130	40
National insurance contributions		
Disregard for:		
Share Incentive Plan	140	100
Approved savings-related share schemes	210	160
Enterprise Management Incentives	80	60
Approved company share option plans	70	50
Employer contributions to registered pension schemes	8,200	9,000
Capital gains tax		
Exemption of gains arising on disposal of only or main residence	14,500	5,300
Inheritance tax		
Relief for:		
Agricultural property	215	185
Business property	195	130
Exemption of transfers to charities on death	375	270

Table A3.1 Estimated costs of principal tax expenditures and structural reliefs (continued)

	£ million	
	2007-08	2008-09
TAX EXPENDITURES		
Value added tax		
Zero-rating of:		
Food	12,050	12,000
Construction of new dwellings (includes refunds to DIY builders)	7,350	5,600
Domestic passenger transport	2,600	2,500
International passenger transport (UK portion)	200	200
Books, newspapers and magazines	1,650	1,500
Children's clothing	1,250	1,200
Water and sewerage services	1,350	1,350
Drugs and supplies on prescription	1,350	1,350
Supplies to charities	200	200
Ships and aircraft above a certain size	700	650
Vehicles and other supplies to disabled people	350	350
Reduced rate for:		
Domestic fuel and power	3,050	3,450
Certain residential conversions and renovations	150	150
Energy-saving materials	50	50
Women's sanitary products	50	50
Landfill Tax		
Exemption of waste for contaminated land	55	50
Climate change levy		
Reduced rate for participants in Climate Change agreements	270	280
Exemption of electricity generated from certain renewable resources	80	90
Hydrocarbon oils duty		
Rate differential for biofuels	110	240
STRUCTURAL RELIEFS		
Income tax		
Personal allowance	45,300	49,700
Corporation tax		
Life companies reduced rate of corporation tax on policy holders' fraction of profit	740	160
Tonnage tax	100	110
Income tax and corporation tax		
Double taxation relief	16,000	16,000
National insurance contributions		
Contracted-out rebate occupational schemes:		
Rebates deducted at source by employers	7,940	8,270
Rebates paid by the National Insurance Contributions office direct to the scheme	220	230
Contracted-out rebate personal and stakeholder pension schemes	2,360	2,330

Table A3.1 Estimated costs of principal tax expenditures and structural reliefs (continued)

	£ million	
	2007-08	2008-09
STRUCTURAL RELIEFS		
Value added tax		
Refunds to:		
Northern Ireland Government bodies of VAT incurred on non-business purchases under the Section 99 refund scheme	300	300
Local Authority-type bodies of VAT incurred on non-business purchases under the Section 33 refund scheme (includes museums and galleries under the Section 33A refund scheme)	7,850	8,100
Central Government, Health Authorities and NHS Trusts of VAT incurred on contracted-out services under the Section 41 (3) refund scheme	4,350	4,600
Hydrocarbon oils duty		
Tied oils scheme (Industrial Relief Scheme)	1,300	1,400
Climate change levy		
Supply of taxable commodities not for burning or consuming in the UK	190	190
RELIEFS WITH TAX EXPENDITURE AND STRUCTURAL COMPONENTS		
Income tax		
Age-related allowances	2,500	3,000
Reduced rate for savings	360	N/A
Exemption of:		
British Government securities where owner not ordinarily resident in UK	1,460	1,460
Child benefit (including one parent benefit)	1,190	1,190
Long-term incapacity benefit	370	390
Attendance allowance	160	150
Disability living allowance	400	410
War disablement benefits	70	70
Corporation tax		
Small companies' reduced corporation tax rate	4,500	4,500
Exemption for gains on substantial shareholdings	260	260
Income tax and corporation tax		
Capital allowances	20,600	21,500
Of which:		
First year allowances for SMEs	640	N/A
Annual Investment Allowance	N/A	1,560
Enhanced capital allowances for energy saving technology	115	95
Accelerated capital allowances for enterprise zones	50	50
Relief for trading losses against capital gains	60	30
Capital gains tax		
Indexation allowance and rebasing to March 1982	250	N/A
Taper relief	6,800	N/A
Exemption of:		
Annual exempt amount (half of the individual's exemption for trustees)	3,500	1,700
Gains accrued but unrealised at death	550	260
Petroleum revenue tax		
Oil allowance	580	690
Tariff receipts allowance	60	60
Exemption for gas sold to British Gas under pre-July 1975 contracts	40	50

Table A3.1 Estimated costs of principal tax expenditures and structural reliefs (continued)

	£ million	
	2007-08	2008-09
RELIEFS WITH TAX EXPENDITURE AND STRUCTURAL COMPONENTS		
Inheritance tax		
Nil rate band for chargeable transfers not exceeding the threshold	11,100	11,800
Exemption of transfers on death to surviving spouses and civil partners	2,100	1,800
Stamp duty land tax		
Exemption of transfers of residential land and property where the consideration does not exceed the £125,000 threshold up to 2nd September 2008 (thereafter the threshold is temporarily increased to £175,000 for the period of the SDLT Holiday), and non-residential land and property where the consideration does not exceed £150,000	470	340
Exemption of all transfers of residential land and property in designated disadvantaged wards where the consideration exceeds the £125,000 threshold but does not exceed £150,000 up to 2nd September 2008 (thereafter the threshold is temporarily increased to £175,000 for the period of the SDLT Holiday).	50	15
Transfers to charities	130	200
Group relief	1,410	770
Transfers to registered social landlords	95	120
Alternative property finance	110	25
Transfers involving public bodies	30	150
National insurance contributions		
Reduced contributions for self-employed not attributable to reduced benefit eligibility	2,000	1,950
Value added tax		
Exemption of:		
Rent on domestic dwellings	3,750	3,600
Supplies of commercial property	200	200
Private education	50	50
Health services	900	850
Postal services	200	200
Burial and cremation	50	50
Finance and insurance	4,500	4,350
Betting and gaming and lottery duties	1,150	1,100
Small traders below the turnover limit for VAT registration	1,600	1,600
Air Passenger Duty		
Non-passengers (e.g. cabin crew)	110	110
Vehicle Excise Duty		
Exemption for disabled motorists	180	190

B The economy

The world economy was hit by a succession of shocks during 2007 and 2008. Initially, credit conditions tightened across advanced economies. Then the rise in global commodity prices squeezed real incomes. Together, these factors pushed many advanced economies into recession. Finally, the intensification of the credit shock into a global financial crisis delivered a severe blow to an already weakened world economy, precipitating a steep and synchronised global downturn.

In late 2008, world trade and manufacturing contracted very sharply as confidence evaporated and the availability of credit was further curtailed. World GDP fell, and is forecast to contract by 1¼ per cent in 2009, the first full-year decline in the post-war period. World trade is forecast to drop by more than 10 per cent, by far the largest post-war annual fall. The UK, like other advanced economies, has seen a steep fall in output, with GDP down 1.6 per cent in the final quarter of 2008 and industrial production down 4.5 per cent, each the sharpest fall since the early 1980s.

Faced with these exceptional challenges, governments around the world have utilised all available policy levers to support their economies. Banking systems have been recapitalised and action taken to ensure access to finance for creditworthy borrowers. Interest rates have been cut to historic lows, a number of central banks have adopted quantitative easing to boost demand further, and governments have set expansionary fiscal policies. The Budget 2009 forecast is underpinned by the assumptions that G20 authorities deliver on policy commitments and that financial conditions ease as a result. As this policy stimulus takes hold, the world economy is forecast to grow by 2½ per cent in 2010, picking up further to 4¼ per cent in 2011.

In the UK, the Government has undertaken a set of measures to improve the flow of credit to creditworthy borrowers, and significant macroeconomic policy stimulus is in place. A combination of discretionary fiscal action and the automatic stabilisers is delivering fiscal support worth 4 per cent of GDP in 2009-10. Bank Rate has been cut to ½ per cent, and a £75 billion programme of quantitative easing is under way. In addition, lower commodity prices and the depreciation of sterling help provide the conditions for a rebalanced recovery.

The Budget 2009 economic forecast reflects the balance of key forecasting considerations relating to the negative effect of the global financial crisis and private sector retrenchment, and the positive effect of large-scale macroeconomic stimulus, both domestically and internationally, on growth. The economic forecast is for:

- UK GDP to contract by 3½ per cent in 2009. As macroeconomic stimulus builds and credit conditions ease, the economy is forecast to pick up progressively through 2010 and 2011, with annual growth of 1¼ per cent in 2010, supported by net exports, picking up to 3½ per cent in 2011, as the significant degree of spare capacity begins to be brought back into productive use, helped by the UK's flexible markets; and
- CPI inflation to fall to 1 per cent by the end of 2009 and to remain below target during 2010, as the lagged effects of sterling depreciation and monetary policy are more than offset by downward pressure on prices from spare capacity and lower energy prices. Inflation is forecast to return close to target during 2011 as the lagged effects of monetary policy easing build.

The forecast is presented within ½ percentage point ranges, based on alternative assumptions about supply-side performance of the economy, with the public finance projections based on the lower end of the range where GDP is forecast to contract by 3¾ per cent in 2009 before recovering to 1 per cent in 2010 and 3¼ per cent in 2011. The forecast ranges are not designed to reflect the very significant uncertainties around these forecasts. The key risks include the pace and balance of the global recovery, effectiveness of global policy stimulus, availability of sufficient credit growth to support recovery, and intensity of private sector retrenchment.

INTRODUCTION[1,2]

B.1 This chapter discusses recent economic and financial market developments, and provides updated forecasts for the UK and world economies in the period to 2011. It begins with an overview of the global economic shocks of 2007 and 2008, and their implications for world economic developments and prospects, which provides the global context for developments and prospects in the UK economy. The chapter then outlines the UK economic forecast, before concluding with a more detailed discussion of sectoral issues, components of growth, and the forecast issues and risks that are addressed throughout.

THE WORLD ECONOMY

Global shocks and world downturn

Global economic shocks

B.2 The world economy was hit by a succession of shocks during 2007 and 2008, beginning with the tightening of global credit conditions as disruption gripped financial markets. The effect of constrained credit on households and businesses was exacerbated by the squeeze on real incomes caused by a surge in commodity prices in the middle of 2008. As commodity prices subsequently fell, the failure of Lehman Brothers in the US triggered an intensification of credit market stress into the worst global financial crisis for generations.

Synchronised global downturn

B.3 With global demand already weakened by the impact of credit restrictions and high commodity prices, the loss of confidence across the global financial system and among households and businesses around the world precipitated a steep and synchronised global downturn. Figures compiled by the Netherlands Bureau of Economic Policy Analysis suggest that world trade volumes have fallen almost 17 per cent since September 2008. JPMorgan estimates that in the final quarter of 2008, global manufacturing fell at an annualised rate of 21 per cent and world GDP at nearly 7 per cent.

B.4 Almost every major advanced economy is currently in recession, with output falling particularly sharply in those economies most reliant on exports. Out of 51 countries reporting components of growth for the final quarter of 2008, over two thirds saw double-digit annual falls in exports. At the same time, a growing number of emerging and developing economies have experienced sharp slowdowns or recession. The International Labour Organisation of the United Nations predicts that global unemployment could increase by 38 million by the end of 2009. As the financial crisis intensified, borrowers in many emerging markets found it increasingly difficult to access international capital markets, with a number of countries approaching the IMF and other international financial institutions for emergency support.

B.5 The interaction between global financial markets and the wider economy is a key factor influencing the depth and duration of the world recession, and the timing and strength of the recovery. In the early stages of the credit shock, growth prospects were dominated by the state of global financial markets and the implications for credit conditions faced by households and businesses. As the downturn has deepened, the nature of the relationship has evolved, with weakness in the wider economy adversely affecting the financial system through the credit quality of loans, further impacting on credit conditions and financial markets.

[1] The UK forecast is consistent with National Accounts and balance of payments statistics to the final quarter of 2008 released by the Office for National Statistics (ONS) on 27 March 2009. A detailed set of charts and tables relating to the economic forecast is available in *Budget 2009: the economy and public finances – supplementary material* on the Treasury's internet site. Copies can be obtained on request from the Treasury's Public Enquiry Unit (020 7270 4558).

[2] The forecast is based on the assumption that the exchange rate moves in line with an uncovered interest parity condition, consistent with the interest rates underlying the economic forecast.

Global financial markets

B.6 Box A1 of the 2008 Pre-Budget Report set out the sequence of events that led the disruption in specific credit markets linked to US subprime mortgages to spread and intensify into the worst global financial crisis for generations. Following the failure of Lehman Brothers in the US in September 2008, global asset prices fell sharply. While the value of world stock markets is currently around that at the time of the Pre-Budget Report, it is down by around half, or $30 trillion, from its peak in 2007. Spreads on corporate bonds in advanced economies and emerging market government bonds have started to ease from the highs of recent months. Meanwhile, with investors anxious to reduce exposure to private sector risk, yields on the safest assets, particularly advanced economies' government bonds, have fallen sharply.

Credit conditions

B.7 Surveys of credit conditions in the major economies suggest that the tightening of credit conditions facing households and firms has slowed. In the US, the Federal Reserve's senior loan officer opinion survey showed that credit conditions in the final quarter of 2008 had stabilised relative to the previous quarter. Surveys conducted by the ECB and Bank of Japan showed that credit conditions continued to tighten.

Oil and other commodity prices

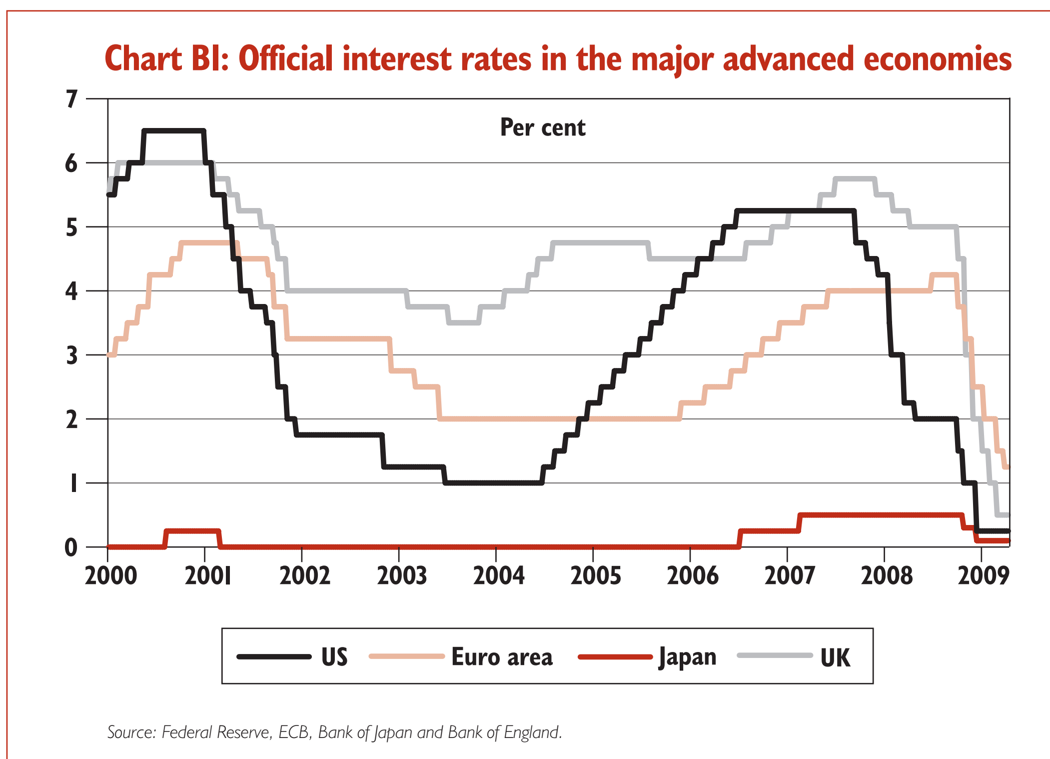
B.8 The dramatic rise and fall of commodity prices through 2008 was set out in Box A2 of the 2008 Pre-Budget Report. Since that time, commodity prices have generally remained low by the standards of recent years, reflecting falling demand in advanced economies and, more recently, emerging markets. The price of Brent crude oil, the European standard, currently stands at around $50 a barrel, down 65 per cent from its peak in mid-2008. The price of oil has remained low despite OPEC's successive cuts in its production quota since September 2008. Prices of metals and agricultural commodities have fallen to well below their summer 2008 peaks.

Global policy response and prospects for recovery

Global policy response

B.9 Faced with the exceptional challenges posed by the global financial crisis and synchronised downturn in the world's economies, governments around the world have utilised all available policy levers to support their economies. Banking systems have been recapitalised and action taken to ensure that the presence of impaired assets on banks' balance sheets does not limit access to finance for creditworthy borrowers. To support demand, interest rates have been cut to historic lows, a number of central banks have introduced quantitative easing policies, and governments have adopted expansionary fiscal policies. At the London Summit, G20 leaders agreed a global plan for recovery and reform, and recognised that "*acting together strengthens the impact and the exceptional policy actions announced so far must be implemented without delay.*" The Budget 2009 forecast is underpinned by the assumption that G20 authorities deliver on policy commitments and that they are effective.

Chart B1: Official interest rates in the major advanced economies



Source: Federal Reserve, ECB, Bank of Japan and Bank of England.

Prospects for the global economy

B.10 With a sharp recession taking place in the world's economies, global forecasts are marked by very significant uncertainties and risks. World GDP is forecast to fall by 1¼ per cent in 2009, the first full-year contraction in the post-war period. Advanced economies are expected to contract most sharply, with G7 GDP forecast to fall by 4 per cent this year. Emerging economies are expected to continue growing, but at a greatly reduced pace, highlighting how closely aligned prospects in emerging and advanced economies have become in a world economy characterised by integrated global supply chains. As the global policy response takes hold and credit conditions start to ease, the world economy is forecast to begin to recover towards the end of 2009, with growth picking up through 2010 and 2011.

Table B1: The world economy

	Percentage change on a year earlier, unless otherwise stated				
			Forecast		
	2007	2008	2009	2010	2011
World GDP	5	3¼	–1¼	2½	4¼
Major 7 countries[1]					
Real GDP	2¼	½	–4	¾	3
Consumer price inflation[2]	3	1¾	–½	1	1¾
Euro area GDP	2¾	¾	–4¼	¼	2
World trade in goods and services	7¼	2½	–10¾	¼	6½
UK export markets[3]	6½	2	–8¾	–1	4¾

[1] G7: US, Japan, Germany, France, UK, Italy and Canada.

[2] Per cent, Q4.

[3] Other countries' imports of goods and services weighted according to the importance of imports from the UK in those countries' total imports.

Advanced economies

Euro area **B.11** The euro area has been hit hard by weakness in domestic confidence and labour markets, and by falling global trade, affecting domestic and external sources of demand. Net exports subtracted significantly from growth in the final quarter of 2008, while weak demand and the effects of housing corrections in some Member States caused investment to fall sharply. Euro area GDP contracted 1.6 per cent in the final quarter of 2008, while industrial production fell more than 18 per cent in the year to February.

B.12 Euro area GDP is forecast to fall 4¼ per cent in 2009, and recover gradually from the start of 2010. Deteriorating labour markets, tight lending conditions and continued lack of confidence are likely to weigh on private consumption in the near term. Investment is set to drop sharply reflecting the weakness of global demand and restricted access to finance. Global factors and the euro's appreciation also suggest that net exports will continue to subtract from growth. Reflecting the worsening outlook, the consensus forecast for euro area GDP growth in 2009, which stood at 2.0 per cent at the beginning of 2008 and -0.2 per cent at the time of the 2008 Pre-Budget Report, has been revised down a further 3.2 percentage points to a contraction of 3.4 per cent. The consensus forecast for 2010 suggests a subdued recovery with growth of 0.3 per cent.

Box B1: Government policy on EMU

The Government's policy on membership of the single currency was set out by the former Chancellor in his statement to Parliament in October 1997. In principle, the Government is in favour of UK membership; in practice, the economic conditions must be right. The determining factor is the national economic interest and whether, on the basis of an assessment of the five economic tests, the economic case for joining is clear and unambiguous. An assessment of the five economic tests was published in June 2003. This concluded that: *"a clear and unambiguous case for UK membership of EMU has not at the present time been made"*.

The Chancellor's statement to the House of Commons on 9 June 2003 on UK membership of the single currency set out a reform agenda of concrete and practical steps to address the policy requirements identified by the assessment of the five economic tests. This Budget sets out progress on the Government's reform agenda, including continued efforts to maintain the flexibility of labour, capital and product markets in the UK.

In his statement to the House of Commons on 9 June 2003, the former Chancellor committed the Government to an annual review of progress. The Government does not propose a euro assessment to be initiated at the time of this Budget. The Treasury will again review the situation at Budget time next year, as required by the Chancellor's June 2003 statement.

United States **B.13** The adjustment of private consumption in the US has led other advanced economies, and has so far been the most severe. Equities are an important component of US households' financial wealth, and feature heavily in consumption decisions. Since mid-2007, falls in equity prices have reduced household financial wealth by over $4 trillion, equivalent to 40 per cent of annual household disposable income. Retail sales declined by 10 per cent in the year to February 2009, as the saving ratio increased from close to zero to 4¼ per cent.

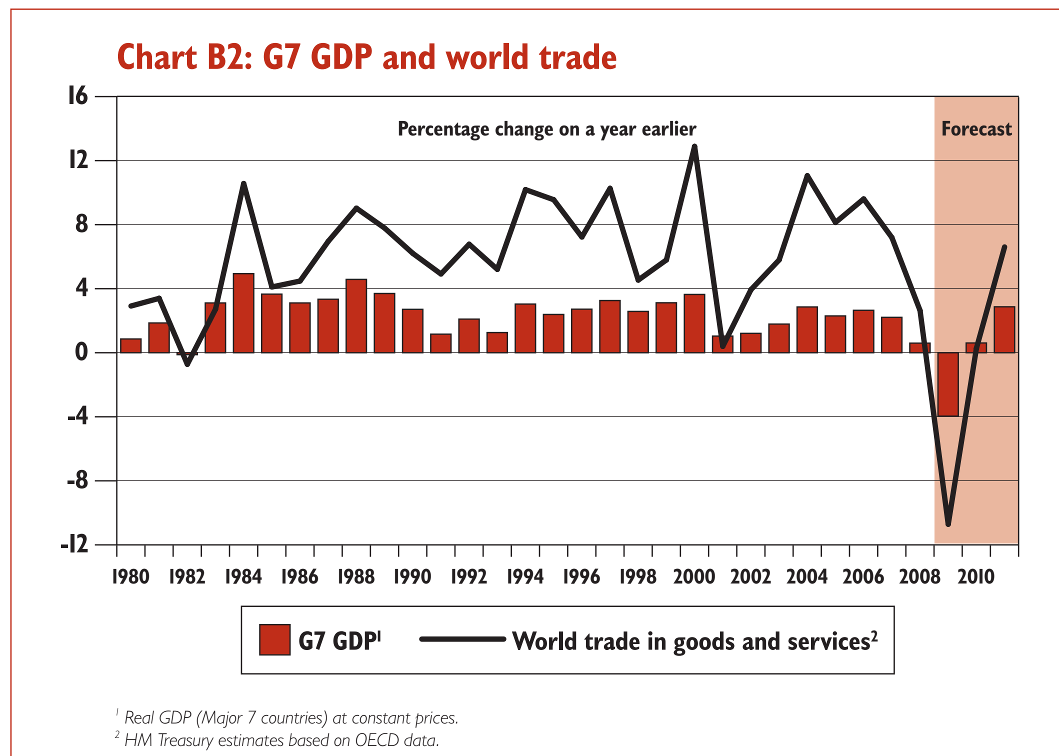
B.14 Businesses have responded to weakening demand by cutting back investment, reducing demand for credit and bearing down on other costs. This has included shedding 5 million jobs, pushing the unemployment rate up from 5 per cent to 8½ per cent, since December 2007. Job losses have dealt a further blow to consumer confidence, increasing the precautionary motive for saving. GDP fell 1.6 per cent in the final quarter of 2008.

B.15 Monthly indicators suggest the US economy was similarly weak in early 2009. Industrial production fell 5.4 per cent in the first quarter. The consensus forecast for US GDP growth in 2009, which stood at 2.7 per cent at the beginning of 2008 and -0.6 per cent at the time of the 2008 Pre-Budget Report, has been revised down a further 2.1 percentage points to a contraction of 2.7 per cent. However, the consensus forecast is for growth in 2010, reflecting the impact of a policy response of unprecedented scale and scope partially offsetting the weakness in private demand. The weak outlook for near-term activity combined with falls in commodity prices mean that the consensus forecast for US inflation in 2009 as a whole is negative, at -0.3 per cent.

Japan

B.16 Although the Japanese economy was relatively insulated from the tightening in credit conditions in the early stages of the credit shock, the subsequent effect on confidence and global demand has had a powerful impact. In February 2009, export volumes contracted by an unprecedented 45½ per cent on a year earlier, with shipments to all regions falling sharply. Unemployment in Japan has now reached 4½ per cent, and there are signs that domestic demand is also weakening. GDP fell by 3.2 per cent in the final quarter of 2008.

B.17 Japan is likely to experience the deepest recession among the G7 economies, with GDP possibly contracting as sharply in the first quarter of 2009 as in the final quarter of 2008. The pace at which prospects have deteriorated is evident from movement in the consensus forecast for 2009 GDP growth, which stood at 2.0 per cent at the beginning of 2008 and -0.1 per cent at the time of the 2008 Pre-Budget Report, but has since been revised down a further 6.2 percentage points to a contraction of 6.3 per cent. External forecasts also show the considerable uncertainty over Japanese growth prospects, ranging from -4.2 per cent to -8.7 per cent for 2009.



[1] Real GDP (Major 7 countries) at constant prices.
[2] HM Treasury estimates based on OECD data.

Emerging markets

B.18 Contracting domestic demand in advanced economies has hit emerging markets. Steep declines in exports, particularly in a number of Asian countries, has highlighted how closely aligned prospects in emerging and advanced economies have become in a world economy characterised by integrated global supply chains. Prospects for recovery in emerging markets are therefore in large part dependent on the success of policy interventions in advanced economies delivering a recovery in global demand.

B.19 Since the intensification of the global financial crisis in September 2008, public and private sector borrowers in emerging markets have found it increasingly difficult to access international capital markets. This has led to a number of emerging markets approaching the IMF and other international financial institutions for emergency support, and it is likely that further countries will require emergency funding. In view of this, at the London Summit leaders agreed to a tripling of the IMF's resources to $750 billion and endorsed reforms to the IMF's lending instruments, including the creation of a new Flexible Credit Line (FCL), which will operate as a type of insurance policy for strongly performing economies, mainly among emerging market countries. Mexico and Poland have been the first countries to seek voluntary access to the FCL.

Box B2: Global imbalances and emerging market capital flows

Over the past 20 years, global trade and financial integration has been accompanied by a steady increase in global current account imbalances. These imbalances peaked in 2006, following a sustained period of historically strong rates of world GDP and trade growth.

The financial flows associated with these current account imbalances were characterised by funds moving from some emerging and oil-producing economies to advanced economies with large liquid capital markets, and indirectly to emerging Europe.

The intensification of the global financial crisis in September 2008 and the associated rise in global risk aversion caused a general flight into dollar-denominated assets. In many cases, financial institutions' desire to bolster domestic capital positions in advanced economies prompted the sale of emerging market investments. This led to a sharp reversal in international flows of capital. Indeed, the Institute of International Finance forecasts that capital flows to emerging markets in 2009 will be down 80 per cent from their 2007 peak.

This capital flight exposed serious weaknesses in emerging market financial systems, particularly in countries with a high dependence on cross-border credit and a large degree of foreign currency-denominated domestic lending. Coupled with reduced export demand and sizeable short-term external debt, the reduction in capital inflows contributed to the sharp deterioration in the economic and financial situation in emerging markets.

Emerging Europe has been the hardest hit due to its dependence on short-term external financing through the banking system, often provided by parent banks in western Europe. Latin America and Asia have also been affected, especially after the fall in commodity prices and world trade.

The evolution of imbalances in the medium term will depend on how the crisis and the response to it affects the long-term saving and investment behaviour of the private and public sectors globally. Already the US current account deficit has narrowed and the US household saving ratio has increased. OECD analysis suggests that current account inbalances will continue to reduce into 2010.

Emerging Europe and Russia

B.20 Emerging Europe has been particularly affected by the financial crisis given the region's strong trade and financial links with western Europe. Growth slowed sharply in most countries, with some entering deep recessions, and currencies came under pressure. Several countries in the region have already received external financial assistance. While the economic and financial situation in emerging Europe is not homogeneous – some economies are on a more sound economic footing than others – further contraction in economic activity is expected across the region, and more countries are likely to require external financial support.

B.21 In Russia, as with emerging Europe, capital flight led to significant currency depreciation. However, in addition, the fall in commodity prices, particularly oil and gas, has had a significant effect on the public finances. A managed exchange rate regime and relatively high inflation have constrained monetary policy. As a result, the consensus forecast is for the Russian economy to contract by 1.5 per cent in 2009, with recovery particularly dependent on global demand and commodity prices.

Emerging Asia

B.22 The decline in global trade has perhaps had its greatest impact on emerging Asia. A number of countries, including Thailand, Malaysia and the Philippines, have seen exports fall by between 20 and 40 per cent. Sound macroeconomic policy reform and the accumulation of foreign exchange reserves mean that emerging Asia is less exposed to financial crisis than in previous years.

China

B.23 Rapid growth over a sustained period means that China now accounts for more than 10 per cent of world GDP.[3] The weakness of China's main export markets in the US and Europe is acting as a drag on activity, which has led to rising unemployment and slowing consumption, investment and industrial production growth. The consensus forecast for Chinese GDP growth in 2009 is around 7 per cent, which would represent a significant slowing from the peak of 13 per cent in 2007.

B.24 In November 2008, in response to slowing growth, the Chinese government announced a large fiscal package worth an estimated 4 per cent of GDP, focused on investment in infrastructure and earthquake reconstruction. Although growth in the first quarter of 2009 was the lowest since 1992 at just over 6 per cent on a year earlier, strong growth in fixed asset investment suggests fiscal support is starting to take effect. A further boost to the Chinese economy is being provided by monetary policy. With inflation turning moderately negative, the People's Bank of China cut interest rates and relaxed administrative controls on credit growth. Together, these factors represent an important upside risk for growth in the rest of this year, both for China and for the world as a whole.

India

B.25 Prospects for the Indian economy are also key to medium-term global growth. Domestic demand in China and India could provide an important driver of recovery. However, in the near term, the global financial crisis is exacerbating a cyclical downturn that was already underway. India is less export-focused than China, but has been affected more significantly through a decline in investment. This trend is unlikely to be reversed until global credit conditions ease. India entered the downturn with a large budget deficit, and this has limited the government's ability to respond with counter-cyclical fiscal policy as the crisis has developed. The authorities have greater room to loosen monetary policy, but risk aversion in the banking sector currently limits the effectiveness of the monetary transmission mechanism. The consensus forecast is for Indian GDP growth to weaken significantly in 2009 to around 5 per cent.

[3] When measured at 'purchasing power parity' exchange rates, a measure most suitable for aggregating global GDP when considering the growth of global living standards. When measured at market exchange rates, a measure more appropriate for considering the size of global markets, China's share of world GDP is closer to 7 per cent.

Latin America **B.26** Latin America is particularly exposed to spillover effects from developments in the US economy, and the decline in commodity prices. Problems in accessing external finance pose serious risks to some countries, making it very likely that growth in 2009 will be weaker than in 2008 for the majority of countries in the region. However, the creation of the IMF's FCL may provide support to some countries. Those most heavily exposed to developments in advanced economies are at the greatest risk of experiencing outright declines in output.

World trade and UK export markets

World trade **B.27** The nature of the global downturn has meant the impact on world trade flows has been particularly large. The loss of confidence among households and businesses has had a direct impact on demand, particularly for heavily-traded durable goods and capital equipment, while the financial crisis has curtailed the availability of the forms of credit and insurance that facilitate world trade. The relative importance of trade finance and falls in demand in explaining the weakness of trade volumes vary across regions, with trade finance considered to have been more of a factor in parts of Asia as set out in Box B3. At a global level, the sharp fall in global output is consistent with world trade volumes that are forecast to contract by more than 10 per cent in 2009, by far the biggest annual fall in the post-war period. World trade volumes are forecast to pick up through 2010, and grow by 6½ per cent in 2011, closer to the average of the past 30 years.

UK export markets **B.28** UK export markets, a measure of world trade that is weighted to reflect the geographical pattern of UK trade, have typically grown more slowly than world trade overall. This reflects the large contributions of emerging markets to world trade growth, while a greater share of UK export demand is from slower growing advanced economies. In 2009, UK export markets are set to contract less sharply than world trade, reflecting the sharper contraction in emerging market trade to which the UK is less exposed. UK export markets are forecast to contract by 8¾ per cent in 2009, a downward revision of almost 10 percentage points compared with the 2008 Pre-Budget Report forecast. In 2010, the rebound in world trade is expected to be focused among emerging and developing economies, so that UK export markets are forecast to decline further.

Box B3: World trade and global manufacturing

World trade has fallen dramatically, particularly across advanced economies, Asia and Latin America. The steep decline primarily reflects the significant weakening of domestic demand around the world as economies have been hit by successive shocks to credit and commodity prices. This demand shock was transmitted along the complex global supply chains that have evolved in recent years, where production processes involve many stages in different countries. It was exacerbated by restricted access to trade financing and elevated exchange rate volatility caused by the global financial crisis.

The sharp drop in world goods trade reflected a similarly dramatic decline in global manufacturing and demand for commodities. The transport and electronics sectors have been particularly badly hit, with JPMorgan estimating global motor vehicle production is currently down 13 per cent since the first half of 2008, while world semiconductor billings have fallen almost 30 per cent. In addition, the International Energy Agency estimates global oil demand declined in 2008 and projects it will decline again in 2009, which would be the first consecutive annual falls since the early 1980s. Demand for industrial metals also contracted in 2008.

The drop in world trade seems to have been amplified by restricted access to trade finance. Possible factors driving this include: retrenchment by banks seeking to repair balance sheets, elevated perceptions of counterparty and country risk, and increased cost of finance. Although there is some evidence that credit restrictions have played a role, considerable uncertainty remains over their importance relative to the broader demand shock. A recent IMF survey of private sector trade credit developments suggested that this had been factor in emerging markets, particularly in Asia. The G20 have moved to address this issue by making available $250 billion of support for trade finance over the next two years, the successful implementation of which will help trade to rebound as global demand recovers. Chapter 4 sets out the UK Government's support for exporters.

THE UK ECONOMY

The Treasury's approach to economic forecasting

B.29 Economic forecasting inevitably involves judgement about uncertain future events and their domestic and international consequences. Given the nature of the global credit shock, the steep and synchronised world downturn, and the scale of the international macroeconomic and financial policy response, all of which have intensified since the 2008 Pre-Budget Report, the judgements on which the Budget 2009 forecast are based are subject to exceptional uncertainty.

Growth cycle approach

B.30 The Treasury's approach to forecasting macroeconomic developments, set out in detail in Budget 2007, accords with the growth cycle approach favoured by many policymakers. The essential building blocks of this approach are the estimates of the 'trend' level and rate of growth of output, and analysis of cyclical movements around that trend, the 'output gap'. The trend output projection provides the medium-term anchor for the forecast on the supply side. The current output gap, and an assessment of the economy's momentum based on analysis of output, income and expenditure components of activity, informs the judgement taken on the demand-side path of the economy back towards trend.

Treatment of uncertainty in the forecast

B.31 The Treasury has in the past adopted two approaches to treating uncertainties in economic forecasts. Firstly, the absolute average forecast errors from past forecasts have always been presented alongside the latest forecasts, as in Table B9 of this chapter. Secondly, uncertainties relating to the world economy and financial markets, the balance of demand and supply, individual components of demand, and policy developments, have been discussed in the text on economic developments and prospects. The Treasury has considered alternative

approaches, described in Box A3 of the 2008 Pre-Budget Report, concluding that a more extensive focus on key judgements, and how prospects may vary, was the most appropriate method of presenting the exceptional uncertainties surrounding forecasts at present. The forecast ranges used to present the economic forecast represent alternative assumptions about the supply-side performance of the economy, not forecast uncertainties. The external forecasts reviewed in more detail at the end of this chapter also give a sense of the magnitude of current forecast uncertainties.

Overview of recent developments

B.32 Since the 2008 Pre-Budget Report, the impact of the financial crisis on the UK and world economies has been more severe than forecast. Despite the decisive interventions of governments in the UK and around the world containing the crisis, its effects on confidence and demand have been far worse than expected.

Credit conditions

B.33 The Bank of England's latest *Credit Conditions Survey*, published on 2 April, reported a slight easing in the availability of credit to companies during the first quarter of 2009, and expectations of further easing in the second quarter. The availability of credit to households continued to tighten, although it was expected to ease in the coming months. The latest Bank of England data show that while effective interest rates paid by households and companies have not fallen by the same amount as some wholesale interest rates, they have declined significantly, with effective rates on:

- all outstanding loans to companies down by 3.2 percentage points since September 2008, to 3.7 per cent;
- secured lending to households down by 1.7 percentage points to 4.1 per cent, driven by a 2.9 percentage point decline for outstanding floating rate mortgages to 3.0 per cent; and
- unsecured personal loans to households lower by 1.3 percentage points at 7.3 per cent.

Credit growth

B.34 The Bank's new *Trends in Lending* report drawing on data collected on behalf on the Lending Panel, and described in Chapter 3, suggests that restricted supply of credit from lenders and weaker demand for credit from borrowers have contributed to a slowing of lending growth. The flow of net lending to UK private non-financial companies has markedly declined from an average of £5¾ billion a month in 2007 to an average repayment of £½ billion in the second half of 2008. However, growth of lending to companies turned positive in January and February 2009, and companies have increasingly returned to capital markets to raise funds, with bond issuance in particular having picked up. Secured lending to households has slowed sharply, in large part reflecting a withdrawal from new lending by specialist lenders and a reduction in the number of higher loan-to-value mortgages. Bank data show that secured lending to households increased by an average of £7¼ billion a month in 2007, which fell to £3½ billion a month in the second half of 2008 and £2¾ billion in the first two months of 2009. Mortgage lenders on average expect an increase in overall credit availability during the coming quarter.

GDP growth

B.35 UK GDP growth has slowed sharply reflecting the cumulative impact of the succession of shocks that hit the global economy during 2007 and 2008. As credit conditions tightened and commodity prices squeezed real incomes, the economy entered recession, contracting 0.7 per cent in the third quarter of 2008. In the final quarter of the year, the intensification of the global financial crisis caused a loss of confidence and further reduction in the availability of credit that led to a sharp 1.6 per cent drop in GDP, in line with falls in activity across advanced

economies, and much greater than that forecast in the 2008 Pre-Budget Report. Overall, GDP and growth slowed from 3 per cent in 2007 to ¾ per cent in 2008.

B.36 Monthly output indicators and private business surveys suggest that the first quarter of 2009 saw a similarly sharp fall in output to that seen at the end of 2008. Industrial production fell by 2.7 per cent in January and 1.0 per cent in February, while service sector output was down by 1.3 per cent in the three months to January. On average, the purchasing manager surveys compiled by the Chartered Institute of Purchasing and Supply indicate some slowing in the rate of decline of activity during the first quarter of 2009, though the surveys remain at historically very low levels. The preliminary ONS estimate for GDP growth in the first quarter will not be published until Friday 24 April.

Inflation

B.37 Consumer price inflation peaked at 5.2 per cent in September 2008. As commodity prices have fallen, inflation has eased in line with the Pre-Budget Report forecast. CPI inflation was 2.9 per cent in March, while RPI inflation was -0.4 per cent. The unusually large difference between these two measures mainly reflects the impact of monetary policy easing on the cost of servicing mortgages, with the mortgage interest payment component of RPI inflation falling more than 40 per cent on a year earlier.

B.38 Within CPI inflation, the price of petrol and the first effects of recently announced cuts in household energy bills have subtracted from overall inflation. Food price inflation has eased from its peak last summer, but remained high, partly reflecting the impact of sterling depreciation on the cost of imported food products.[4] Goods prices excluding food and energy fell by 3.7 per cent in the year to December, and have since risen, but still registered an annual fall of 1.5 per cent in March. Services price inflation peaked in December 2008, and has since eased to 3.9 per cent.

Nominal demand growth

B.39 With inflation easing and real GDP contracting sharply, growth of money GDP – the value of final goods and services produced across the economy – has slowed significantly. In 2008, money GDP grew by 3 per cent, the smallest increase in the post-war period, with the economy contracting in nominal terms in the third and fourth quarters. The biggest contributor to the downturn in nominal demand was investment, particularly in dwellings where the price and volume of investment have both fallen sharply.

Labour market developments

B.40 As the economy turned down through 2008, and companies' finances came under pressure, the labour market weakened. Unemployment has increased relatively sharply, particularly in recent months. While the employment rate has fallen over the past year, the impact of the downturn on the level of total employment has been more muted than that on full-time employee jobs. The Workforce Jobs Survey points to manufacturing, distribution and business services as the sectors where the number of jobs has fallen most. By contrast, employment in the education, health and social work sectors continues to grow. Economic inactivity has remained broadly stable, and has continued to fall once growth in the number of students is taken into account.

B.41 Average earnings growth has slowed over the past year, particularly measures that include bonus payments. The experimental Average Weekly Earnings data point to a very sharp fall in earnings in the financial sector, which were down 27 per cent on a year earlier in January 2009 due to a 53 per cent fall in average bonus payments.

Property markets

B.42 The impact of the credit shock on the UK's property markets remains severe, with residential and commercial property prices continuing to fall and activity in both markets reaching historically low levels. House prices, according to the main lenders' indices, have

[4] At the producer level, the price of imported meat products increased by 18 per cent in the year to March 2009 and imported fruit and vegetables by 33 per cent.

fallen by around 20 per cent since peaking in late 2007, while commercial property prices have declined by more than 40 per cent. The volume of property transactions has fallen by around two thirds over the same period. Mortgage approvals in February 2009 were 11,000 up from their low of 27,000 in November 2008, but remain at historically low levels, down 93,000 from their November 2006 peak.

Sterling

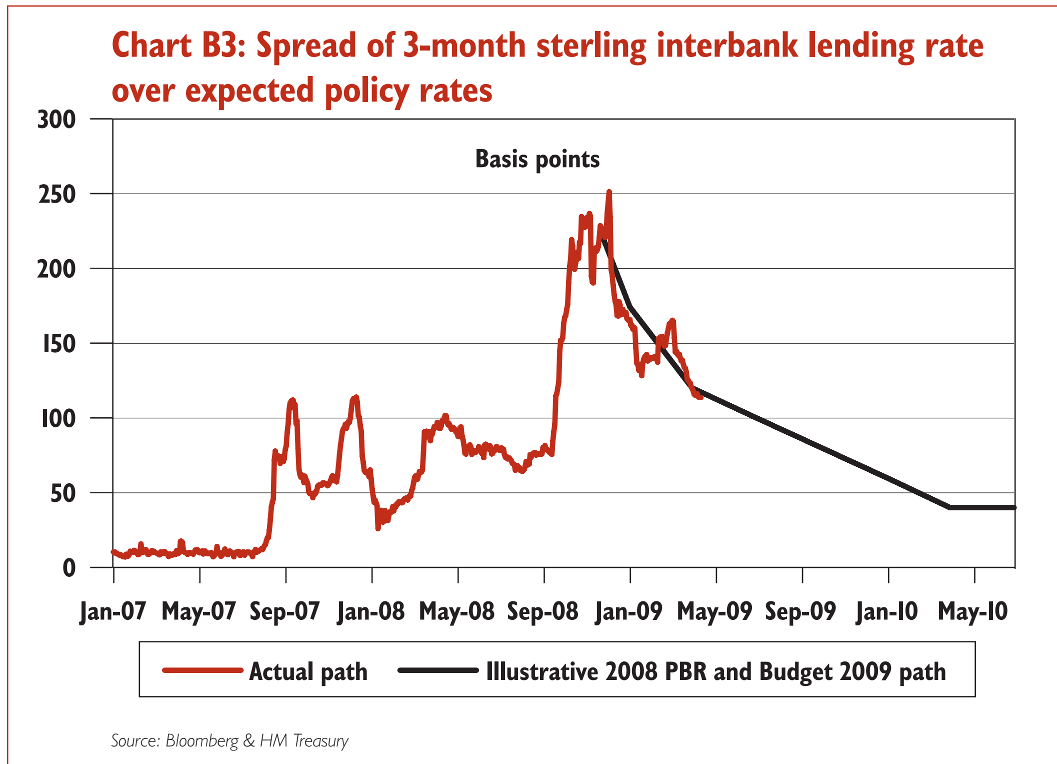
B.43 Since the disruption to global financial markets began in July 2007, sterling has depreciated by around 25 per cent in effective terms. That depreciation has been associated with a wide range of factors, including monetary easing, disruption in the financial sector, downward revisions to UK growth prospects, and higher risk premia demanded on sterling assets.

Prospects for credit conditions

Forecasting judgement

B.44 The 2008 Pre-Budget Report forecast was conditioned on the assumption that credit conditions would ease slowly through 2009 and stabilise in 2010. This forecasting judgement was illustrated using the spread between interbank lending rates and expected policy rates, noting that this measure can capture only the price dimension of factors influencing credit conditions, and in illiquid markets is likely to be an imperfect indicator of that dimension. For example, sterling corporate bond spreads, another indicator of the price of credit for companies, have not followed the same path since the Pre-Budget Report, with corporate bond yields having typically fallen by less than government bond yields, increasing the spread.

B.45 Since the Pre-Budget Report, further action to address problems in the financial system, described in Chapter 3, has delivered further easing of interbank lending spreads, consistent with the Pre-Budget Report assumption. In addition, the latest Bank of England *Credit Conditions Survey* points to the expectation among lenders that credit conditions will ease in the coming three months, again consistent with the Pre-Budget Report assumption. The Budget 2009 economic forecast is therefore conditioned on an unchanged assumption that credit conditions will ease slowly through 2009 and stabilise in 2010 at a level where risk is more appropriately priced. The forecast assumes that the Government's interventions to improve the flow of credit in the economy ensure that a sufficient volume of credit will be available to support economic recovery.



Assessment of trend growth

B.46 This section sets out the revised Budget 2009 forecast assumptions on trend output, which build on the judgement taken at the 2008 Pre-Budget Report that the global credit shock would lead to a permanent loss of trend output of around 4 per cent by mid-2009. This was highlighted as a key forecasting judgement around which there was very considerable uncertainty, and which would be kept under review.

Global credit shock and trend output

B.47 The 2008 Pre-Budget Report noted that there are a number of ways in which the global credit shock could affect trend output, including the effect of a higher cost of credit on the level of capital and the impact of a reduction in the supply of credit on the efficient allocation of resources.[5] Box B4 draws on a range of external commentary and analysis, much of which has been published since the Pre-Budget Report, that has provided further evidence to inform the Treasury's approach.

[5] See Box A4 of the 2008 Pre-Budget Report.

Box B4: Analysis of recent economic shocks and the supply-side

Box A4 of the 2008 Pre-Budget Report set out a number of ways in which the global credit shock might affect the prospects for trend output. In particular, increases in risk premia are likely to increase the cost of capital. As set out in OECD analysis,[a] this is likely to bring about a downward adjustment in the stock of capital in the economy, and so a reduction in the capital to labour ratio, reducing the level of trend productivity.

The potential impact of the global credit shock on the sustainable level of the capital stock has been identified by a number of external commentators. In its latest *Economic Review*, the National Institute for Economic and Social Research (NIESR) suggest that "*The recent downturn has been associated with a rise in risk premia and hence a reduction in the equilibrium capital stock… In gauging the long-run sustainable level of output, we have to estimate how much the equilibrium capital stock will change*".[b] NIESR estimate that the increase in risk premia may reduce the level of sustainable output by around 2 per cent. Similarly, the European Commission has noted that "*both the increase in the capital cost and a tightening of credit to private households is expected to have a medium-run effect on the capital stock*".[c]

More generally, a reduced supply of credit is likely to impair the pivotal role that the financial system plays in intermediating funds from savers to investors and spreading concentrations of risk. Recent OECD analysis notes that the financial market shock could adversely affect trend productivity through "*impairing the efficient allocation of capital*".[d]

In addition, financial sector employment, earnings and profits are expected to fall as a result of the global financial crisis. While the sector is expected to resume stronger growth, it is likely to make up a smaller share of the economy for the foreseeable future, reducing its contribution to whole economy productivity. In particular, to the extent that the financial sector has generally observed higher than average levels of measured productivity, a reduction in the relative size of the sector will have implications for the level of trend productivity as resources are reallocated to other sectors. Recent estimates produced by NIESR[e] suggest that the adjustment of the financial sector may reduce the sustainable level of whole economy output by around 2 per cent.

[a] *The implications of supply-side uncertainties for economic policy*, OECD Economic Outlook No.83, June 2008.
[b] *Prospects for the UK Economy*, Kirby, S., Barrell, R. and Pillonca, V. in NIESR Economic Review Vol.207, January 2009.
[c] Economic Forecast, European Commission, Autumn 2008.
[d] *The Macroeconomic Consequences of Banking Crises in OECD Countries*, Haugh, D., Olivaud, P. and Turner, D., OECD Working Paper No.683, March 2009.
[e] *Commentary: Growth prospects and financial services*, Weale, M. in NIESR Economic Review Vol.207, January 2009.

B.48 For the 2008 Pre-Budget Report, a phased reduction in the level of trend productivity, and therefore the level of trend output, of 4 per cent was assumed. Since then, it has become clear that the impact of the global financial crisis on economic activity has been more severe than expected, which could have further implications for trend output. In particular, it is likely that the effects of the financial market shock on trend productivity, as set out in Box B4, have intensified relative to the assessment set out in the 2008 Pre-Budget Report, suggesting that a somewhat larger adjustment to trend productivity would be appropriate.

Trend population growth

B.49 The Pre-Budget Report also noted uncertainties around prospects for trend population growth related to prospects for net migration. While recent outturns have been somewhat above the assumption of 190,000 a year set out by the Treasury alongside the 2006 Pre-Budget Report, a sharper recession may be associated with significantly weaker net migration over the next few years. Net migration into the UK has typically fallen following previous recessions, and while estimates for net migration in 2008 are not yet available, recent administrative data relating to

National Insurance applications from overseas nationals and applications to the Worker Registration Scheme from A8 citizens[6] point to a slowdown in gross inflows during 2008.

B.50 It is unclear whether such a reduction would be indicative of cyclical or more structural factors, but, while net migration flows are likely to recover over the medium term, it is unlikely that they would fully offset the reduction in the trend population level brought about by weaker net inflows in the shorter term. Accordingly, the Treasury has adjusted down the population component of trend output by around ½ per cent over the three years between mid-2007 and mid-2010. This adjustment brings the Treasury's net migration assumption for this period broadly into line with the average level of net migration underpinning the ONS 2006-based low migration variant population projection,[7] and is consistent with recent estimates of the impact of a weaker outlook for economic activity on net inflows.[8]

Forecasting judgement

B.51 Table B2 sets out the Treasury's Budget 2009 projection for trend output. Taken together, the projections for the underlying trend output components imply a downward adjustment to the trend level of output of around 5 per cent between mid-2007 and mid-2010, a period broadly consistent with the credit conditions assumption that underpins the economic forecast more generally. This judgement is subject to considerable uncertainty, and will be kept under review. Beyond this period of adjustment, trend growth is projected to continue at 2¾ per cent a year, as the capacity of the flexible and open UK economy to reallocate resources and grow from this reduced level of trend output remains intact.

B.52 This adjustment is within the range of external estimates of the impact of the global credit shock on medium-term potential output. In the Institute for Fiscal Studies' Green Budget, it stated "*the credit crunch will reduce the productive potential of the economy by about 4 per cent*", noting that "*there are upside risks too. In particular, there may be positive supply-side responses to the shocks, which would reduce the loss of productive potential*".[9] Recent analysis by NIESR suggests that the shock may have reduced the level of trend output in the UK by around 4 per cent, taking into account both the impact on sustainable output of higher risk premia and the adjustment of the financial sector.[10] Research by the OECD suggests that the shock may have reduced trend output by around 3 to 6 per cent in the euro area and 1½ to 2 per cent in the US,[11] although it is not clear the extent to which the authorities in these countries have taken into account the impact on the supply-side.[12]

[6] The 'A8' refers to the eight Central and Eastern European countries – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia – that joined the EU in May 2004 alongside Cyprus and Malta, whose citizens already had the right to work in the UK.

[7] See www.gad.gov.uk. The ONS will publish updated (2008-based) population projections in autumn 2009.

[8] *Projections of migration inflows under alternative scenarios for the UK and world economies*, Department for Communities and Local Government, April 2009.

[9] *The IFS Green Budget*, Institute for Fiscal Studies, January 2009.

[10] *Prospects for the UK Economy,* Kirby, S., Barrell, R. and Pillonca, V., and *Commentary: Growth prospects and financial services,* Weale, M., in NIESR Economic Review Vol.207, January 2009. NIESR estimate that the increase in risk premia may reduce the level of sustainable output by around 2 per cent, while the adjustment of the financial sector may reduce sustainable output by a further 2 per cent.

[11] *The implications of supply-side uncertainties for economic policy*, OECD Economic Outlook No.83, June 2008.

[12] For example, the US administration has maintained an average growth assumption of around 2.7 to 3 per cent over the medium term in forecasts published since 2007. See *Economic Report of the President*, available at http://www.gpoaccess.gov/eop/download.html

Table B2: Contributions to trend output growth[1,2]

	Estimated trend rates of growth, per cent per annum, unless otherwise stated					
	Trend output per hour worked[3,4]		Trend average hours worked[4]	Trend employment rate[4]	Population[5]	**Trend output**
	Underlying	Unadjusted				
	(1)	(2)	(3)	(4)	(5)	(6)
1986Q2 to 1997H1						
Budget 2008	2.12	1.93	–0.11	0.37	0.26	**2.46**
PBR 2008 and Budget 2009	2.13	1.95	–0.11	0.36	0.26	**2.47**
Over the recent past						
1997H1 to 2001Q3						
Budget 2008	2.86	2.61	–0.45	0.49	0.51	**3.17**
PBR 2008 and Budget 2009	3.12	2.87	–0.46	0.50	0.52	**3.45**
2001Q3 to 2006H2						
Budget 2008	2.26	2.21	–0.31	0.09	0.75	**2.76**
PBR 2008 and Budget 2009	2.12	2.07	–0.26	0.11	0.75	**2.68**
Projection[6]						
2006H2 onwards						
Budget 2008	2.25	2.30	–0.25	–0.1	0.8	**2¾**
PBR 2008	2.25	2.30	–0.25	–0.1	0.8	**2¾**
Level effect: 2007Q3 to 2009Q3[7]	*–4*	*–4*	*0*	*0*	*0*	***–4***
Budget 2009[8]	2.25	2.30	–0.25	–0.1	0.8	**2¾**
Level effect: 2007Q3 to 2010Q3[8,9]	*–4½*	*–4½*	*0*	*0*	*–½*	***–5***

[1] Treasury analysis based on judgement that 1986Q2, 1997H1, 2001Q3 and 2006H2 were on-trend points of the output cycle. Figures independently rounded. Trend output growth is estimated as growth of non-oil gross value added between on-trend points for the past, and by projecting components going forward.
Full data definitions and sources are set out in Annex A of 'Trend growth: new evidence and prospects', HM Treasury, December 2006.
[2] Interim projections between Budget 2002 and PBR 2007 are provided in an expanded table in 'Budget 2008: the economy and public finances – supplementary material'.
[3] The underlying trend rate is the unadjusted trend rate adjusted for changes in the employment rate, i.e. assuming the employment rate had remained constant. Column (1) = column (2) + (1-a).column (4), where a is the ratio of new to average worker productivity levels. The figuring is consistent with this ratio being of the order of 50 per cent, informed by econometric evidence and LFS data on relative entry wages.
[4] The decomposition makes allowances for employment and hours worked lagging output. Employment is assumed to lag output by around three quarters, so that on-trend points for employment come three quarters after on-trend points for output, an assumption which can be supported by econometric evidence. Hours are easier to adjust than employment, and the decomposition assumes that average hours worked lag output by just one quarter, though this lag is harder to support by econometric evidence.
[5] UK resident household basis. Population aged 16 and over.
[6] Neutral case assumptions for trend from 2006H2.
[7] Adjustment reflecting a phased reduction to the level of trend output of around 4 per cent between mid-2007 and mid-2009.
[8] Underlying trend assumptions around which the mid-points of the GDP forecast growth ranges from 2006H2 are anchored.
[9] Adjustment reflecting a phased reduction to the level of trend output of around 5 per cent between mid-2007 and mid-2010.

Assessment of the output gap

Latest National Accounts data

B.53 Since the 2008 Pre-Budget Report, minor revisions to ONS estimates of non-oil GVA growth from 2007, and the release of estimates for the final quarter of 2008, indicate that growth slowed to below-trend rates in the first half of 2008, before contracting sharply in the second half of the year. Taken together with the Budget 2009 trend output assumptions, this implies a negative output gap of around 2 per cent had opened up by the end of 2008.

Evidence from the cyclical indicators

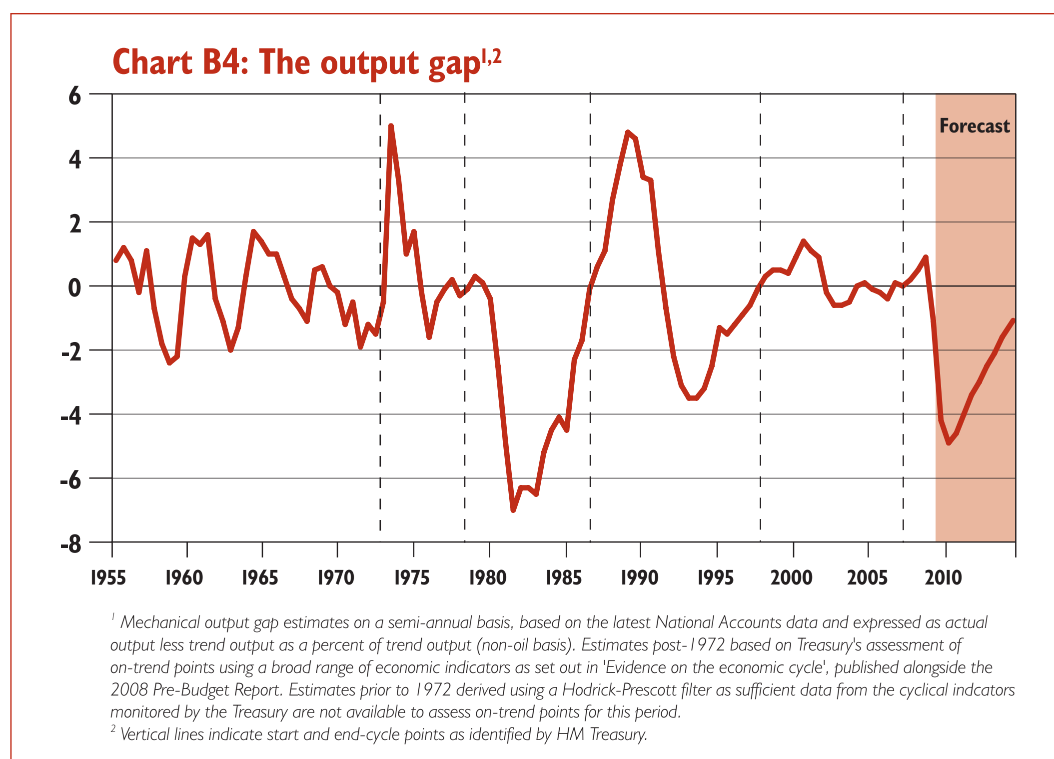
B.54 Given the degree of judgement inherent in the forecasting assumption on trend output, there is a significant degree of uncertainty surrounding the current mechanical estimates of the output gap. Evidence drawn from the cyclical indicators monitored by the Treasury has therefore been used to corroborate the latest assessment of the cyclical position of the economy. The cyclical indicators suggest the economy fell back towards trend during

the first half of 2008 and below trend during the second half of the year, to a degree consistent with the output gap implied by the latest data and Budget 2009 trend output assumptions:

- capacity utilisation indicators from the British Chambers of Commerce moved slightly below their long-term averages by the end of 2008, while those from the Confederation of British Industry (CBI) and the Bank of England's Regional Agents are consistent with a larger degree of spare capacity having opened up. It is possible that survey indicators may currently overstate the degree of spare capacity if companies have yet to adjust expectations of normal levels of operation to the possible impact of the global financial crisis on the wider economy; and

- survey indicators of recruitment conditions reported further falls in the final quarter of 2008, suggesting that a significant degree of slack in the labour market has opened up. The unemployment rate has increased from 5¼ per cent at the end of 2007 to 6¼ per cent at the end of 2008, and has risen further in 2009. Demand for labour has dropped, with the number of vacancies in the economy declining from the peak of almost 700,000 in early 2008 to below 500,000.

Chart B4: The output gap[1,2]



[1] Mechanical output gap estimates on a semi-annual basis, based on the latest National Accounts data and expressed as actual output less trend output as a percent of trend output (non-oil basis). Estimates post-1972 based on Treasury's assessment of on-trend points using a broad range of economic indicators as set out in 'Evidence on the economic cycle', published alongside the 2008 Pre-Budget Report. Estimates prior to 1972 derived using a Hodrick-Prescott filter as sufficient data from the cyclical indcators monitored by the Treasury are not available to assess on-trend points for this period.

[2] Vertical lines indicate start and end-cycle points as identified by HM Treasury.

GDP forecast

Macroeconomic stimulus

B.55 Since the global financial crisis hit, and in light of the range of evidence that has built since the Pre-Budget Report of its severe impact on the economy, the Bank of England has cut Bank Rate by a total of 4½ percentage points to ½ a per cent, the lowest rate in the 315-year history of the Bank. As set out in Chapter 2, with Bank Rate approaching zero, the Government authorised the use of a new instrument by the Bank, to provide further monetary policy support to the economy and ensure that the Government's 2 per cent inflation target can be met. This allows the Bank to influence the quantity of money in the economy through the purchase of government debt and private sector assets. In March, the Monetary Policy Committee initiated a three-month programme to purchase £75 billion of assets. Public sector

net borrowing has also increased significantly to provide support for the economy through discretionary fiscal action and the full operation of the automatic stabilisers. From 2.4 per cent of GDP in 2007-08, public sector net borrowing increased to 6.3 per cent of GDP in 2008-09, cushioning the economy from the impact of a similarly large downward adjustment to private sector borrowing.

Forecasting judgement

B.56 The Budget 2009 economic forecast reflects the balance of key forecasting considerations relating to the strength of the negative effect of the global financial crisis and private sector retrenchment, and the positive effect of large-scale macroeconomic support, both domestically and internationally, on growth. The effects of lower commodity prices and sterling depreciation will further support demand. The forecast is also underpinned by the assumption that G20 authorities deliver on policy commitments and that they are effective, so that the world economy is forecast to grow by 2½ per cent in 2010, picking up further to 4¼ per cent in 2011.

B.57 In the near term, the negative effects of the steep downturn in global and domestic demand will dominate, with prospects for 2009 revised down substantially since the 2008 Pre-Budget Report. The forecast is based on the judgement that the effects of macroeconomic stimulus increasingly to take hold, driving recovery in demand and output in the UK and globally.

Table B3: Summary of UK forecast

			Forecast		
	2007	**2008**	**2009**	**2010**	**2011**
GDP growth (per cent)[1]					
Upper end of forecast range			–3¼	1½	3¾
Economic forecast	**3**	**¾**	**–3½**	**1¼**	**3½**
Forecast underpinning public finance projections			–3¾	1	3¼
CPI inflation (per cent, Q4)	**2**	**4**	**1**	**1**	**2¼**

[1] *See footnote to Table B9 for explanation of different growth assumptions.*

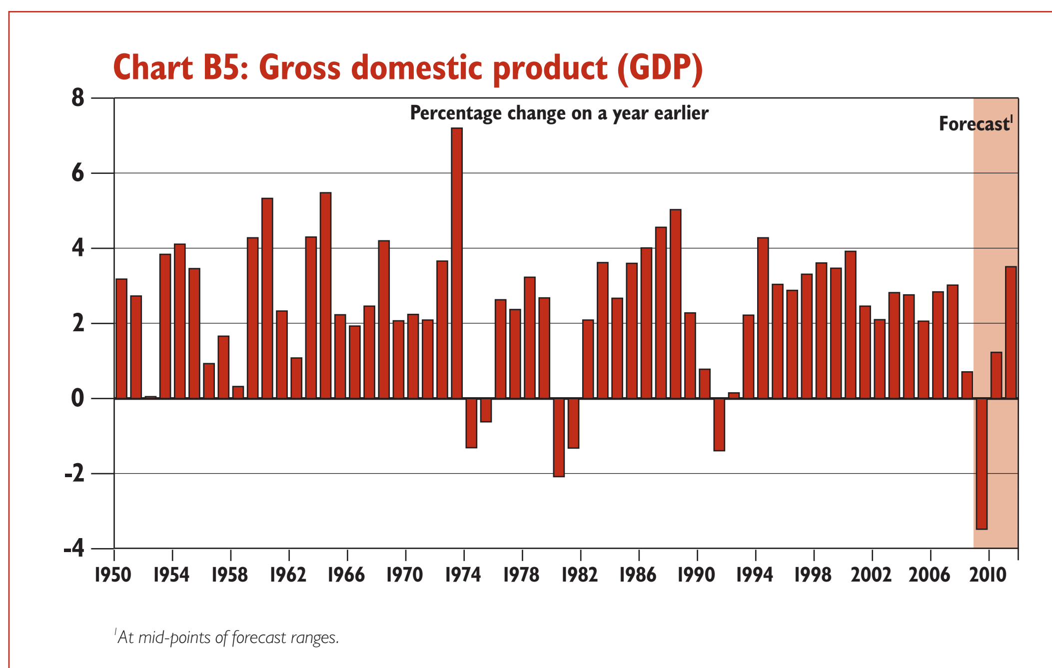
GDP growth

B.58 GDP growth slowed to ¾ per cent in 2008, in line with the 2008 Pre-Budget Report forecast, but the contraction of 1.6 per cent in the final quarter was steeper than expected. The Pre-Budget Report forecast was consistent with GDP contracting by around ¾ per cent in the final quarter. With output contracting more sharply than expected at the end of 2008, and private business survey indicators suggesting a similar rate of contraction in the first quarter of 2009, GDP in 2009 as a whole is set to fall sharply. The Budget 2009 economic forecast is for a contraction of 3½ per cent, much worse than the 1 per cent contraction forecast in the Pre-Budget Report.

B.59 The depth of the recession is therefore forecast to be greater than previously expected but, with significant further policy support, both domestically and internationally, the conditions for sustained recovery are judged to be in place. GDP is forecast to contract sharply in the first half of 2009, by 4 per cent on a year earlier, to stabilise in the second half of the year, and then to pick up progressively through 2010 and 2011 as credit conditions normalise and the lagged effects of significant monetary policy support and the depreciation of sterling take hold. For the economic forecast, GDP growth is forecast to pick up to 1¼ per cent in 2010 as a whole, and to above-trend rates of 3½ per cent in 2011.

B.60 The forecast is presented in Table B3 within ½ percentage point ranges, based on alternative assumptions about supply-side performance of the economy. The public finance

projections are based on the lower end of the range, where GDP is forecast to contract by 3¾ per cent in 2009, before recovering to 1 per cent in 2010 and 3¼ per cent in 2011.



Comparison with past recessions

B.61 By comparison with the recessions of the early 1980s and early 1990s, the current downturn is forecast to be much deeper than that of the early 1990s, but not as deep as that of the early 1980s. In total, GDP is forecast to have contracted by 4½ per cent by late 2009, compared with a fall of 6 per cent in the early 1980s and 2½ per cent in the early 1990s.

B.62 Comparing the expected shape of the current recession with past recessions is of limited value without also considering the ways in which the causes of each, and the policy response to them, differ:

- the shocks that caused the current recession hit when the UK economy was judged to be operating close to trend, inflation was close to target and interest rates were below 6 per cent. This contrasts with the late 1970s oil price shock, and the late 1980s overheating domestic economy, which generated high inflation and, because inflation expectations were poorly anchored, high wage inflation. In order to bring inflation under control, interest rates were raised sharply, peaking at 17 per cent in 1980 and 15 per cent in 1990; and

- the degree of macroeconomic stimulus in place at an early stage of the current recession is of a different order of magnitude to that in either the 1980s or 1990s recessions. Compared with the month prior to the first quarter of falling GDP, sterling oil prices are down 50 per cent, Bank Rate has been cut 4½ percentage points and sterling has depreciated by around 16 per cent, each well in excess of the change over the first nine months of the previous two recessions. In addition, the increase in public sector net borrowing has been significantly larger, providing greater support to the economy at a time when the private sector is retrenching.

B.63 The extent of macroeconomic stimulus, and the assumption that this stimulus progressively takes hold during 2009 and 2010, underpins the Budget 2009 forecast for an earlier, more sustained and stronger recovery than seen in the 1980s or 1990s. Experience of those recoveries points to the possibility that recovery can deliver strong growth rates for a

number of years as spare capacity is brought back into productive use. For example, as Chart B5 shows, GDP growth was strong in the five years from 1982 and again in the five years from 1993, averaging 3¼ per cent a year. While there is considerable uncertainty over the extent to which the current downturn will ultimately prove to have been the result of cyclical or structural factors, it is clear that considerable spare capacity is likely to have emerged during the second half of 2008 and 2009.

Inflation forecast

B.64 Inflation will be subject to a number of strong forces over the forecast horizon, with the large negative output gap exerting significant downward pressure on prices and wages, while the lagged effects of sterling's depreciation will put upward pressure on import costs, and monetary policy remains extremely supportive. Very low interest rates are also having a significant impact on the RPI measure of inflation, which includes mortgage interest payments. Given these strong opposing influences, the inflation forecast is subject to significant uncertainty.

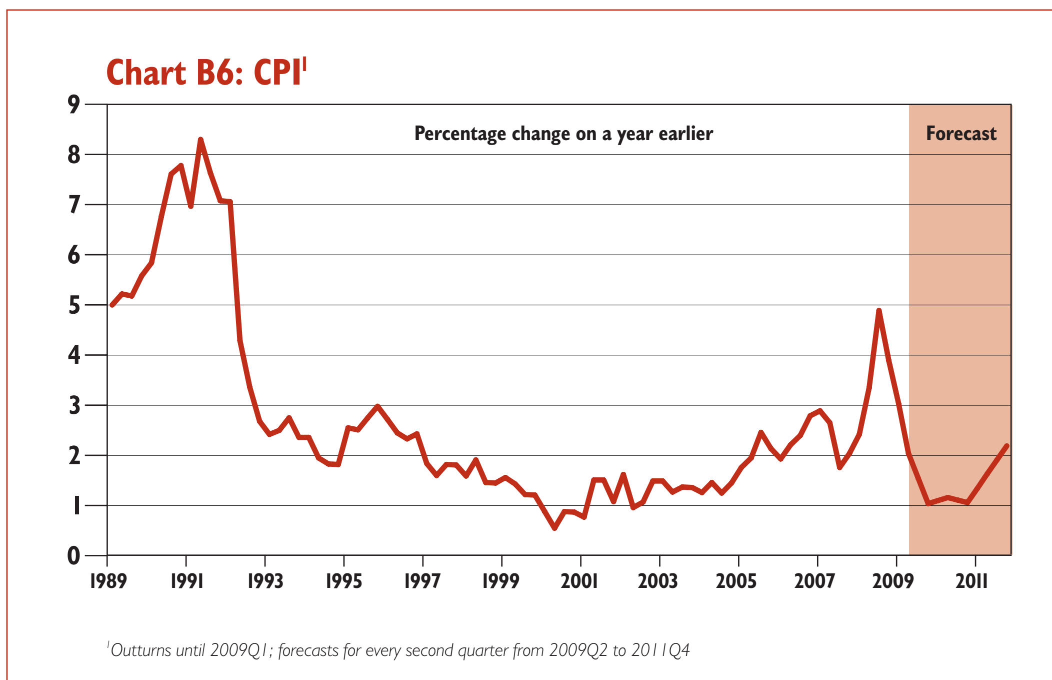
CPI inflation

B.65 CPI inflation is forecast to continue to ease through 2009, moving well below target by the end of the year as the downward pressure from increasing spare capacity and lower energy prices more than offsets upward pressure from the pass-through of higher import prices, and before the lagged effects of recent monetary policy easing fully take hold. Recent evidence suggesting that an increased proportion of companies have decided to freeze pay in 2009 is indicative of the likely impact of spare capacity on inflationary pressure.[13] CPI inflation is projected to pick up slightly through late 2009 and early 2010 as the forecast assumes retailers will smooth the pass-through of the pre-announced return of the VAT rate to 17½ per cent as other cost and demand factors evolve. CPI inflation is forecast to remain below target during 2010 when the negative output gap is forecast to peak, though downward pressure on inflation is countered by monetary policy support further taking hold. CPI inflation is forecast to return close to target during 2011 as the lagged effects of monetary policy easing, described in Box B5, are assumed to have their maximum impact.

RPI inflation

B.66 As well as being subject to the same influences as CPI inflation, the RPI measure of inflation will be subject to additional downward pressures during 2009. Further declines in house prices and the lagged feed-through from Bank Rate to mortgage rates will put downward pressure on the measures of housing depreciation and mortgage interest payments included in the RPI. As a result, RPI inflation is forecast to fall further, to –3 per cent in September, but to move back above zero in 2010 as these additional downward pressures recede.

[13] The IRS pay databank reported 25 per cent of pay deals recorded for January and February 2009 were pay freezes, considerably higher than the previous full-year peak of 9 per cent in 1993, although it is important to note that historical comparisons based on nominal pay deals will not properly reflect developments in real earnings over time.



[1]Outturns until 2009Q1; forecasts for every second quarter from 2009Q2 to 2011Q4

Box B5: The Asset Purchase Facility and the economic forecast

The Monetary Policy Committee (MPC) of the Bank of England announced on 5 March 2009 that, in addition to setting Bank Rate at ½ per cent, it would start to inject money directly into the economy in order to meet the inflation target. The MPC decided that the Bank should purchase £75 billion worth of assets, including gilts and private sector assets, through the Asset Purchase Facility (described further in Chapter 2).

For the purpose of the economic forecast, it has been necessary to make judgements on the impact of quantitative easing on nominal GDP growth. The MPC stated in the minutes of its March 2009 meeting that the February *Inflation Report* projections "*suggested a shortfall in nominal GDP of at least 5 per cent*". The Budget 2009 forecast adopts the forecasting assumption that the MPC's decision to purchase £75 billion of assets, just over 5 per cent of money GDP in 2008, is successful in raising nominal GDP by approximately that amount over the normal horizon over which monetary policy affects inflation and GDP growth.

These forecast judgements are subject to significant uncertainty given the unconventional nature of the policy. Implicitly, these uncertainties can be disaggregated into three steps between asset purchases by the Bank of England, which will increase the quantity of 'base money', and nominal GDP:

- the extent to which an increase in 'base money', via an increase in commercial banks' reserves at the Bank of England, feed through to broader lending growth, expressed in terms of the 'marginal money multiplier', which will be affected by the Government's direct interventions in the financial system to improve the flow of lending to creditworthy borrowers;
- the extent to which nominal spending in the economy responds to growth in broader measures of credit, expressed in terms of the 'velocity of money'; and
- the speed with which these effects take hold, which could differ from the typical lags between changes in Bank Rate and the rate of inflation and GDP growth.

UK DEMAND AND OUTPUT IN DETAIL

Rebalancing and macroeconomic adjustment

B.67 The tightening of credit conditions facing households and companies, and the depreciation of sterling since mid-2007, provide the conditions for a significant rebalancing of demand in the UK economy. This macroeconomic adjustment is likely to entail increased saving by households, increased investment by companies as they respond to new opportunities, and a rebalancing of domestic and external demand. In the near term, it will involve a significant stock-adjustment cycle in the company sector, and a substantial increase in public sector net borrowing, as set out in Chapters 2 and C, that will have the effect of smoothing the private sector adjustment to a more balanced economy.

B.68 Developments in the second half of 2008 suggest that this adjustment may be taking place at a more rapid pace than expected. Compared with the 2008 Pre-Budget Report forecast, the second half of 2008 saw a slightly larger than expected fall in consumer spending but a slightly smaller than expected fall in investment. Reflecting the downturn in world trade, both exports and imports fell sharply, but imports fell further, beginning to rebalance demand between domestic sources and net exports. In terms of the contributions to growth, the largest difference between the Pre-Budget Report forecast and the latest ONS estimates was in inventory accumulation. Firms have cut inventories substantially, especially in the final quarter, pointing to a relatively swift downward adjustment of production and inventories in the face of falling demand, indicative of a flexible economy responding quickly to changed circumstances.

B.69 Table B4 sets out the contributions to growth through the forecast period. In the near term, there is a significant positive contribution from government spending, both consumption and investment, during 2009 and 2010. In 2011, government gives way to private sector sources of demand, as consumption and business investment pick up. Net exports are forecast to contribute positively throughout the forecast, as the rebalancing of demand between domestic and external sources continues. Over the forecast horizon, the positive contribution to growth from net trade is similar to that seen between 1993 and 1995, a period that also followed a significant sterling depreciation.

Table B4: Contributions[1] to GDP growth[2]

	Percentage points, unless otherwise stated					
	Average			Forecast		
	2000 to 2006	2007	2008	2009	2010	2011
GDP growth, per cent	**2¾**	**3**	**¾**	**–3¾ to –3¼**	**1 to 1½**	**3¼ to 3¾**
Main contributions						
Private consumption	2	2	1	–2	¼	2¼
Business investment	¼	1	0	–1¼	–½	1
Dwellings investment[3]	¼	0	–¼	–½	–¼	¼
Government[4]	¾	½	1	1	¼	–¾
Change in inventories	0	¼	–½	–1	1	0
Net trade	–¼	–¾	¼	½	½	½

[1] *Based on central case. For the purpose of projecting public finances, forecasts are based on the bottom of the GDP forecast range.*
[2] *Components may not sum to total due to rounding and omission of transfer costs of land and existing buildings and the statistical discrepancy.*
[3] *The sum of public corporations and private sector investment in new dwellings and improvement to dwellings.*
[4] *The sum of government consumption and general government investment.*

Households and consumption

B.70 Household consumption is the largest expenditure component of demand, accounting for just over 64 per cent of nominal GDP in 2008. Having trended lower over the preceding five years, the share of nominal consumer spending in total demand increased slightly during 2008 as energy and food prices rose sharply, and tighter credit conditions and demand uncertainty weighed on investment spending.

Table B5: Household sector[1] expenditure and income

	Percentage change on a year earlier, unless otherwise stated					
				Forecast		
	Average 2000 to 2006	2007	2008	2009	2010	2011
Household consumption[2]	3	3	1¼	–3¼ to –2¾	0 to ½	3 to 3½
Real household disposable income	2¾	¼	2¼	–1¼ to –¾	¼ to ¾	2¾ to 3¼
Saving ratio[3] (level, per cent)	4¾	2¼	2	4½	5	5½

[1] *Including non-profit institutions serving households.*
[2] *Chained volume measures.*
[3] *Total household resources less consumption expenditure as a percent of total resources, where total resources comprise households' disposable income plus the increase in their net equity in pension funds.*

Disposable income

B.71 Real disposable income growth picked up from ¼ per cent in 2007 to 2¼ per cent in 2008, which, on current estimates, is significantly above the 2008 Pre-Budget Report forecast. Real income growth was reported to have been particularly strong in the final quarter of 2008. The latest National Accounts data suggest that monetary policy easing, the increased income tax personal allowance, and the automatic stabilisers, have begun to provide significant support for household income as the recession impacts on growth of employment and earnings. Overall, nominal disposable income is estimated to have grown by £14½ billion on a year earlier, of which wages and salaries contributed £4½ billion, lower net interest payments £4½ billion, and the combination of higher net social transfers, both public and private, and lower tax payments £8 billion.[14]

B.72 Real disposable income is forecast to contract in 2009, reflecting the balance of strong upward and downward influences. Monetary and fiscal support, and the operation of the automatic stabilisers, will lift incomes, but will be more than offset by weakness in labour income, particularly in the financial sector. Real income growth is forecast to pick up in 2010 and 2011, as labour income recovers.

Consumer spending

B.73 Consumer spending growth slowed from 3 per cent in 2007 to 1¼ per cent in 2008, slightly below the 2008 Pre-Budget Report forecast. Consumer spending began contracting in the second quarter of the year, and fell ¾ per cent in the second half of 2008 compared with the first half. In volume terms, relatively steep declines were seen in discretionary items such as cars, down 8¾ per cent on a year earlier, furniture and household goods, 5½ per cent, and restaurants and hotels, 2¼ per cent, and in those items where prices had increased most substantially such as food, 2½ per cent, and vehicle fuels, 5 per cent.

Saving ratio

B.74 With consumer spending having declined progressively through 2008, and estimated real income growth picking up, the saving ratio is currently estimated to have risen rapidly from a low of -1¼ per cent in the first quarter to 4¾ per cent by the final quarter of the year. On average, the saving ratio in 2008 was 2 per cent, above the 2008 Pre-Budget Report forecast. As noted in the Pre-Budget Report, estimates of the saving ratio can be revised quite heavily as

[14] The difference between the sum of these three sources of income and the total is largely accounted for by households' gross operating surplus and mixed income, which fell in the year to the final quarter of 2008.

new data on income and spending become available. The pace and extent of the adjustment currently reported are therefore subject to considerable uncertainty.

Prospects **B.75** Consumer spending is forecast to continue contracting in 2009, and by 3 per cent in the year as a whole. With the temporary cut in the standard rate of VAT to be reversed in January 2010, consumers are assumed to bring forward some spending from early 2010 to late 2009 in order to capitalise on lower prices. Consumer spending is therefore forecast to dip early in 2010 before recovering through the year. This forecast recovery is towards the upper end of external forecasts, reflecting a judgement that monetary policy stimulus and support to incomes from discretionary fiscal action and the automatic stabilisers will feed through to a stronger recovery in consumer spending than some forecasters assume. However, in 2010 and 2011, growth of consumer spending is still forecast to be slightly below that of GDP as a whole, reflecting the ongoing rebalancing of domestic demand in the economy as households adjust their finances and increase saving to more sustainable rates. As such, the saving ratio is forecast to pick up further in 2010 before settling close to the average ratio of the past 20 years in 2011.

Housing

House prices **B.76** A range of factors will affect prospects for house prices. In terms of affordability, the 20 per cent decline in prices since late 2007 reported by the main lenders has reduced the ratio of house prices to average incomes while the sharp reduction in interest rates has fed through to lower mortgage interest payments. Total household sector interest payments were only 3.4 per cent of disposable income in the final quarter of 2008, the lowest since at least 1987.[15] However, the availability of credit remains constrained with average deposits made by first-time buyers at historical highs.

B.77 On average, external forecasters expect the adjustment in house prices to continue this year, predicting house prices to be down by 12 per cent on a year earlier by the end of 2009. (Most forecasts refer to the lenders' indices rather than the official CLG measure.) There is a broad range of views over prospects for 2010, with the average independent forecast pointing to house prices stabilising during the year. Consistent with the 2008 Pre-Budget Report assumption, house prices are expected to recover through 2010 and are then assumed to grow at rates slightly above average earnings growth, supported by buyers who have delayed purchases returning to a housing market characterised by restricted supply.

Investment in dwellings **B.78** Dwellings investment grew by 2¾ per cent in 2007 as a whole, reflecting strong growth at the start of the year but declines in activity thereafter. As the availability of mortgage lending tightened through 2008, and expectations of further house price falls formed, dwellings investment contracted sharply through 2008, by 10¾ per cent in the year as a whole, including 4¾ per cent quarterly falls in the third and fourth quarters of the year. With turnover in the housing market particularly weak in 2008, household spending on the costs associated with house purchase – surveyors' fees, estate agents' commissions, etc – fell very sharply, down 46 per cent on a year earlier to the lowest level since 1986. As orders for housing construction continue to fall, dwellings investment is forecast to be particularly weak in 2009 and to contract further into 2010. Despite this significant decline, the adjustment in dwellings investment is forecast to be somewhat smaller than that experienced in the early 1990s recession.

Companies and investment

B.79 On conventional measures, business investment accounts for around 10 per cent of nominal GDP, but its role in the economy extends beyond that, affecting future growth by

[15] Detailed UK National Accounts sectoral income and expenditure data are available from 1987.

raising the amount of physical capital available to each worker with which to produce goods and services. It is a feature of firms' investment spending that it typically exhibits much larger cyclical fluctuations than other components of demand.

Company finances

B.80 Companies can finance investment internally, using the cashflow generated by their operations, or externally, either through bank lending or by issuing equity or debt to investors. Internal sources of finance came under increasing pressure during 2008, with private non-financial corporations' gross operating surplus falling 2 per cent in nominal terms in the second half of the year and bank deposits falling by 6½ per cent between February and December. The flow of lending to companies was on average negative during the second half of the year, while the cost of raising equity or debt finance from financial markets increased significantly. The most recent data for early 2009 show deposit balances and the flow of lending increasing moderately, while corporate bond issuance has increased, although at relatively high spreads over government bond yields.

B.81 The Bank of England's latest *Credit Conditions Survey* suggests that the very tight credit conditions facing companies may be beginning to ease, while effective interest rates on bank lending to companies have fallen. The Bank's Asset Purchase Facility should, over time, help ease the cost of debt finance for companies, particularly larger companies that are able to issue highly-rated securities. While these factors suggest that credit conditions might become less of a constraint on investment and output, the latest surveys from the CBI suggest the negative impact of credit-related factors on activity is currently large.

Business investment

B.82 Following strong growth of almost 10 per cent in 2007, business investment was flat in 2008 as a whole. On current estimates, by the final quarter of 2008 business investment had declined 4½ per cent on a year earlier. The contraction was particularly sharp in the construction and distribution sectors, with negative growth rates of 37 per cent and 11½ per cent respectively. Manufacturing and service sector surveys conducted by the CBI suggest that uncertainty over demand prospects is the key factor holding back investment, while access to external sources of credit and the availability of internal finance have also been material factors.

B.83 In the near term, the positive impact of significant macroeconomic stimulus and Government interventions are expected to be dominated by factors depressing investment, particularly uncertainty over demand prospects. Business investment is forecast to contract by 11¼ per cent in 2009. As policy measures take hold, including the temporary investment incentive, and credit conditions ease, partly through measures to ease access to finance for creditworthy borrowers, investment is forecast to recover through 2010 and to grow strongly in 2011 as companies take advantage of new opportunities in a rebalanced UK economy.

Table B6: Gross fixed capital formation

	Percentage change on a year earlier					
				Forecast		
	Average 2000 to 2006	2007	2008	2009	2010	2011
Whole economy[1]	3¼	6¾	–3	–11¼ to –10¾	–3¼ to –2¾	6¼ to 6¾
of which:						
Business[2,3]	2¼	9¾	0	–11½ to –11	–4¾ to –4¼	9 to 9½
Private dwellings[3]	4½	2¾	–10¾	–19 to –18½	–12¾ to –12¼	8 to 8½
General government[3]	5¼	6½	17¼	1½	2	–16¾

[1] *Includes costs associated with the transfer of ownership of land and existing buildings.*
[2] *Private sector and public corporations' non-residential investment. Includes investment under the Private Finance Initiative.*
[3] *Excludes purchases less sales of land and existing buildings.*

Inventories **B.84** The downturn in activity in the second half of 2008 prompted companies to undertake a significant adjustment in their stock of inventory. On current estimates, inventories were cut by over £4 billion in the final quarter of 2008, and subtracted 1.6 percentage points from GDP growth in the quarter. Reductions in inventories are forecast to subtract 1 percentage point from growth in 2009 as a whole. As GDP growth is affected by changes in inventory accumulation, rather than changes in the stock of inventory, as the rate of stock adjustment slows and inventories are brought to a desired level, inventory adjustment is forecast to contribute positively to GDP growth. Inventories are therefore forecast to contribute 1 percentage point to growth in 2010.

Trade and the balance of payments[16]

B.85 The depreciation of sterling provides the conditions for a rebalancing of domestic and external sources of demand, so that net exports contribute positively to growth. As set out in Box A6 of the 2008 Pre-Budget Report, that rebalancing is likely to be driven by a combination of export competitiveness and import substitution effects, with import substitution expected to dominate while global demand remains weak.

Exports of goods and services **B.86** Export volume growth slowed progressively during 2008 before, in a pattern repeated around the world, contracting sharply in the final quarter. In the year as a whole, the volume of goods and services exports was unchanged on a year earlier. As global trade contracted in the final quarter of the year, the volume of UK exports fell by 3¾ per cent on the previous quarter. Consistent with the global financial crisis having a greater impact on physical goods that require access to credit in order to transport, and with spending on consumer durables and capital equipment falling most sharply, goods exports fell 6¾ per cent while services exports held up. On current estimates, the volume of services exports increased 1 per cent in the final quarter of the year. In value terms, 10 per cent growth of services exports in the final quarter was almost entirely accounted for by a 30 per cent increase in financial services exports, pointing to the possibility of measurement difficulties as the global financial crisis elevated the levels of volatility in financial markets.

B.87 With world trade forecast to contract sharply in 2009, and GDP in the euro area forecast to fall 4¼ per cent, UK export volumes are forecast to decline by 8¾ per cent in the year as a whole. As the world economy recovers in 2010 and 2011, export growth is forecast to pick up. The depreciation of sterling is assumed to allow the UK to gain export market share through the forecast horizon.

Imports of goods and services **B.88** Import volumes declined marginally in 2008 as a whole, by ½ a per cent on a year earlier, reflecting small falls in the first three quarters of the year followed by a sharp 5¾ per cent drop in the final quarter. As with exports, goods volumes were hit harder than services. Estimated growth in the value of financial services imports in the final quarter was strong, at 13 per cent on the previous quarter.

B.89 With consumer spending and business investment forecast to contract in 2009 and 2010, the volume of imports is also expected to fall. In line with the recovery in domestic demand, but tempered by the effect of sterling's depreciation on consumers' incentives to substitute domestically produced goods and services for imports, import volumes growth is forecast to pick up through 2010 and 2011.

[16] The volume of exports and imports in the economic forecast abstracts from the effects of activity related to Missing Trader Intra-Community fraud (MTIC), which significantly inflated the value of measured goods trade in early 2006, by making a neutral assumption that the adjustment for MTIC-related activity remains constant throughout the forecast horizon at the latest quarterly estimate, and that trade grows in line with underlying determinants. For a fuller explanation of the effect of MTIC-related activity on trade in recent years, see paragraphs B.76 to B.82 of Budget 2008. All figures cited in this section and those reported in Table B7 relate to export and import growth excluding the MTIC adjustment.

Net exports **B.90** Having subtracted from growth through 2007, net exports contributed positively in each quarter of 2008, with the contribution rising to 0.7 percentage points in the final quarter. In the year as a whole, net exports accounted for a ¼ percentage point of overall GDP growth of ¾ per cent. In 2009, with imports forecast to contract more sharply than exports, net trade is forecast to add ½ percentage point to GDP growth. Further ahead, the depreciation of sterling is expected to support a rebalancing between domestic and external demand as the UK and world economies recover, with net trade continuing to contribute positively to growth in 2010 and 2011.

Table B7: Trade in goods and services

	Percentage points, unless otherwise stated					
				Forecast		
	Average 2000 to 2006	2007	2008	2009	2010	2011
Volumes (excluding MTIC)[1]						
Exports	4¾	1½	0	–8¾ to –8½	¾ to 1¼	4¾ to 5¼
Imports	5½	3¾	–½	–9¼ to –9	–¾ to –¼	2¼ to 2¾
Prices[2]						
Exports	1	2½	12¾	2¼	1¼	2½
Imports	1	1	11¼	5	4	2¾
Terms of trade[3]	0	1½	1¼	–2½	–2½	–¼
Goods and service balance (£ billion)	–30¾	–47¼	–44	–49½	–56¼	–49¾

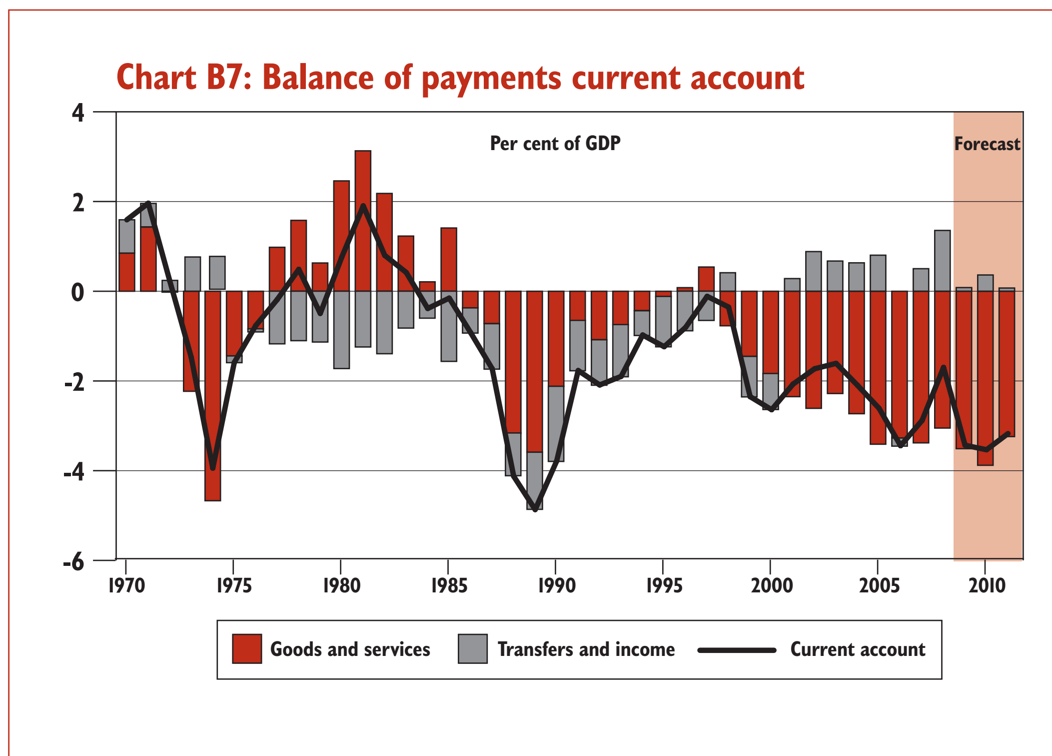
[1] *Table B9 contains figures including the effects of MTIC-related activity. The forecast is therefore based on the neutral assumption that the level of MTIC-related activity stays flat at the latest quarterly estimate throughout the forecast.*

[2] *Average value indices.*

[3] *Ratio of export to import prices.*

Current account balance **B.91** On current estimates, the UK's current account deficit narrowed from 3½ per cent of GDP in 2006 and 3 per cent in 2007 to 1¾ per cent in 2008. Much of the improvement reflected flows related to the financial services industry, adding considerable uncertainty to the underlying trend in the current account balance. For example, while the deficit on trade in goods remained stable at 6½ per cent of GDP, the services trade surplus increased from 3 per cent to 3½ per cent of GDP due to the rapid growth of financial services exports. The income surplus increased by ¾ percentage points to 2¼ per cent of GDP due to a large increase in the foreign direct investment (FDI) income surplus to 4½ per cent that was partially offset by the balance on portfolio investment earnings turning negative. Measured flows of FDI-related earnings have been affected by the large losses incurred by the world's financial institutions reducing the cross-border flow of repatriated profits. Between the second quarter of 2007, before the credit shock hit, and the final quarter of 2008, FDI-related credits fell from 6½ per cent of GDP to 2¼ per cent while FDI-related debits fell from 3¾ per cent of GDP to -½ per cent, the first aggregate loss on record, driven by losses made by foreign banks and securities dealers operating in the UK.

B.92 As temporary factors related to the financial crisis recede, the income surplus is likely to decline and so the current account deficit is forecast to increase to 3½ per cent of GDP again in 2009. Beyond 2010, the deficit is forecast to narrow reflecting the balance of domestic demand in the UK and globally, supported by the lagged import substitution and export competitiveness effects of sterling depreciation.



Foreign direct investment **B.93** Inward and outward flows of FDI to the UK declined substantially in 2008, particularly in the second half of the year as the global credit shock intensified. Comparable figures for the world are not yet available, but are likely to be dominated by cross-border investment flows related to capital raised by financial institutions. For example, FDI flows to the US increased by 37 per cent in 2008, with all of this growth accounted for by increased flows to the financial sector. Relative to GDP, the UK continues to be home to the largest stock of FDI among G7 economies, and to have the largest outward stock of FDI assets. Sterling's depreciation has increased the sterling value of the UK's overseas assets, narrowing the UK's net international liability position to less than 5 per cent of GDP, down from 21 per cent a year earlier and the lowest level since 1996.

Output sectors

Services **B.94** The services sector grew by 1½ per cent in 2008 as a whole, having slowed progressively since mid-2007 and contracted in the second half of 2008. By the final quarter of 2008, services output was ½ per cent down on a year earlier, though there was contrasting performance across different sub-sectors. With credit availability and lack of confidence constraining the purchase of consumer durables, output fell by 17 per cent on a year earlier in the motor trades sector[17] and by 10 per cent in wholesale distribution. The broad 'other business services' sector also contracted sharply. By contrast, retail distribution output remained 3 per cent up on a year earlier, while on current estimates financial intermediation grew by 3½ per cent.

Construction **B.95** Construction output has been hit by the adjustment in the residential and commercial property markets. The sector grew by a ¼ per cent in 2008 as a whole, but output was down 5¾ per cent on a year earlier by the final quarter. The breakdown between types of construction work shows that the falls were concentrated in private industrial, commercial and residential new building, with repair and maintenance work declining by less. Private sector construction orders remained subdued in the first two months of 2009. The bringing forward of public

[17] The motor trades sector comprises services related to motor vehicles, including sales, maintenance and repair, and the sale of petrol and diesel. The sector accounted for around 2 per cent of nominal GVA in 2007.

investment spending into 2009-10 should provide some offsetting demand for the construction sector in the near term, while medium-term prospects should benefit from the forecast recovery in business and housing investment described above.

Manufacturing **B.96** Manufacturing output contracted throughout 2008, falling by 2½ per cent in the year as a whole. In common with advanced and emerging economies around the world, UK manufacturers were hit hard by the loss of confidence and steep falls in world trade in recent months. Manufacturing output fell by 5 per cent in the final quarter of 2008 and a further 3¾ per cent in the first two months of 2009. In line with a broad range of indicators across countries, the decline in manufacturing output in the UK over the past year illustrates the effects of weak confidence and restricted credit on demand for major items. While manufacturing output as a whole was down 14 per cent on a year earlier by February 2009, production of capital equipment was down 17 per cent and consumer durables 21 per cent. Government interventions in the UK and globally to restore the flow of credit in the economy, and to support trade finance in particular, should bolster the manufacturing sector. As such, while manufacturing is forecast to fall by 12½ per cent in 2009 as a whole, output is forecast to recover in 2010. This is in line with the April 2009 CBI forecast for a 12 per cent fall in 2009, recovering to ½ per cent growth in 2010.

Independent forecasts

B.97 Since the 2008 Pre-Budget Report, the average of independent forecasts for GDP growth in 2009 has been revised down significantly, from –0.9 per cent to –3.4 per cent, in line with the Budget 2009 forecast range. The average has now fallen by more than 5 percentage points since Budget 2008. A comparison of prominent forecasts published around the time of the Pre-Budget Report and more recently illustrates the extent to which the steep downturn of recent months, and its implications for growth in 2009 as a whole, has taken all forecasters by surprise:

- in the November 2008 *Inflation Report* the Bank of England mean forecast was for GDP growth of around –1.3 per cent in 2009 and 1.7 per cent in 2010; in the February 2009 *Inflation Forecast* the mean forecast was revised down to around –3.7 per cent in 2009 and 1.0 per cent in 2010;[18]
- the OECD's November 2008 *Economic Outlook* forecast GDP would contract by 1.1 per cent in 2009; the March 2009 *Economic Outlook Interim Update* forecast a contraction of 3.7 per cent;
- in their *Economic & Business Outlook* for November 2008, the CBI forecast a contraction of 1.7 per cent in 2009; the April 2009 forecast is for a 3.9 per cent contraction;
- the Ernst & Young Item Club Autumn 2008 forecast, published in October, was for a 1.0 per cent contraction in 2009; the Spring 2009 forecast, published in April, is for a fall of 3.5 per cent; and
- since last November, among City forecasters included in the Treasury's *Comparison of independent forecasts*, Goldman Sachs have revised their 2009 GDP growth forecast down from –0.4 to –2.6 per cent; HSBC from –1.7 to –3.8 per cent; Citigroup from –1.6 to –4.5 per cent; and Deutsche Bank from –0.5 to –4.0 per cent.

[18] Based on market interest rates. Forecasts based on the Bank of England's estimates of past growth and derived from the four-quarter growth rates published on the Bank of England's website.

B.98 The average independent forecast for GDP growth in 2010 has also been revised down, to 0.3 per cent from 1.2 per cent at the time of the Pre-Budget Report. These changes have been driven by large downward revisions to the outlook for investment and private consumption. While the majority of independent forecasters expect positive growth next year, around a third forecast GDP to contract for a second consecutive year in 2010. Different forecasts will reflect different weights being placed on the drag to growth from private sector retrenchment and the global downturn, and the boost to growth from macroeconomic policy, lower commodity prices and the depreciation of sterling. Different forecasters are also likely to predicate their forecasts on different paths for the normalisation of credit conditions.

B.99 The contrast between individual independent forecasts illustrates the range of views held. For example, compared with the Budget 2009 forecast, Goldman Sachs forecast a milder recession in 2009 and a somewhat stronger rebound in 2010, of 1.5 per cent. By contrast, Citigroup forecast a deeper downturn in 2009, followed by a slower medium-term recovery. The OECD's recent forecast for 2009 is within the Budget forecast range, but they forecast a slower recovery in 2010, with GDP expected to fall 0.2 per cent. This is just a snapshot of external views and, like all forecasters, these institutions will be constantly reviewing economic developments.

B.100 Inflation has eased since the Pre-Budget Report and forecasts for CPI inflation in the final quarter of 2009 average 0.7 per cent, implying further falls to come. Few forecasters expect CPI inflation to be negative at the end of 2009. CPI inflation is then expected to pick up through 2010 as the economy begins to recover, with the independent average at 1.6 per cent by the end of the year. The broad range of forecasts for 2010, spanning 3.7 percentage points, illustrates the uncertainty surrounding current forecasts. At the same time in 2007, forecasts for CPI inflation at the end of 2008 were in a narrow range of 0.9 percentage points.

Table B8: Budget and independent[1] forecasts

			Percentage change on a year earlier					
			2009			2010		
		At time of:	Budget 2008	2008 PBR	**Budget 2009**	Budget 2008	2008 PBR	**Budget 2009**
GDP	**HM Treasury**		2¼ to 2¾	–1¼ to –¾	**–3¾ to –3¼**	2½ to 3	1½ to 2	**1 to 1½**
	Independent:	average	1.9	–0.9	**–3.4**	2.6	1.2	**0.3**
		range	–1.3 to 2.7	–2.1 to 0.4	**–4.5 to –1.3**	1.7 to 3.3	–1.0 to 2.6	**–1.2 to 2.5**
CPI (Q4)	**HM Treasury**		2	½	**1**	2	2¼	**1**
	Independent:	average	2.0	1.7	**0.7**	2.1[2]	1.8[2]	**1.6**
		range	1.3 to 3.3	0.7 to 2.6	**–0.8 to 1.8**	1.5 to 3.6[2]	1.2 to 2.6[2]	**0.1 to 3.8**

[1] *Taken from* 'Forecasts for the UK economy: A comparison of independent forecasts', *February 2008, March 2008, November 2008 and April 2009.*

[2] *CPI independent forecasts for 2010 made in 2008 are drawn from the medium-term forecasts and so refer to the annual average rather than Q4.*

SUMMARY OF FORECAST ISSUES AND RISKS

B.101 All economic forecasts remain subject to exceptional uncertainties across a broad range of factors, including the resolution of the global financial crisis and its impact on confidence and activity, and the implementation and effectiveness of the unprecedented global policy response to the downturn. Uncertainties over the way in which factors affecting growth and inflation unfold are compounded by uncertainties over the intensity of their impact. That distinction has been illustrated clearly by the large downward revisions to all forecasts since the time of the Pre-Budget Report, which have typically reflected errors in judging the extent to which the financial crisis would damage confidence and activity, rather than further unanticipated deterioration in financial markets from the crisis conditions of September and October 2008.

World demand and the global policy response

Short-term prospects

B.102 The falls in trade, production and GDP around the world in the final quarter of 2008 were much steeper than expected. Private business survey indicators suggest a similar rate of contraction in the first quarter of 2009, with that rate easing more recently. A key uncertainty over near-term prospects relates to the extent of inventory adjustment taking place in manufacturing and retail sectors, and the extent to which the sharp falls in production have been more, or less, than sufficient to offset the sharp drop in demand. In addition, business surveys, which typically report the breadth rather than depth of output falls, may be less useful as indicators of GDP growth during a period of unusually rapid adjustment.

Global policy response and recovery

B.103 Prospects for recovery in advanced economies are closely linked to the delivery and effectiveness of macroeconomic stimulus. Monetary policy stimulus is largely in place already, but there are uncertainties over the effectiveness of historically low interest rates in encouraging spending when confidence has been severely affected by the global financial crisis. If confidence remains low, consumers may increase saving for precautionary reasons and businesses may continue to cut back investment due to uncertainties over demand; if confidence is quickly restored, supportive financing conditions could deliver a more rapid rebound in spending. A significant proportion of planned global fiscal support is yet to be delivered. The Budget forecast is based on the assumption that it will be delivered as planned, so delays or reversals could represent a risk that the recovery will be weaker or later than forecast. As with monetary policy, there is uncertainty over the effectiveness of stimulus measures, relating to the degree to which they encourage private sector spending. There is also a longer-term risk from the balance of the global recovery.

Global financial system

B.104 Policy interventions by governments and central banks around the world appear to have stabilised financial systems, such that the risk to the wider economy from system-wide banking sector problems has been reduced. However, the global financial system continues to present significant risks to the economic forecast, with the efficacy of macroeconomic policy support depending to an extent on the degree to which increased private sector demand is met by the supply of credit to creditworthy borrowers. The economic forecast is predicated on credit conditions easing through 2009, for which there is only tentative evidence. If this financial crisis leads to a permanent decline in global capital flows, then it would jeopardise past gains from financial globalisation, and prevent a quick recovery of the global economy.

Protectionism

B.105 Protectionism is another risk to global economic prospects and to lifting developing countries out of poverty. As the world downturn deepens and job losses increase, there is a risk that countries retreat to protectionism or trade-distorting subsidies in a counter-productive attempt to support their domestic economies. Further economic cooperation will help to boost trade and investment flows to the benefit of global growth. At the London Summit, the G20 committed not to repeat the historic mistakes of protectionism in previous eras.

UK economy

B.106 In a world downturn precipitated by common global economic shocks, similar uncertainties apply to the UK forecast as to the world forecast: the effectiveness of macroeconomic policy support and interventions to improve the flow of credit to creditworthy borrowers, the degree to which consumer and business confidence can be restored, and uncertainties over the extent of inventory adjustment in the near term. The following paragraphs set out how these general uncertainties, and other risks specific to developments in the UK, relate to the economic forecast.

The Asset Purchase Facility and nominal demand

B.107 As set out in Box B5, the impact of the Asset Purchase Facility on nominal demand represents a key forecast uncertainty. The forecast is based on the judgement that the £75 billion programme of asset purchases will raise money GDP by approximately the same amount and bring inflation back up to target. However, in the absence of historical precedent for advanced economies successfully employing such measures, there are clearly very large uncertainties around this judgement. It is possible that inflation could react sooner or by more than assumed, or that demand for and supply of credit remain weak, limiting the impact of asset purchases on nominal demand.

Bank lending

B.108 While the Bank of England's recent *Credit Conditions Survey* and *Trends in Lending* report suggest credit conditions may be beginning to ease, the capacity of financial institutions to supply sufficient credit to support economic recovery remains an important risk to the forecast. That risk is diminished by the Government's comprehensive interventions to improve the flow of credit to creditworthy borrowers, described in Chapter 3.

Trend output and the cyclical position

B.109 The Budget 2009 forecasting judgement on the impact of the credit shock on trend output is very uncertain. This has implications for assessing the balance between cyclical demand and potential supply, and hence prospective inflationary pressures and the labour market implications of the recession. If the shock has a greater adverse impact than assumed, demand pressures are likely to bite sooner than expected, putting upward pressure on inflation earlier. Conversely, if the shock has had a smaller impact on trend output, then a larger degree of spare capacity will open up as output contracts, placing additional downward pressure on inflation.

Consumer spending and business investment

B.110 The macroeconomic adjustments that have been triggered by the global credit shock have already delivered an increase in the household saving ratio, and a reduction in household consumption and investment in dwellings. The degree to which households will further increase saving to rebuild their finances, and the speed with which any further adjustment takes place, are subject to considerable uncertainty. These uncertainties present risks to the consumer spending and dwellings investment forecasts. Businesses have reduced investment in the face of demand uncertainty so that, despite profits falling in the second half of the year, in aggregate the corporate sector continues to run a surplus. Investment is forecast to fall sharply in 2009 and 2010, before recovering strongly. There are upside and downside risks to this forecast related to the impact of household sector adjustments on demand, the availability of credit and restoration of business confidence.

Trade and sterling

B.111 The depreciation of sterling is expected to support the net export contribution to GDP through import substitution and export competitiveness effects. In the near term, prospects for export growth will be dominated by trends in global demand and will be subject to the uncertainties set out above. As global demand recovers, the extent to which UK exporters are able to maintain market share is uncertain. The availability of credit to finance investment in the production of tradable goods and services represents a key uncertainty.

Interactions between forecast risks

B.112 The interaction between these factors points to the possibility that a more positive or intensifying negative feedback could generate upside or large downside risks to the UK and world economic forecasts. On the upside, the interaction between restored confidence and private sector spending could reinforce the effectiveness of the substantial macroeconomic stimulus already in place, reducing the extent of the recession and the expected losses for financial institutions, thereby easing credit conditions even more quickly than assumed. If this played out across many countries, world trade could rebound very strongly, with positive implications for UK export and GDP growth.

B.113 On the downside, the interaction between restricted access to credit and weakness in private sector spending could further exacerbate the downturn, increasing losses for financial institutions, and so causing further tightening of credit conditions and damage to consumer and business confidence. Again, if a similar pattern was seen across many countries, the impact on UK prospects could be further amplified. Such scenarios illustrate the broad risks around all economic forecasts at present.

Table B9: Summary of economic prospects[1]

	Percentage change on a year earlier, unless otherwise stated						
			Forecast[2,3,4]			Average errors from past forecasts[5]	
	2007	2008	2009	2010	2011	2009	2010
Output at constant market prices							
Gross domestic product (GDP)	3	¾	–3¾ to –3¼	1 to 1½	3¼ to 3¾	¾	¾
Manufacturing output	¼	–2¾	–12¾ to –12¼	¼ to ¾	2 to 2½	1¾	2
Expenditure components of GDP at constant market prices[6]							
Domestic demand	3½	¾	–4 to –3½	½ to 1	2½ to 3	¾	¾
Household consumption[7]	3	1¼	–3¼ to –2¾	0 to ½	3 to 3½	¾	1
General government consumption	1½	3½	4¾	1	–1¼	1	¾
Fixed investment	6¾	–3	–11¼ to –10¾	–3¼ to –2¾	6¼ to 6¾	2¼	2
Change in inventories[8]	¼	–½	–1	1	0	¼	¼
Exports of goods and services[9]	–4¼	0	–9 to –8½	¾ to 1¼	4¾ to 5¼	2½	4¼
Imports of goods and services[9]	–1½	–½	–9½ to –9	–¾ to –¼	2¼ to 2¾	3	3
Exports of goods and services (excluding MTIC)	4¾	0	–8¾ to –8½	¾ to 1¼	4¾ to 5¼	–	–
Imports of goods and services (excluding MTIC)	5½	–½	–9¼ to –9	–¾ to –¼	2¼ to 2¾	–	–
Balance of payments current account							
£ billion	–40¼	–24½	–48½	–51	–48¾	11¾	9½
Per cent of GDP	–3	–1¾	–3½	–3½	–3¼	¾	¾
Inflation							
CPI (Q4)	2	4	1	1	2¼	½	¾
Producer output prices (Q4)[10]	4	5½	–½	¼	1½	1¼	1¾
GDP deflator at market prices	2¾	2¼	1½	1 ¼	2¼	½	½
Money GDP at market prices							
£ billion	1,401	1,443	1,411 to 1,415	1,443 to 1,454	1,525 to 1,544	12¾	11¼
Percentage change	6	3	–2¼ to –2	2¼ to 2¾	5¾ to 6¼	1	¾

[1] *The forecast is consistent with the quarterly National Accounts and balance of payments data for the fourth quarter of 2008, released by the Office for National Statistics on 27 March 2009. See also footnote 1 on the second page of this chapter.*

[2] *All growth rates in tables throughout this Chapter are rounded to the nearest ¼ percentage point.*

[3] *As in previous Budget and Pre-Budget Reports, the economic forecast is presented in terms of forecast ranges, based on alternative assumptions about the supply-side performance of the economy. The mid-points of the forecast ranges are anchored around the neutral assumption for trend output. The figures at the lower end of the ranges are consistent with the deliberately cautious assumption of trend growth used as the basis for projecting the public finances, which is a ¼ percentage point below the neutral assumption.*

[4] *The size of the growth ranges for GDP components may differ from those for total GDP growth because of rounding and the assumed invariance of the levels of public spending within the forecast ranges.*

[5] *Average absolute errors for current year year-ahead projections made in spring forecasts over the past 10 years. The average errors for the current account are calculated as a per cent of GDP, with £ billion figures calculated by scaling the errors by forecast money GDP in 2009 and 2010. CPI average derived from past five years only.*

[6] *Further detail on the expenditure components of GDP is given in Table B10.*

[7] *Includes households and non-profit institutions serving households.*

[8] *Contribution to GDP growth, percentage points.*

[9] *Figures up to and including 2008 are distorted by MTIC.*

[10] *Excluding excise duties.*

Table B10: Gross domestic product and its components

	£ billion chained volume measures at market prices, seasonally adjusted									
	Household consumption[1]	General government consumption	Fixed investment	Change in inventories	Domestic demand[2]	Exports of goods and services	Total final expenditure	*Less* imports of goods and services	*Plus* statistical discrepancy[3]	GDP at market prices
2007	819.2	252.5	226.5	6.4	1305.1	350.7	1655.8	391.1	1.6	1266.3
2008	830.3	261.2	219.5	1.0	1313.3	350.9	1664.2	388.9	0.0	1275.3
2009	804.1 to 806.5	273.4	195.1 to 195.7	–10.8 to –10.0	1261.7 to 1265.6	319.8 to 320.7	1581.5 to 1586.3	352.4 to 353.5	–0.3	1228.8 to 1232.5
2010	804.6 to 811.0	276.4	189.0 to 190.5	–0.4 to 1.8	1269.5 to 1279.6	322.2 to 324.8	1591.8 to 1604.4	350.1 to 352.9	–0.3	1241.4 to 1251.2
2011	829.0 to 839.6	272.6	200.6 to 203.2	0.2 to 3.7	1302.4 to 1319.1	337.7to 342.0	1640.1 to 1661.2	358.1 to 362.8	–0.3	1281.7 to 1298.1
2007 1st half	405.6	125.6	112.2	2.1	645.9	173.2	819.1	191.3	0.8	628.6
2nd half	413.6	126.9	114.2	4.3	659.2	177.5	836.7	199.8	0.8	637.8
2008 1st half	416.9	129.4	111.9	4.1	662.9	177.7	840.6	198.2	0.1	642.5
2nd half	413.4	131.8	107.6	–3.1	650.4	173.2	823.6	190.7	–0.1	632.8
2009 1st half	403.7 to 404.4	135.1	100.5 to 100.7	–7.1 to –6.8	632.2 to 633.4	161.4 to 161.7	793.6 to 795.1	177.8 to 178.1	–0.1	615.7 to 616.9
2nd half	400.4 to 402.1	138.2	94.5 to 94.9	–3.7 to –3.2	629.5 to 632.2	158.3 to 159.0	787.8 to 791.2	174.6 to 175.4	–0.1	613.1 to 615.7
2010 1st half	400.1 to 402.8	138.5	93.6 to 94.2	–0.3 to 0.7	631.9 to 636.1	159.6 to 160.6	791.4 to 796.8	174.6 to 175.8	–0.1	616.7 to 620.9
2nd half	404.5 to 408.2	137.9	95.4 to 96.3	–0.2 to 1.1	637.7 to 643.5	162.7 to 164.2	800.3 to 807.7	175.6 to 177.2	–0.1	624.6 to 630.4
2011 1st half	411.2 to 415.9	137.0	98.6 to 99.7	–0.1 to 1.5	646.6 to 654.1	166.8 to 168.8	813.4 to 822.9	177.8 to 179.9	–0.1	635.5 to 642.9
2nd half	417.8 to 423.7	135.6	102.0 to 103.4	0.3 to 2.2	655.7 to 665.0	170.9 to 173.3	826.6 to 838.3	180.3 to 182.9	–0.1	646.1 to 655.3
	Percentage change on a year earlier[4,5]									
2007	3	1½	6¾	¼	3½	–4¼	1¾	–1½	¼	3
2008	1¼	3½	–3	–½	¾	0	½	–½	–¼	¾
2009	–3¼ to –2¾	4¾	–11¼ to –10¾	–1	–4 to –3½	–9 to –8½	–5 to –4½	–9½ to –9	0	–3¾ to –3¼
2010	0 to ½	1	–3¼ to –2¾	1	½ to 1	¾ to 1¼	¾ to 1¼	–¾ to –¼	0	1 to 1½
2011	3 to 3½	–1¼	6¼ to 6¾	0	2½ to 3	4¾ to 5¼	3 to 3½	2¼ to 2¾	0	3¼ to 3¾

[1] *Includes households and non-profit institutions serving households.*

[2] *Also includes acquisitions less disposals of valuables.*

[3] *Expenditure adjustment.*

[4] *For change in inventories and the statistical discrepancy, changes are expressed as a percent of GDP.*

[5] *Growth ranges for GDP components do not necessarily sum to the ½ percentage point ranges for GDP growth because of rounding and the assumed invariance of the levels of public spending within the forecast ranges.*

C THE PUBLIC FINANCES

The Government's fiscal policy objectives are:

- over the medium term, to ensure sound public finances and that spending and taxation impact fairly within and between generations; and
- over the short term, to support monetary policy and, in particular, to allow the automatic stabilisers to help smooth the path of the economy.

Chapter 2 sets out the action the Government is taking to achieve these goals. This chapter presents more detailed information on the fiscal projections, consistent with the *Code for Fiscal Stability*.

INTRODUCTION

C.1 This chapter explains the latest public finance outturns and the fiscal projections in more detail[1]. It includes:

- five-year projections of the current budget, the cyclically-adjusted current budget, public sector net borrowing (PSNB) and public sector net debt excluding financial sector interventions; and
- detailed analyses of the outlook for government receipts and expenditure.

C.2 As set out in Chapter 2, the Budget presents information on the public finances on three different bases:

- **Including financial sector interventions on a national accounts basis.** These measures reflect the treatment of financial sector interventions as determined by the national accounts, including temporary and exceptional effects from, for example, the inclusion of the balance sheets and operations of banks classified to the public sector.
- **Excluding liabilities and unrealised losses from financial sector interventions.** These measures remove the temporary effects of financial sector interventions on the fiscal aggregates. As losses are realised for central government, and so can be reliably included in the fiscal projections, they will score in these measures.
- **Including unrealised losses on financial sector interventions.** These measures include the anticipated future loss stemming from the Government's financial sector interventions, and so are better measures of the sustainability of the medium term fiscal position than those on the other two measurement bases. They remove the temporary effects of financial sector interventions on the fiscal aggregates.

C.3 The projections set out in this chapter are based on the first two of these bases. The estimate of unrealised losses is not included in these projections, because both the quantum and the timing are uncertain.

[1] For further detail, see *Budget 2009: the economy and public finances – supplementary material* on the Treasury's internet site. This includes tables on public expenditure, sub-sector and economic category analyses, and conventions used in presenting the public finances.

FORECAST ASSUMPTIONS AND RISKS

Key assumptions **C.4** This section sets out the key assumptions on which the fiscal projections are based:

- the economy follows the path described in Chapter B. The fiscal projections continue to be based on the assumption that trend output growth will be ¼ percentage point lower than the Government's neutral view, which is designed to add caution, implying growth of the economy for the public finances projections of -2¾ per cent in 2009-10, 1¾ per cent in 2010-11 and 3¼ per cent in 2011-12;
- there are no tax or spending policy changes beyond those announced in or before this Budget. Rates, thresholds and limits increase in line with projected indexation or announced policy. Consistent with the *Code for Fiscal Stability*, the forecast does not take account of measures proposed in this Budget for consultation or other proposals where final decisions are yet to be taken;
- Departmental Expenditure Limits (DEL) to 2010-11 are adjusted as set out in Chapter 2, in order to help support the economy;
- total Annually Managed Expenditure (AME) programmes to 2010-11 have been forecast consistent with the economic assumptions and policy decisions in this Budget;
- public sector current expenditure is then projected to grow at 0.7 per cent on average in real terms from 2011-12 to 2013-14; and
- net investment is projected to move to 1¼ per cent of GDP in 2013-14.

Table C1: Economic assumptions for the public finance projections

	Percentage changes on previous year unless otherwise specified						
	Outturn	Estimate	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Output (GDP)	3	-1	-2 ¾	1 ¾	3 ¼	3 ¼	3 ¼
Prices							
CPI	2 ¼	3 ¾	1 ¼	1	2	2	2
GDP deflator	2 ¾	2 ½	1	1 ½	2 ½	2 ¾	2 ¾
RPI[1] (September)	4	5	-3	1 ¾	3 ¾	3 ¾	3
Rossi[2] (September)	2 ¼	6 ¼	¼	¾	2 ¼	2 ½	2 ½
Money GDP[3] (£ billion)	1,420	1,439	1,412	1,460	1,548	1,644	1,745

[1] *Used for revalorising excise duties in current year and uprating income tax allowances and bands and certain social security benefits in the following year. Unless a fall is specifically allowed for in statute, tax parameters and benefit levels depending on the negative RPI value for 2009 are assumed to remain unchanged from their previous values.*

[2] *RPI excluding housing costs, used for uprating certain social security benefits.*

[3] *Not seasonally adjusted.*

C.5 The estimates for 2008-09 are based on all available data within the Treasury and other government departments involved in producing tax and spending forecasts. The estimates are consistent with those set out in today's joint Office for National Statistics (ONS) and HM Treasury monthly public sector finances release.

The use of NAO audited assumptions

C.6 The use of assumptions audited by the National Audit Office (NAO) under the three-year rolling review process is designed to add caution into the public finance projections. Details of the audited assumptions are given in Box C1. The trend rate of GDP growth is assumed to be ¼ per cent below the neutral view, which means that the rate of economic growth on which the public finances projections are based is the lower end of the forecast range, as set out in Table C1.

Trend output assumption

C.7 For Budget 2009, the Comptroller and Auditor General has audited the assumption for underlying trend growth used for the purposes of projecting the public finances. His audit incorporated a review of the three changes made to the assumption by the Treasury over the three-year rolling review period.

C.8 The review concluded that the increase in the working-age population growth rate component of the assumption made at the 2006 Pre-Budget Report, to reflect higher projected inward migration, proved to be cautious. On the trend growth assumption itself, he concluded that:

- while the assumption was reasonable in 2006, with hindsight and reflecting the impact of the financial crisis on the economy, the immediate impact of which on trend growth was difficult to judge, the overall trend growth assumption that applied in 2007 and up to the 2008 Pre-Budget Report did not prove to be cautious compared to the latest external estimates of trend growth;
- the new lower assumption for trend output adopted by the Treasury at the 2008 Pre-Budget Report, to reflect the impact of the shock that had occurred and on which sufficient information had by then become available to make a considered change, appears on current information to have been reasonable within the latitudes arising from uncertainties in making estimates of trend growth, though on the basis of his comparisons with the most recent external forecasts and his consultations, there was no longer a clear margin for caution; and
- on the same basis, the revised assumption adopted by the Treasury at Budget 2009, incorporating an additional downward adjustment to reflect the further intensification of the global economic shocks from the time of the 2008 Pre-Budget Report, is reasonable, as well as containing an element of caution.

Cyclical-adjusted methodology

C.9 The Comptroller and Auditor General also audited the Treasury's approach to producing estimates of the public finances adjusted for the effects of the economic cycle (the cyclical-adjustment methodology). He concluded that the Treasury's approach is a reasonable one to adopt, provided that its limitations and the inherent uncertainties in the method are acknowledged transparently, as the Treasury has done in past analyses. He recommended that the Treasury sets out an analysis of the key uncertainties relevant at the time of forecasting rounds, and that as an assurance of the continued reasonableness of its methodology, that the Treasury should periodically examine external estimates of the cyclical adjustment coefficients and publish a broad reconciliation of any differences with its own estimates.

Short-term interest rates

C.10 The Comptroller and Auditor General concluded that the interest rates convention, that forward three-month interest rates will be based on market expectations, resulted in projections for the past three years of the rolling review period that were cautious overall. He concluded that, while projections of interest rates remain uncertain and are likely to be more so in the medium term, the adjustment to the interest rate convention made by the Treasury to account for the disruption in financial markets over the rolling review period is reasonable, and explicitly seeks to maintain an element of caution.

Privatisation proceeds

C.11 The review also concluded that the convention on privatisation proceeds, that only proceeds from announced sales are included in the fiscal projections, had resulted in actual proceeds greater than the level included in the fiscal projections, and that the convention remains a reasonable and cautious approach. No other assumptions were due for review in this Budget.

Forecast differences and risks

C.12 Forecasts of the public finance forecast are always subject to a significant degree of uncertainty. As set out in Chapter B, the scale of the shocks, the downturn in activity and the policy interventions currently at play in the global economy means economic forecasts are subject to exceptional uncertainty. As set out in *Public finances and the cycle*[2], published by HM Treasury at the 2008 Pre-Budget Report, each 1 percentage point lower or higher growth in a year typically leads to a 0.5 percentage point of GDP increase or decrease in PSNB in that year and 0.2 percentage point of GDP in the following year. Another key uncertainty is the outlook for the financial sector, which has been an important source of tax receipts in the UK. To help deal with uncertainty a number of key assumptions underlying the forecast are audited by the NAO and designed to add caution to the forecast. The impact of these assumptions on the forecast is set out in Box C2.

[2] Public finances and the cycle: Treasury Economic Working Paper No.5, HM Treasury, November 2008.

Box C1: Key assumptions audited by the NAO[a]

Trend GDP growth [f]	2½ per cent a year to 2014. A downward adjustment of around 5 per cent has been made to the level of trend output, phased in between mid-2007 and mid-2010, as set out in Chapter B.
Dating of the cycle [e]	The previous economic cycle, which began in the first half of 1997, ended in the second half of 2006.
Composition of GDP [c]	Shares of labour income and profits in national income are broadly constant in the medium term.
Consistency of price indices [b]	Projections of price indices used to project the public finances are consistent with CPI.
Oil prices [e]	$46.7 a barrel in 2009, the average for the three months to 14 April, and then constant in real terms. This is lower than the $48.4 average of independent forecasts for 2009.
Equity prices [b]	FTSE All-share index rises from 2097 (close 17 April) in line with money GDP.
VAT [c]	The underlying VAT gap will rise by 0.5 percentage points per year from the estimated outturn for the current year.
Tobacco [c]	The underlying level of duty paid consumption of cigarettes will be set at least three per cent per year lower than the estimated outturn for the current year.
UK claimant unemployment [d,g]	Projections are based on the average of independent forecasts. Under the convention, the most recent data result in a projection of the UK claimant unemployment rising from recent levels of 1.39 million to 2.09 million at the end of 2009, and to 2.44 million at the end of 2010.
Interest rates [f]	3-month market rates change in line with market expectations (as of 14 April).
Funding [c]	Funding assumptions used to project debt interest are consistent with the forecast level of government borrowing and with financing policy.
Privatisation proceeds [f]	Credit is taken only for proceeds from sales that have been announced.

[a] For details of all NAO audits before the 2006 Pre-Budget Report, see Budget 2006, 22 March 2006 (HC 937).
[b] Audit of Assumptions for the 2006 Pre-Budget Report, 6 December 2006 (HC 125).
[c] Audit of Assumptions for Budget 2007, 21 March 2007 (HC 393).
[d] Audit of Assumptions for Budget 2008, 12 March 2008 (HC 345).
[e] Audit of Assumptions for the 2008 Pre-Budget Report, 24 November 2008 (HC 1150).
[f] Audit of Assumptions for Budget 2009, 22 April 2009 (HC 408).
[g] Seasonally-adjusted UK claimant unemployment. This is a cautious assumption based on the average of external forecasts and is not the Treasury's economic forecast.

FISCAL PROJECTIONS

C.13 Table C2 shows five-year projections for the current budget, cyclically-adjusted current budget, public sector net borrowing and public sector net debt[3]. Outturns and projections of other important measures of the public finances are also shown.

Table C2: Summary of public sector finances

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Fiscal consolidation							
Surplus on current budget	-0.4	-3.6	-9.3	-9.4	-7.2	-5.6	-4.3
Cyclically-adjusted surplus on current budget	-0.7	-3.1	-6.7	-6.4	-4.9	-3.9	-3.2
Consolidation in the cyclically-adjusted surplus on current budget [1]	-	-	-	0.3	1.6	1.0	0.7
Economic impact							
Net investment	2.1	2.6	3.1	2.5	1.9	1.6	1.3
Public sector net borrowing (PSNB)	2.4	6.3	12.4	11.9	9.1	7.2	5.5
Cyclically-adjusted PSNB	2.7	5.7	9.8	8.9	6.8	5.5	4.5
Sustainability							
Public sector net debt[2,3]	36.5	43.0	55.4	65.0	70.9	74.5	76.2
Core debt[2,3]	36.6	42.5	52.4	59.2	63.2	65.7	66.9
Net worth[4]	28.9	25.5	21.1	10.5	4.0	-0.3	-2.9
Primary balance	-0.9	-4.6	-10.8	-9.3	-6.1	-4.1	-2.5
Financing							
Central government net cash requirement	2.3	11.3	15.6	12.3	9.6	7.3	6.0
Public sector net cash requirement[3]	1.5	4.2	13.3	12.3	9.7	7.5	6.0
Stability and Growth Pact							
Treaty deficit[5]	2.8	7.1	12.6	12.0	9.2	7.3	5.8
Cyclically-adjusted Treaty deficit[5]	3.1	6.6	10.0	9.0	6.9	5.7	4.7
Treaty debt ratio[6]	43.2	55.2	71.9	82.1	87.2	89.9	90.7
Memo: Output gap	0.6	-1.3	-4.8	-4.0	-3.0	-2.1	-1.2
Memo: PSND including financial sector interventions	43.1	52.4	64.9	74.2			
Memo: PSNCR including financial sector interventions	1.5	5.8	13.4	12.5			

[1] *Change in the cyclically-adjusted surplus on the previous year.*
[2] *Debt at end March; GDP centred on end March.*
[3] *Excluding liabilities and unrealised losses from financial sector interventions.*
[4] *Estimate at end December; GDP centred on end December.*
[5] *General government net borrowing on a Maastricht basis.*
[6] *General government gross debt measures on a Maastricht basis.*

Current budget

C.14 The Budget projections expect the current budget to remain in deficit throughout the forecast period, peaking at 9.4 per cent of GDP in 2010-11, and then falling to 4.3 per cent by 2013-14. The cyclically-adjusted surplus removes the estimated effects of the economic cycle on the current balance. The cyclically-adjusted deficit is expected to fall from 6.7 per cent in 2009-10 to 3.2 per cent in 2013-14.

Net debt to GDP ratio

C.15 PSND is projected to rise over the forecast period to 76.2 per cent of GDP by 2013-14. The projections for core debt, which excludes the estimated impact of the economic cycle, is expected to rise to 66.9 per cent in 2013-14.

[3] As set out in Chapter 2, the measure of public sector net debt (PSND) used for the assessment of fiscal sustainability excludes the impact of liabilities and unrealised losses from the financial sector interventions. Table C2 also reports on PSND including the impact of these interventions.

Contingent liabilities

C.16 Fiscal aggregates published by the Government, such as net debt and net worth, reflect public sector liabilities that have been accrued in the past and are certain to require future transfers to meet the obligations. In addition, there are provisions or contingent liabilities that may have to be met in the future but where the timing or existence of the liability is not certain, these include, for example, nuclear decommissioning liabilities. The Government considers these types of liabilities in the sustainability analysis published in the *Long-term public finance report*, including most recently in the 2008 report. The report publishes estimates of net liabilities, which include provisions and are based on dry run Whole of Government Accounts (WGA). When WGA are published for the year 2009-10, contingent liabilities will be disclosed as a note to the accounts. However, measures of contingent liability are subject to significant uncertainties, which limits the extent to which they can be used to determine fiscal policy in the short run.

Net worth

C.17 Public sector tangible and financial assets net of financial liabilities can be calculated to provide an estimated measure of net worth. Because capital spending adds to assets and current spending does not, this measure is the approximate stock counterpart of the current budget. On this measure net worth is projected to become negative in the medium term as current borrowing continues. This borrowing reduces net worth, as it is not offset by an increase in the Government's existing assets. As such measures include liabilities accrued to date that will have to be met in the future, but do not take account of future government revenues, the concept of net worth is not comprehensive. Net worth is not used as a key indicator of the public finances, mainly as a result of the difficulties involved in accurately measuring many government assets and liabilities. The estimates of values of tangible assets are subject to wide margins of error because they depend on broad assumptions, for example about asset lives, which may not be appropriate in all cases.

Net investment

C.18 Public sector net investment has increased rapidly in recent years from 1¼ per cent of GDP in 2003-04 to 2.1 per cent of GDP in 2007-08. As a result of decisions taken in this Budget and the 2008 Pre-Budget Report, net investment will increase to 3.1 per cent of GDP in 2009-10 and then move to around 1¼ per cent of GDP in 2013-14.

Public sector net borrowing

C.19 Public sector net borrowing (PSNB) is projected to increase to 12.4 per cent of GDP in 2009-10 from 6.3 per cent in 2008-09. With tax receipts expected to fall further and the automatic stabilisers projected to increase expenditure since the 2008 Pre-Budget Report, PSNB will peak in 2009-10 and then fall each year to 5.5 per cent of GDP in 2013-14 as a result of economic recovery and the Government's action to ensure the sustainability of the public finances.

Financing

C.20 The central government net cash requirement (CGNCR) was 2.3 per cent of GDP in 2007-08 and 11.3 per cent in 2008-09, which is higher than forecast in the 2008 Pre-Budget Report due to higher net investment and lower receipts. The CGNCR is projected to be around 15.6 per cent of GDP in 2009-10 and is expected to fall steadily to 6.0 per cent in 2013-14 as net borrowing falls. The impact on the CGNCR of financial sector interventions is included in Table C15.

Stability and Growth Pact

C.21 Table C2 shows the Treaty measures of debt and deficit used for the purposes of the Excessive Deficit Procedure – Article 104 of the Treaty. The treaty deficit in 2007-08 was 2.8 per cent of GDP. The deficit is expected to peak at 12.6 per cent of GDP in 2009-10 before falling to 5.8 per cent in 2013-14. Treaty debt is forecast to rise from 43.2 per cent of GDP in 2007-08 to 90.7 per cent in 2013-14.

CHANGES TO THE FISCAL BALANCES

C.22 Table C3 compares the latest estimates for the main fiscal balances with those in Budget 2008 and the 2008 Pre-Budget Report.

Table C3: Fiscal balances compared with Budget 2008 and the 2008 Pre-Budget Report

	Outturn[1]	Estimate[2]	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Net borrowing (£ billion)							
Budget 2008	**36.4**	**42.5**	**38**	**32**	**27**	**23**	
Changes to current budget	-1.2	31.6	74	77	65	56	
Changes to net investment	1.4	3.5	5 ½	-4	-5 ½	-8	
2008 Pre-Budget Report	**36.6**	**77.6**	**118**	**105**	**87**	**70**	**54**
Changes to current budget	-1.4	11.1	53 ½	64 ½	57	54	53 ½
Changes to net investment	-0.6	1.2	3 ½	3 ½	-3 ½	-6 ½	-10 ½
Budget 2009	**34.6**	**90.0**	**175**	**173**	**140**	**118**	**97**
Surplus on current budget (£ billion)							
Budget 2008	**-7.9**	**-9.6**	**-4**	**4**	**11**	**18**	
Effect of revisions and forecasting changes	1.2	-23.3	-61	-78	-75	-72	
Effect of discretionary changes[3]	0.0	-8.3	-13	1	10	16	
2008 Pre-Budget Report	**-6.7**	**-41.2**	**-78**	**-73**	**-54**	**-37**	**-21**
Effect of revisions and forecasting changes	1.3	-11.1	-48	-64 ½	-63 ½	-66 ½	-71
Effect of discretionary changes[3]	0.0	0.0	-5 ½	½	7	12 ½	17 ½
Budget 2009	**-5.3**	**-52.3**	**-132**	**-137**	**-111**	**-91**	**-74**
Net investment (£ billion)							
Budget 2008	**28.5**	**32.9**	**35**	**37**	**38**	**41**	
Effect of revisions and forecasting changes	1.4	2.5	2 ½	- ½	-2	-1 ½	
Effect of discretionary changes[3]	0.0	1.0	3 ½	-3 ½	-4	-6 ½	
2008 Pre-Budget Report	**29.9**	**36.5**	**40**	**33**	**33**	**33**	**33**
Effect of revisions and forecasting changes	-0.6	1.2	1 ½	2 ½	-2	-1 ½	-1 ½
Effect of discretionary changes[3]	0.0	0.0	1 ½	1	-1 ½	-5	-9
Budget 2009	**29.3**	**37.7**	**44**	**36**	**29**	**26**	**22**
Cyclically-adjusted surplus on current budget (per cent of GDP)							
Budget 2008	-0.7	-0.5	0.1	0.5	0.8	1.0	
2008 Pre-Budget Report	-0.8	-2.8	-4.4	-3.4	-2.3	-1.6	-1.0
Budget 2009	**-0.7**	**-3.1**	**-6.7**	**-6.4**	**-4.9**	**-3.9**	**-3.2**
Cyclically-adjusted net borrowing (per cent of GDP)							
Budget 2008	2.7	2.7	2.2	1.8	1.5	1.2	
2008 Pre-Budget Report	2.9	5.3	7.2	5.6	4.3	3.5	2.8
Budget 2009	**2.7**	**5.7**	**9.8**	**8.9**	**6.8**	**5.5**	**4.5**
Net debt (per cent of GDP)[4]							
Budget 2008	37.1	38.5	39.4	39.8	39.7	39.3	
2008 Pre-Budget Report	36.3	41.2	48.2	52.9	55.6	57.1	57.4
Budget 2009	**36.5**	**43.0**	**55.4**	**65.0**	**70.9**	**74.5**	**76.2**

Note - Totals may not sum due to rounding.

[1] *The 2007-08 figures were estimates in Budget 2008.*

[2] *The 2008-09 figures were projections in Budget 2008.*

[3] *Including changes to forecasting assumptions on spending growth in 2011-12 and 2012-13.*

[4] *Debt at end March; GDP centred on end March; excluding liabilities and unrealised losses from financial sector interventions.*

Changes to 2007-08

C.23 The outturn for the current budget in 2007-08 shows a deficit of £5.3 billion, £2.7 billion lower deficit than expected at Budget 2008. The changes since Budget 2008 largely reflect revisions following reclassification of some central and local government expenditure from current to capital expenditure, which was partly offset by downward revisions to current receipts. The 2007-08 outturn for net borrowing is £1.9 billion lower than the Budget 2008 estimate, slightly less than the fall in the current deficit, due to the revised increase in capital expenditure.

Changes to 2008-09

C.24 The outturn for the current deficit in 2008-09 is higher than forecast in the 2008 Pre-Budget Report due primarily to weaker than expected receipts driven by the deterioration in the economy. In particular receipts from income tax, VAT and corporation tax have been lower than expected at the Pre-Budget Report due to lower than expected nominal wages, consumption and profits growth, and due to greater use of the support for business offered by the Government's time-to-pay facility. The impact of the 2008 Pre-Budget Report fiscal stimulus increased the current deficit in 2008-09 by £8.3 billion. Net borrowing in 2008-09 is expected to be £12 billion above the 2008 Pre-Budget Report forecast, driven by the higher current budget deficit and by higher net investment. As a result of increased borrowing, PSND for 2008-09 is forecast to be 43.0 per cent of GDP, 1.8 per cent of GDP higher than the 2008 Pre-Budget Report forecast and 4.5 per cent higher than the Budget 2008 forecast.

Changes from 2009-10

C.25 The current budget deficit has been revised up in all years in the forecast period from 2009-10, with a peak deficit of 9.3 per cent of GDP in 2010-11, a difference of 4.7 per cent of GDP since the 2008 Pre-Budget Report forecast, as the sharp downturn in 2009 drives further falls in receipts and higher spending, in particular on social security, and further borrowing to fund targeted support for the economy. Net borrowing is forecast to peak in 2009-10 at £175 billion, which is £57 billion above the 2008 Pre-Budget Report forecast. Net borrowing in 2009-10 is expected to be 12.4 per cent of GDP, of which, the Government is delivering fiscal support worth 4.0 per cent of GDP through discretionary support and the automatic stabilisers. In total, borrowing for capital investment accounts for 3.1 per cent of GDP in 2009-10.

C.26 Net borrowing falls to 5.5 per cent of GDP by the end of the forecast period, reflecting the action the Government is taking to ensure the sustainability of the public finances over the medium term, including through fiscal support, as shown in Table C3. PSND increases over the forecast period, particularly in 2009-10 and 2010-11, as additional borrowing is reflected in these years, and then begins to stabilise at 76.2 per cent by the end of the forecast period.

BUDGET POLICY DECISIONS

C.27 Consistent with the requirements of the *Code for Fiscal Stability*, the updated projections take into account the fiscal effects of all firm decisions announced in this Budget or since the 2008 Pre-Budget Report. The fiscal impacts of these measures are set out in Chapter A.

C.28 Expenditure measures affecting AME and DEL in 2009-10 and 2010-11 have been added to total AME and total DEL, respectively.

C.29 Consistent with the *Code for Fiscal Stability*, the projections do not take account of decisions where the impact cannot yet be quantified or of measures where consultation is proposed in this Budget, or where final decisions have yet to be taken.

FISCAL AGGREGATES

C.30 Tables C4 and C5 provide more detail on the projections for the current and capital budgets.

Table C4: Current and capital budgets

	£ billion						
	Outturn	Estimate			Projections		
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Current budget							
Current receipts	548.0	530.7	496	528	577	620	662
Current expenditure	535.6	564.5	608	645	666	689	712
Depreciation	17.8	18.6	20	21	22	23	24
Surplus on current budget	**-5.3**	**-52.3**	**-132**	**-137**	**-111**	**-91**	**-74**
Capital budget							
Gross investment[1]	47.1	56.2	63	57	51	49	46
Less depreciation	-17.8	-18.6	-20	-21	-22	-23	-24
Net investment	29.3	37.7	44	36	29	26	22
Net borrowing	**34.6**	**90.0**	**175**	**173**	**140**	**118**	**97**
Public sector net debt - end year[2]	**526.8**	**609.1**	**792**	**977**	**1130**	**1262**	**1370**
Memos:							
Treaty deficit[3]	39.4	102.7	178	175	142	120	100
Treaty debt[4]	613.9	794.0	1014	1199	1351	1478	1582

[1] *Net of asset sales; for a breakdown see Table 2.3 in Budget 2009: the economy and public finances - supplementary material.*
[2] *Debt at end March; excluding liabilities and unrealised losses from financial sector interventions.*
[3] *General government net borrowing on a Maastricht basis.*
[4] *General government gross debt on a Maastricht basis.*

Table C5: Current and capital budgets

	Per cent of GDP						
	Outturn	Estimate			Projections		
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Current budget							
Current receipts	38.6	36.9	35.1	36.2	37.2	37.7	37.9
Current expenditure	37.7	39.2	43.1	44.2	43.0	41.9	40.8
Depreciation	1.3	1.3	1.4	1.4	1.4	1.4	1.4
Surplus on current budget	**-0.4**	**-3.6**	**-9.3**	**-9.4**	**-7.2**	**-5.6**	**-4.3**
Capital budget							
Gross investment[1]	3.3	3.9	4.5	3.9	3.3	3.0	2.6
Less depreciation	-1.3	-1.3	-1.4	-1.4	-1.4	-1.4	-1.4
Net investment	2.1	2.6	3.1	2.5	1.9	1.6	1.3
Net borrowing	**2.4**	**6.3**	**12.4**	**11.9**	**9.1**	**7.2**	**5.5**
Public sector net debt - end year[2]	**36.5**	**43.0**	**55.4**	**65.0**	**70.9**	**74.5**	**76.2**
Memos:							
Treaty deficit[3]	2.8	7.1	12.6	12.0	9.2	7.3	5.8
Treaty debt ratio[4]	43.2	55.2	71.9	82.1	87.2	89.9	90.7

[1] *Net of asset sales; for a breakdown see Table 2.3 in Budget 2009: the economy and public finances - supplementary material.*
[2] *Debt at end March; GDP centred on end March; excluding liabilities and unrealised losses on financial sector interventions.*
[3] *General government net borrowing on a Maastricht basis.*
[4] *General government gross debt on a Maastricht basis.*

C.31 The current budget surplus is equal to public sector current receipts less public sector current expenditure and depreciation. The reasons for changes in receipts and current expenditure are explained in later sections. The current deficit peaks at £137 billion in 2010-11 due to the impact of the downturn on the public finances and as a result of discretionary action to support the economy. The current deficit then declines to £74 billion in 2013-14 as the economy recovers and current expenditure grows at lower rates.

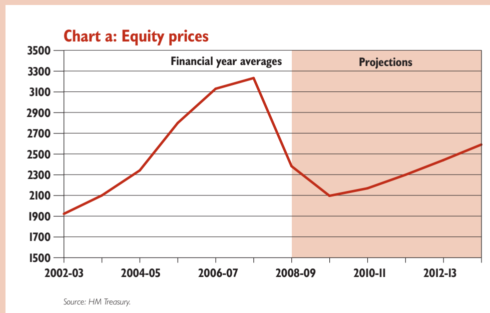
C.32 Table C5 shows that public sector net investment increased from 2.1 per cent of GDP in 2007-08 to 2.6 per cent in 2008-09, and is projected to increase to 3.1 per cent in 2009-10, as the Government brings forward capital spending from 2010-11, as announced in the 2008 Pre-Budget Report. Public sector net investment is then expected to move to around 1¼ per cent of GDP in 2013-14.

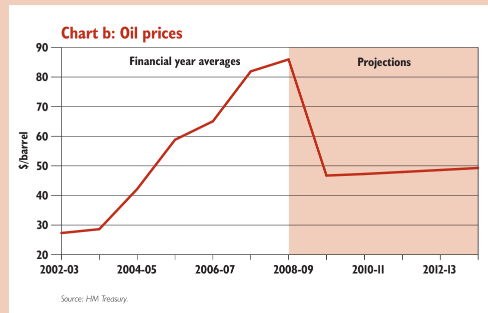
Box C2: Impact of NAO audited assumptions on the fiscal forecast

The National Audit Office (NAO) audited assumptions are designed to add caution to the public finances forecast. Box C1 sets out details of all the NAO assumptions. This box illustrates how three of the assumptions affect the Budget 2009 forecast.

Equity price: The audited assumption is that the FTSE All-share index rises in line with money GDP from its current level. With equity prices falling by over 40 per cent over the past two years, much of this decline has been effectively locked into the public finances projections. By 2013-14, under the assumption equity prices remain over 20 per cent lower than their 2007-08 peak. Equity prices have a direct impact on stamp duty on shares, onshore corporation tax, and with a lag, capital gains tax and inheritance tax and a 1 per cent change in equity prices could change receipts by around £100 million.

Oil price: For Budget 2009 the audited assumption is based on the average price over the past three months, which is then held flat in real terms. The synchronised global downturn has reduced the demand for oil, with an average price over the past three months of $47.6 a barrel. This is a relatively low price compared to those seen in the years of strong global growth between 2005 and 2008. As the world economy picks up and demand for oil recovers the oil price may rise more quickly than suggested by the assumption. Other things equal, a $1 change in oil prices could change North Sea revenues by around £150 million in the first year. There are however a number of offsetting effects from the impact of higher oil prices which would reduce the overall impact on the public finances.





VAT gap: The audited assumption is that the underlying VAT gap (the difference between recorded VAT receipts and the theoretical tax liability) increases by 0.5 percentage points per year from the latest estimated outturn. With firms' cash flows under pressure due to the recession, there has been a rise in VAT debts, pushing up the VAT gap. The forecast allows for a further rise in VAT debt in 2009-10 which would increase the VAT gap by significantly more than the 0.5 percentage points required in the assumption. The higher VAT gap is locked in by the NAO assumption through the medium-term forecast, although with the economy recovering, new VAT debt may stabilise and then fall, which would reduce the VAT gap.

RECEIPTS

C.33 This section analyses the projections for tax receipts in detail. It begins by looking at the main determinants of changes in the overall projections since the 2008 Pre-Budget Report, before looking at changes in the projections of individual tax receipts. Finally, it provides updated forecasts for the tax-GDP ratios.

Changes in total receipts since the 2008 Pre-Budget Report

C.34 The unexpectedly steep downturn in the UK and other advanced economies since the final quarter of 2008 has been reflected in a sharp drop in receipts in the final months of 2008-09. There have also been higher time-to-pay requests to spread tax payments over a longer time frame via HMRC's Business Payment Support Service (BPSS). Net taxes and national insurance contributions (NICs) in 2008-09 were £11.2 billion below the Pre-Budget Report forecast. With the economy expected to contract sharply in the first half of 2009 and to stabilise in the second half of the year, net taxes and NICs are expected to fall by a further 8.0 per cent in 2009-10. Receipts are only expected to be above their 2007-08 peak in 2011-12. This is broadly consistent with the economic forecast for the level of real GDP to recover its early 2008 peak by late 2011.

Impact of the economy on receipts

C.35 The deeper economic downturn in 2009 and the slower rebound in 2010 than forecast in the 2008 Pre-Budget Report means less cumulative real growth over the forecast period to 2013-14. In addition, inflation is expected to be below target for longer than was forecast in the 2008 Pre-Budget Report. This leaves the price level lower throughout the economic forecast. Lower inflation will impact on key tax bases such as nominal consumer spending and earnings growth. In 2013-14, the combination of lower cumulative real growth and lower inflation leaves nominal GDP, which largely comprises the sum of nominal labour income and profits, around 5½ per cent below its 2008 Pre-Budget Report projection.

C.36 Income tax and NICs are around 45 per cent of total receipts. Weaker labour income reduces receipts by around £15 billion in 2011-12, relative to the 2008 Pre-Budget Report forecast. In particular, the level of average earnings is lower throughout the forecast, reflecting that average earnings growth is likely to be subdued in the near-term given low inflation and the opening up of a substantial output gap. Weaker consumer spending takes around £5 billion off receipts by 2011-12, while other GDP effects, such as from lower profits and dividends, reduce receipts by a further £5 billion.

C.37 As in the Pre-Budget Report, the economic forecast assumes a significant rebalancing of demand in the UK economy. With households likely to spend less to increase saving, and sterling having depreciated, the recovery is forecast to include some rebalancing towards investment and net exports. Such a recovery will constrain the medium term upturn in receipts, relative to a consumer-led rebound.

Impact of financial sector on receipts

C.38 Box C3 looks at the impact of the financial and housing sectors on the public finances. The forecast for receipts from the financial and housing sectors was reduced sharply in the 2008 Pre-Budget Report and the Budget forecast has lowered receipts from the sectors further. The forecast allows for weaker financial sector profits in 2009 and then assumes that profit growth averages around 10 per cent over the following four years, rather than the 14 per cent assumed in the Pre-Budget Report. By 2013-14, corporation and income tax from the sector is likely to be around £5 billion lower than previously assumed.

Impact of NAO assumptions on receipts

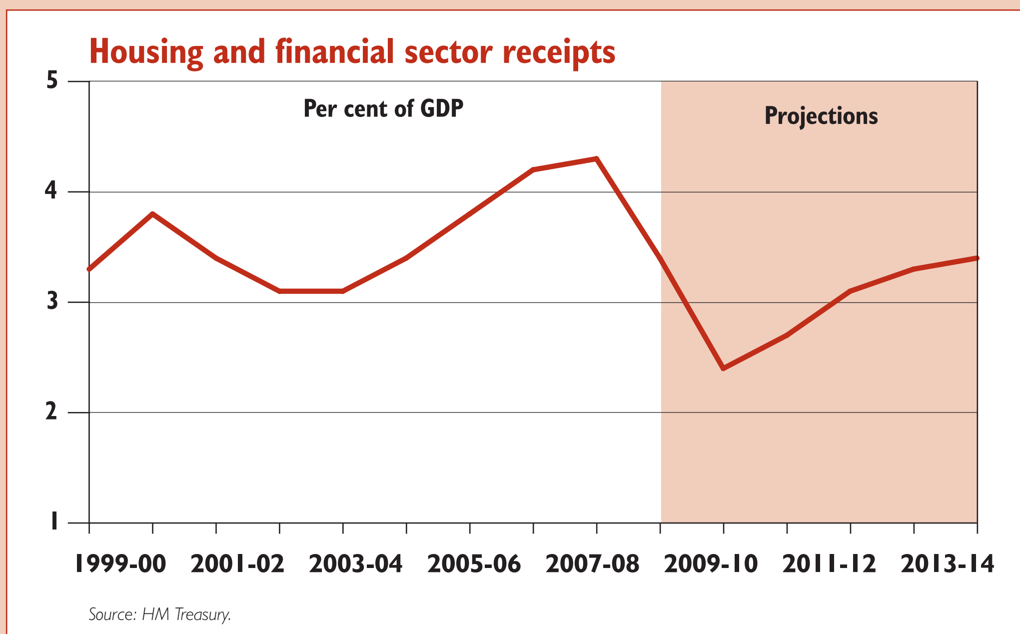
C.39 Box C2 looks at the impact of the NAO audited assumptions on the fiscal forecast. Relative to the Pre-Budget Report forecast, lower oil prices, record low short-term interest rates and a higher VAT gap have all reduced receipts. Oil prices are around $13 a barrel lower throughout the forecast reducing North Sea revenues by around £2 billion per year. Short-term interest rates are based on market expectations. Lower interest rates throughout the forecast than in the Pre-Budget Report take around £2 billion off receipts each year. With the rise in VAT debt pushing up the VAT gap in both 2008-09 and 2009-10 and the higher gap being locked into the medium-term forecast by the NAO audited assumption, VAT receipts are lower by over £4 billion from 2010-11 onwards.

Box C3: The impact of the financial and housing sector on the public finances

The intensification of the credit shock into a financial crisis has particularly affected the financial and housing sectors in the UK, which have typically been significant sources of tax receipts. Financial company corporation tax has accounted for around 25 per cent of overall corporation tax, and the sector provides significant amounts of income tax and NICs on salaries and bonuses. The housing sector provides revenue directly through stamp duty, inheritance tax and capital gains tax and indirectly through the VAT collected on housing-related consumption.

In recent years, the financial and housing sectors saw rapid growth in activity and asset values. This growth was reflected in receipts from taxes linked to the two sectors[a]. In 2002-03, financial and housing sector receipts were equivalent to 3 per cent of GDP. By 2007-08, these receipts had increased to 4¼ per cent of GDP. The rise in housing and financial sector receipts from 2002-03 to 2007-08 accounted for half of the increase in total current receipts over this period.

Receipts from the sectors dropped sharply in 2008-09 and are expected to fall further in 2009-10. Receipts are then expected to recover but the sectors do not recover to the levels of activity, and associated receipts, experienced in 2007-08. With the weaker projections for both financial sector profitability and property markets in the Budget forecast, receipts from the two sectors are predicted to decline to 2½ per cent in 2009-10, before rising to 3¼ per cent of GDP in 2013-14.



Source: HM Treasury.

[a] These revenues include receipts from financial sector corporation tax, financial sector PAYE and NICs, Capital Gains Tax, Inheritance Tax and stamp duties.

Tax by tax analysis

C.40 Table C6 shows the main components of public sector receipts outturn for 2007-08, the estimate for 2008-09 and the projections for 2009-10, as well as the changes to the projections of individual taxes since the 2008 Pre-Budget Report. Table 2.9 in *Budget 2009: the economy and public finances – supplementary material* provides projections of individual taxes up to 2013-14.

Income tax and national insurance contributions

C.41 Cash receipts of income tax and NICs in 2008-09 are expected to be £5.4 billion below their 2008 Pre-Budget Report projection. This includes a shortfall of around £3.3 billion in PAYE and NIC1 receipts and £1.8 billion lower self-assessment receipts. The Pre-Budget Report forecast already allowed for a steep drop in financial sector bonuses and receipts relating to bonuses are likely to be over 50 per cent down on last year. Lower PAYE and NIC1 receipts than expected reflects the deterioration in the labour market and downward pressure on non-bonus earnings growth. The drop in PAYE and NIC1 receipts is most acute in the manufacturing, construction, retail and financial sectors.

C.42 Income tax and NICs receipts are expected to fall by over 4 per cent in 2009-10 from 2008-09 reflecting drops in PAYE and NIC1 receipts, self assessment and tax on savings income. Labour income is expected to fall in 2009-10 due to the weakness in the labour market. The forecast also allows for a further drop in receipts from the financial sector in 2009-10. Self assessment receipts in 2009-10 will relate to 2008-09 liabilities and incomes but are likely to fall given weaker self-employment income, savings and dividend income. The reduction in Bank Rate to a record low is likely to reduce tax on savings income from over £4 billion in 2008-09 to just above £1 billion in 2009-10.

C.43 Income tax and NIC receipts are expected to recover from 2010-11 as the economy picks up. However, with earnings growth more subdued for longer than assumed in the Pre-Budget Report, the level of earnings remains lower throughout the forecast. Consequently, income tax and NICs remain significantly lower than in the Pre-Budget Report.

Non-North Sea corporation tax

C.44 The downturn in the economy and in particular the weakness of the financial sector led to a sharp fall in non-North Sea corporation tax receipts in 2008-09. Receipts from the financial sector fell 32 per cent, while instalment payments from large industrial and commercial companies were down 19 per cent. Non-oil, non-financial profits are expected to decline more sharply than whole economy GDP in 2009 given steeper than expected drops in economic activity both in the UK and other advanced economies. Profits in the financial sector are also expected to remain weak in 2009 with banking losses related to the current downturn potentially rising. Coupled with likely repayments as firms carry back losses against recently paid tax, financial sector corporation tax in 2009-10 is likely to be just 40 per cent of its 2007-08 level.

C.45 As one of the most cyclical taxes, onshore corporation tax receipts are expected to rebound from 2010-11 onwards as both the general economy and the financial sector recover. The forecast incorporates above trend growth in financial sector profits in 2010 and 2011 as the sector recovers from depressed levels, with trend growth in profits thereafter, with profit growth averaging 10 per cent a year over the four year period. Combined with the effect of some firms carrying forward losses against future profits, corporation tax from the financial sector remains below its 2007-08 level, even by 2013-14. With the contribution of the financial sector to overall activity likely to be smaller than envisaged prior to the crisis, onshore corporation tax picks up to 2.5 per cent of GDP by the end of the forecast, well below the recent peak of 2.9 per cent.

Table C6: Current receipts

	£ billion			Changes since PBR 2008 (£ billion)		
	Outturn 2007-08	Estimate 2008-09	Projection 2009-10	Outturn 2007-08	Estimate 2008-09	Projection 2009-10
HM Revenue and Customs						
Income tax (gross of tax credits)	151.8	152.5	140.5	-0.1	-4.2	-10.7
Income tax credits	-4.4	-5.7	-6.2	0.0	-0.1	-0.2
National insurance contributions	100.4	96.4	97.7	0.0	-1.2	-3.1
Value added tax	80.6	78.4	63.7	0.0	-4.1	-8.8
Corporation tax[1]	46.9	43.4	34.7	0.0	-2.1	-7.7
Corporation tax credits[2]	-0.6	-0.6	-0.7	0.0	0.0	0.0
Petroleum revenue tax	1.7	2.6	1.1	0.0	0.0	-0.4
Fuel duties	24.9	24.6	26.6	0.0	-0.4	0.4
Capital gains tax	5.3	7.8	2.2	0.0	2.9	-0.1
Inheritance tax	3.9	2.9	2.3	0.0	-0.2	-0.1
Stamp duties	14.1	8.0	5.0	0.0	-0.3	-1.9
Tobacco duties	8.1	8.2	8.3	0.0	0.0	0.1
Spirits duties	2.4	2.4	2.6	0.0	0.1	0.0
Wine duties	2.6	2.7	2.7	0.0	0.0	-0.2
Beer and cider duties	3.3	3.4	3.4	0.0	0.0	0.1
Betting and gaming duties	1.5	1.5	1.5	0.0	0.0	0.0
Air passenger duty	2.0	1.9	1.8	0.0	-0.1	-0.2
Insurance premium tax	2.3	2.3	2.4	0.0	0.0	-0.1
Landfill tax	0.9	1.0	1.0	0.0	0.1	-0.2
Climate change levy	0.7	0.7	0.7	0.0	0.0	0.0
Aggregates levy	0.3	0.3	0.3	0.0	0.0	0.0
Customs duties and levies	2.5	2.7	2.7	0.0	0.0	-0.1
Total HMRC	**451.1**	**437.4**	**394.2**	**-0.1**	**-9.7**	**-33.3**
Vehicle excise duties	5.4	5.6	5.6	0.0	-0.2	-0.4
Business rates	21.4	22.8	23.8	0.0	-0.6	-0.7
Council tax[3]	23.3	24.3	24.9	0.1	-0.3	-0.8
Other taxes and royalties[4]	14.6	15.3	16.8	0.0	-0.4	0.9
Net taxes and NICs[5]	**515.9**	**505.4**	**465.4**	**0.0**	**-11.2**	**-34.2**
Accruals adjustments on taxes	1.2	-4.4	0.3	0.1	-1.4	-2.2
Less own resources contribution to EC budget	-5.0	-5.2	-4.2	0.0	-0.9	0.6
Less PC corporation tax payments	-0.3	-0.2	-0.2	0.0	0.0	0.0
Tax credits adjustment[6]	0.6	0.6	0.7	0.0	0.0	0.0
Interest and dividends	8.7	7.4	5.6	0.4	-0.3	-2.5
Other receipts[7]	27.0	27.1	28.4	-0.1	-1.0	-1.1
Current receipts	**548.0**	**530.7**	**496.1**	**0.5**	**-14.7**	**-39.4**
Memo:						
North Sea revenues[8]	7.8	12.9	6.9	0.0	-0.3	-1.8

[1] *National Accounts measure, gross of enhanced and payable tax credits.*

[2] *Includes enhanced company tax credits.*

[3] *Council tax increases are determined annually by local authorities, not by the Government. As in previous years, council tax figures are projections based on assumptions and are not Government forecasts.*

[4] *Includes VAT refunds and money paid into the National Lottery Distribution Fund.*

[5] *Includes VAT and 'traditional own resources' contributions to EC budget.*

[6] *Tax credits which are scored as negative tax in the calculation of NTNIC but expenditure in the National Accounts.*

[7] *Includes gross operating surplus, rent and business rate payments by local authorities.*

[8] *Consists of North Sea corporation tax and petroleum revenue tax.*

North Sea revenues

C.46 The surge in oil prices up to mid-2008 is reflected in North Sea revenues of £12.9 billion in 2008-09, up 66 per cent on the previous year. Oil prices averaged almost $100 a barrel in 2008, although the sharp fall in prices in the latter months of last year meant that the final corporation tax instalment payment on 2008 profits made in January was substantially smaller than previous instalment payments.

C.47 North Sea revenues are expected to almost halve in 2009-10. Projections of North Sea revenues for 2009 and beyond use the NAO audited oil price assumption. In line with the average of the past three months' oil price in nominal dollar terms, oil prices are expected to be $46.7 a barrel in 2009, around $13 a barrel lower than assumed at the 2008 Pre-Budget Report. The lower oil price takes around £2 billion off North Sea revenues in 2009-10, compared with the 2008 Pre-Budget Report projection. However, consistent with a weaker oil price, the forecast incorporates a lower level of capital expenditure by North Sea firms than previously assumed. Overall, North Sea revenues are expected to be between £1½ and £2 billion lower than in the Pre-Budget Report throughout the forecast period.

Capital gains tax and inheritance tax

C.48 Receipts from capital gains tax (CGT) in 2008-09 were £2.9 billion higher than projected at the 2008 Pre-Budget Report. CGT paid in 2008-09 relates to gains realised in the previous financial year and higher receipts are due to a number of factors. In part, it is likely to reflect investors making use of the time allowed by the Government for them to rearrange their affairs ahead of the abolition of taper relief, when the CGT regime was reformed in the 2007 Pre-Budget Report.

C.49 CGT is particularly sensitive to equity price changes. This is because financial assets account for two-thirds of chargeable gains and that there is a gearing effect because CGT is charged on the gain rather than the whole disposal price. In addition, many people have leeway on when they realise gains and are less likely to do so in a weak market. With equity prices having fallen by over 40 per cent since their mid-2007 peak, CGT receipts are expected to drop sharply to £2.2 billion in 2009-10 and fall further in 2010-11 to a level last seen after the dotcom-related drop in equity prices. With equity prices assumed to recover in line with nominal GDP growth, CGT receipts start to pick up from 2011-12.

C.50 Inheritance tax receipts dropped sharply by 25 per cent in 2008-09. This is principally due to the impact of the 2007 Pre-Budget Report measure on transferable tax-free allowances for married couples and civil partners. A fall in both equity and house prices is also a factor. With the average of independent forecasts suggesting a further fall in house prices during 2009 and housing accounting for around half of the assets in estates notified for probate, inheritance tax receipts are likely to fall further in 2009-10.

Stamp duties

C.51 Stamp duty land tax (SDLT) fell by nearly a half in 2008-09 from the previous financial year, with stamp duty on shares falling by around a quarter. While both residential and commercial property prices have declined, the key driver of the sharp fall in SDLT is the historically low levels of transactions. The fall in yield on stamp duty on shares reflects both lower prices and trading volumes.

C.52 Stamp duties are expected to fall further in 2009-10. SDLT will be affected by further drops in residential and commercial property prices, while transactions are expected to remain low. Thereafter SDLT recovers with transactions in the property market rising from 2010 onwards and house prices growing broadly in line with their long term average growth rate. With the average equity price in 2009-10 well below the 2008-09 average, stamp duty on shares will fall in 09-10. Thereafter, receipts recover as equity prices are assumed to rise in line with nominal GDP and there is a cyclical recovery in equity volumes.

VAT receipts

C.53 The 2008 Pre-Budget Report forecast that VAT receipts would decline over the remainder of 2008-09, reflecting lower consumer spending and the cut in the standard rate of VAT from 17½ per cent to 15 per cent. However, VAT receipts in recent months have been much weaker than expected and were £4.1 billion lower in 2008-09 than the 2008 Pre-Budget Report forecast. This reflected a smaller VAT tax base, higher time-to-pay requests and a rise in VAT tax debts.

C.54 Like other taxes, VAT receipts have been affected by the much steeper than expected drop in economic activity in the closing months of 2008-09. In addition, the composition of consumer spending, around two-thirds of the total VAT tax base, has moved away from standard-rated goods. The downturn in consumer spending has been most acute for discretionary expenditure on goods and services like meals in restaurants and durable items such as new cars and furniture. Nominal spending on consumer durables (which are mostly standard-rated) fell 10 per cent between the first and final quarters of 2008. In contrast, high food inflation lifted the value of food sales (mainly zero-rated) by 5.4 per cent over the same period. The economic downturn and restrictive credit conditions have put pressure on firms' cash flows and has led to a rise in VAT debts, over and above the effect of some firms using time-to-pay to spread tax payments over a longer time frame. Higher VAT debt growth pushes up the VAT gap (the difference between the theoretical tax liability and actual receipts).

C.55 VAT receipts in 2009-10 are expected to fall by around 19 per cent compared with 2008-09, reflecting both the temporary reduction in the standard rate of VAT to 15 per cent and a continuation of the factors that weakened VAT receipts at the end of 2008-09. Real consumer spending is expected to fall by over 3 per cent in 2009, with spending on consumer durables continuing to drop for much of the year and the forecast allows for a further rise in VAT debt in 2009-10. The forecast also includes a significant provision for additional repayments in 2009-10 and 2010-11 relating to a judicial ruling on the three-year time limit for reclaiming overdeclared or underclaimed VAT for tax periods before May 1997.

C.56 With the VAT rate back at 17½ per cent in 2010-11, a rebound in VAT receipts is forecast. However, growth in the VAT base is held back by consumer spending growing at rates below that of the whole economy, as households continue to adjust their finances. In addition, the NAO audited assumption on the VAT gap locks in the significant increases in the gap in 2008-09 and 2009-10. With the economy recovering, it might be expected that new VAT debt would stabilise and then fall, reducing the VAT gap. However the assumption requires at least a 0.5 percentage point rise in the underlying VAT gap each year.

Excise duties

C.57 Fuel duties in 2008-09 were £0.4 billion below their 2008 Pre-Budget Report projection and were lower than in 2007-08. Since fuel duty is charged on a per litre basis, this reflects a reduction in the demand for fuel. The first half of 2008-09 saw a sharp increase in global oil prices and hence pump prices. The drop in economic activity has also reduced the demand for fuel with nominal consumer spending on vehicle fuels falling 4.6 per cent in the final quarter of 2008. The near-term weakness in the economy will impact on the demand for fuel in 2009-10, although there will be an offset from the sharp drop in pump prices since summer 2008. The forecast incorporates the rise in fuel duties from September 2009 announced in this Budget.

C.58 Alcohol duties in 2008-09 were £0.1 billion above their Pre-Budget Report projection. In 2009-10, the rises in alcohol duties in the 2008 Pre-Budget Report and in this Budget will help to offset the impact from the likely contraction of consumer spending through 2009. Tobacco receipts in 2008-09 were in line with the Pre-Budget Report projection. The forecast for 2009-10 incorporates the decision to raise tobacco duty in this Budget.

Council tax **C.59** Council tax increases are determined annually by local authorities, and not by the Government. The council tax projections are based on stylised assumptions and are not Government forecasts. The projected increase in 2009-10 is based on the estimate released by the Chartered Institute for Public Finance and Accountancy (CIPFA). Increases for later years are based on the arithmetic average of council tax increases over the past three years plus historic base growth. Since changes to council tax are broadly balanced by changes to locally financed expenditure, they have little material impact on the current balance or on net borrowing.

Tax-GDP ratio

C.60 Table C7 shows projections of receipts from the major taxes as a per cent of GDP and Table C8 sets out projections of the overall tax-GDP ratio, based on net taxes and national insurance contributions.

C.61 The tax-GDP ratio dropped by around 1¼ percentage points in 2008-09 and is expected to fall a further 2 percentage points in 2009-10 reflecting the deeper economic downturn, the further decline in receipts from the housing and financial sectors and the temporary reduction in the standard rate of VAT. The tax-GDP ratio falls to just 33 per cent in 2009-10, the lowest since 1994-95. The decline in the tax-GDP ratio between 2009-10 and the last on-trend point in 2006-07 is just over 3 percentage points. In the early 1990s downturn, the tax-GDP ratio fell by a similar amount between 1990-91, when the economy started to move below trend, and 1993-94.

C.62 With the VAT rate returning to 17½ per cent, the tax-GDP ratio starts to rise in 2010-11 and increases further reflecting above-trend growth, a pick up in the financial sector and fiscal consolidation measures from 2011-12 onwards. However, forecasting judgments on the rebalancing of demand in the economy, the receipts take from the financial and housing sectors and the NAO audited assumptions all limit the rise in the tax-GDP ratio from 2010-11 onwards.

Table C7: Current receipts as a proportion of GDP

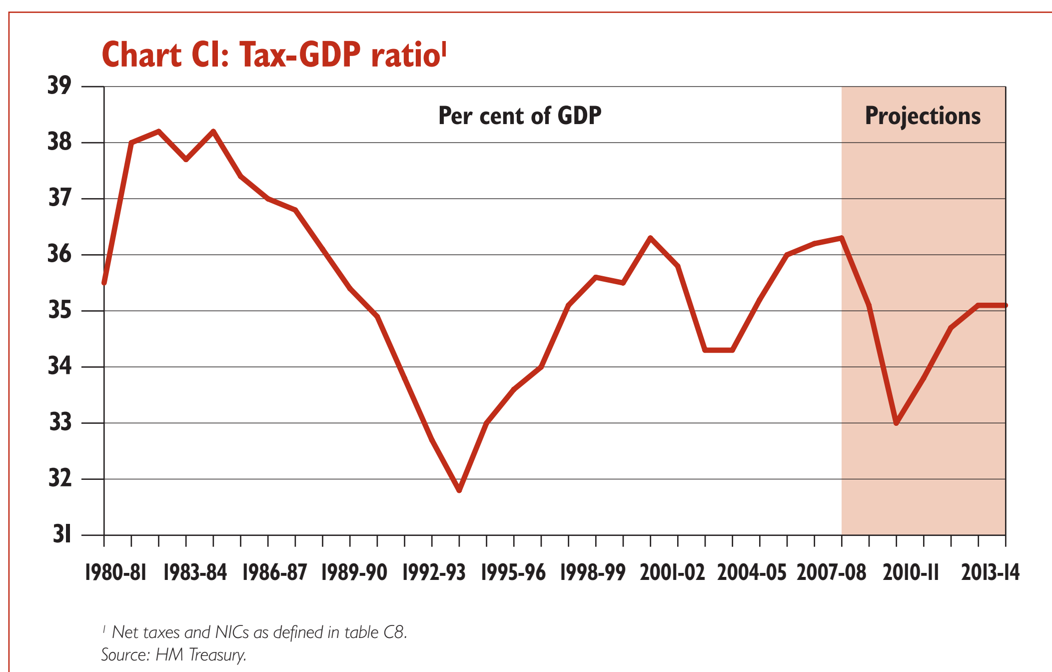
	Per cent of GDP						
	Outturn	Estimate	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Income tax (gross of tax credits)	10.7	10.6	10.0	9.9	10.4	10.8	11.0
National insurance contributions	7.1	6.7	6.9	6.8	7.0	7.1	7.2
Non-North Sea corporation tax[1]	2.9	2.3	2.0	2.3	2.5	2.5	2.5
Tax credits[2]	-0.4	-0.4	-0.5	-0.5	-0.5	-0.4	-0.4
North Sea revenues[3]	0.5	0.9	0.5	0.5	0.4	0.4	0.3
Value added tax	5.7	5.5	4.5	5.0	5.1	5.1	5.0
Excise duties[4]	2.9	2.9	3.1	3.1	3.1	3.0	3.0
Other taxes and royalties[5]	6.9	6.7	6.4	6.6	6.6	6.7	6.7
Net taxes and NICs[6]	**36.3**	**35.1**	**33.0**	**33.8**	**34.7**	**35.1**	**35.3**
Accruals adjustments on taxes	0.1	-0.3	0.0	0.2	0.2	0.3	0.2
Less EU transfers	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3
Other receipts[7]	2.5	2.4	2.4	2.5	2.6	2.6	2.7
Current receipts	**38.6**	**36.9**	**35.1**	**36.2**	**37.2**	**37.7**	**37.9**

[1] *National Accounts measure, gross of enhanced and payable tax credits.*
[2] *Tax credits scored as negative tax in net taxes and national insurance contributions.*
[3] *Includes petroleum revenue tax and North Sea corporation tax.*
[4] *Fuel, alcohol and tobacco duties.*
[5] *Includes council tax and money paid into the National Lottery Distribution Fund, as well as other central government taxes.*
[6] *Includes VAT and 'own resources' contributions to EC budget; cash basis.*
[7] *Mainly gross operating surplus and rent.*

Table C8: Net taxes and national insurance contributions[1]

	Per cent of GDP						
	Outturn[2]	Estimate[3]	Projections				
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Budget 2008	36.8	36.7	36.9	37.3	37.4	37.4	
2008 Pre-Budget Report	36.3	35.3	33.8	34.8	35.4	35.7	36.0
Budget 2009	**36.3**	**35.1**	**33.0**	**33.8**	**34.7**	**35.1**	**35.3**

[1] *Cash basis. Uses OECD definition of tax credits scored as negative tax.*
[2] *The 2007-08 figures were estimates in Budget 2008.*
[3] *The 2008-09 figures were projections in Budget 2008.*



[1] Net taxes and NICs as defined in table C8.
Source: HM Treasury.

PUBLIC EXPENDITURE

C.63 This section looks in detail at the projections for public expenditure. It includes outturn for 2007-08, estimates for 2008-09 and public expenditure plans for 2009-10 to 2010-11. The spending projections cover the whole of the public sector, using the National Accounts aggregate Total Managed Expenditure (TME).

C.64 For fiscal aggregates purposes, TME is split into National Accounts components covering public sector current expenditure, public sector net investment and depreciation. For budgeting and other purposes, TME is split into DEL (firm three-year limits for departments' programme expenditure) and AME (expenditure that is not easily subject to firm multi-year limits). Departments have separate resource budgets, for current and capital expenditure.

C.65 Table C9 sets out projected spending on DEL and the main components of AME to the end of the 2007 Comprehensive Spending Review period in 2010-11. Table C10 shows changes since the 2008 Pre-Budget Report.

Changes in TME since the 2008 Pre-Budget Report

C.66 Estimated outturn information suggests that TME for 2008-09 will be around £2.4 billion lower than in the 2008 Pre-Budget Report. Current expenditure is £3.5 billion lower due to lower departmental spending within current DEL, the receipt of fees associated with financial sector interventions, lower net expenditure transfers to EU institutions, and lower debt interest payments. Public sector net investment was higher by £1.2 billion mainly due to higher net investment by public corporations (PCs), increased by lower receipts from sales of capital assets, including sales of housing from local authority Housing Revenue Accounts, which score as public corporations in the National Accounts.

C.67 The main changes to TME projections in the 2007 Comprehensive Spending Review period since the 2008 Pre-Budget Report are to DEL, where totals for 2009-10 to 2010-11 have been revised as a result of changes to spending announced in this Budget, and changes to the forecasts of individual AME components, again including measures announced in this Budget.

C.68 TME is estimated to be £17.7 billion higher in 2009-10 and £19.9 billion higher in 2010-11 than at the 2008 Pre-Budget Report, mainly due to increases to DELs, and increased spending on social security benefits and tax credits. The reasons for changes in TME are explained in more detail in the paragraphs below on DELs and the individual AME components.

C.69 Chart C2 shows TME as a percentage of GDP from 1970-71 to the end of the 2007 CSR period in 2010-11.

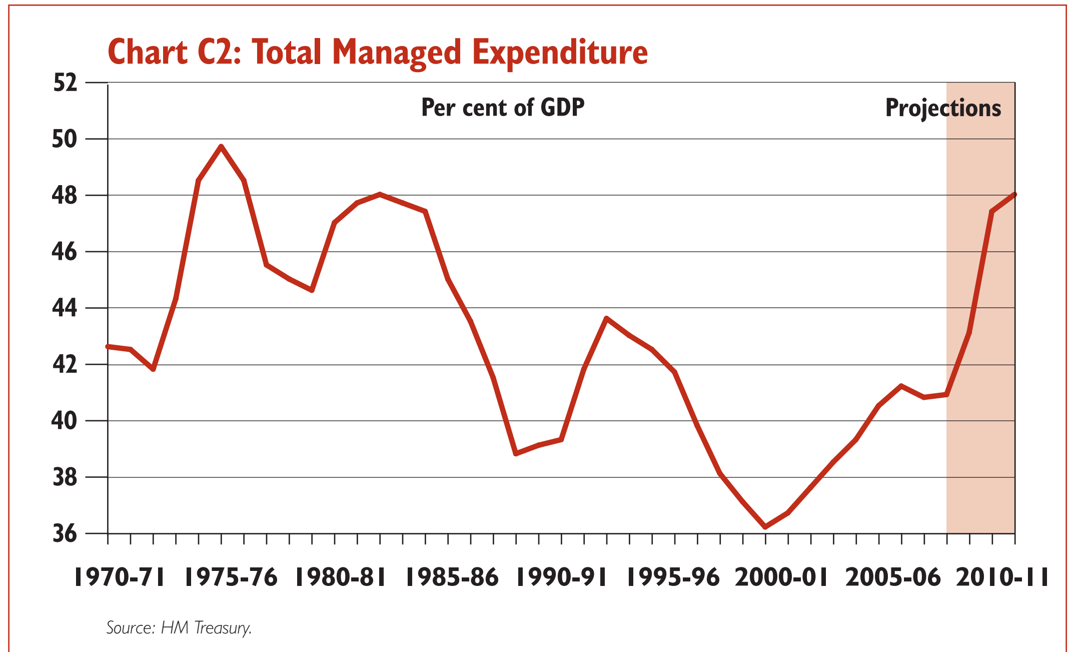


Table C9: Total Managed Expenditure 2007-08 to 2010-11

	£ billion			
	Outturn	Estimate	Projections	
	2007-08	2008-09	2009-10	2010-11
CURRENT EXPENDITURE				
Resource Departmental Expenditure Limits	**309.9**	**324.3**	**342.1**	**352.3**
of which:				
Near-cash Departmental Expenditure Limits	288.4	303.0	319.9	328.8
Non-cash	21.6	21.2	22.3	23.5
Resource Annually Managed Expenditure	**225.7**	**240.2**	**265.9**	**292.6**
of which:				
Social security benefits[1]	138.7	150.1	164.7	170.9
Tax credits[1]	17.2	19.8	21.7	21.8
Net public service pensions[2]	2.3	3.1	4.1	4.6
National Lottery	0.9	0.9	0.9	0.9
BBC domestic services	3.5	3.4	3.5	3.7
Other departmental expenditure	2.7	0.8	2.5	1.7
Net expenditure transfers to EC institutions[3]	5.4	3.1	5.6	7.9
Locally-financed expenditure[4]	24.3	27.3	27.9	28.5
Central government gross debt interest	30.0	30.5	27.2	42.9
AME margin	0.0	0.0	0.9	1.8
Accounting adjustments	0.8	1.2	6.9	7.9
Public sector current expenditure	**535.6**	**564.5**	**608.0**	**644.9**
CAPITAL EXPENDITURE				
Capital Departmental Expenditure Limits	**44.1**	**48.3**	**57.7**	**51.6**
Capital Annually Managed Expenditure	**3.0**	**7.9**	**5.8**	**5.3**
of which:				
National Lottery	0.7	0.6	1.0	0.9
Locally-financed expenditure[4]	4.0	4.5	4.4	3.9
Public corporations' own-financed capital expenditure	5.4	7.2	7.4	7.5
Other capital expenditure	-1.0	0.4	1.5	1.0
AME margin	0.0	0.0	0.1	0.2
Accounting adjustments	-6.1	-4.8	-8.6	-8.1
Public sector gross investment	**47.1**	**56.2**	**63.4**	**56.9**
Less public sector depreciation	-17.8	-18.6	-19.6	-20.7
Public sector net investment	**29.3**	**37.7**	**43.8**	**36.2**
TOTAL MANAGED EXPENDITURE[5]	**582.7**	**620.7**	**671.4**	**701.7**
of which:				
Departmental Expenditure Limits	343.2	360.7	387.3	390.5
Annually Managed Expenditure	239.4	260.0	284.1	311.2

[1] For 2007-08 to 2008-09, child allowances in Income Support and Jobseekers' Allowance have been included in the tax credits line and excluded from the social security benefits line.

[2] Net public service pensions expenditure is reported on a National Accounts basis.

[3] AME spending component only. Total net payments to EC institutions also include receipts scored in DEL, VAT based contributions which score as negative receipts and some payments which have no effect on the UK public sector in the National Accounts. Latest estimates for total net payments, which exclude the UK's contribution to the cost of EU aid to non-Member States (which is attributed to the aid programme) and other costs attributed to Departmental DELs, and the UK's net contribution to the EC Budget, which includes these attributed costs, are (in £ billion):

	2007-08	2008-09	2009-10	2010-11
Net payments to EC institutions	3.5	2.2	3.3	5.6
Net contribution to EC Budget	4.2	3.0	4.1	6.5

[4] This expenditure is mainly financed by council tax revenues. See footnote to Table C6 for an explanation of how the council tax projections are derived.

[5] Total Managed Expenditure is equal to the sum of public sector current expenditure, public sector net investment, and public sector depreciation.

Table C10: Changes to Total Managed Expenditure since the 2008 Pre-Budget Report

	£ billion			
	Outturn	Estimate	Projections	
	2007-08	2008-09	2009-10	2010-11
CURRENT EXPENDITURE				
Resource Departmental Expenditure Limits	**-0.1**	**-1.1**	**2.9**	**2.2**
of which:				
Near-cash Departmental Expenditure Limits	-0.3	-1.4	2.6	2.3
Non-cash	0.2	0.3	0.4	0.0
Resource Annually Managed Expenditure	**-0.7**	**-2.4**	**11.4**	**14.4**
of which:				
Social security benefits	0.0	0.9	5.1	6.9
Tax credits	0.0	0.3	1.1	1.4
Net public service pensions	0.0	0.2	0.4	0.7
National Lottery	0.0	-0.1	0.1	0.0
BBC domestic services	0.2	0.0	0.0	0.0
Other departmental expenditure	0.1	-1.3	0.2	0.1
Net expenditure transfers to EC institutions	0.0	-0.7	0.4	0.7
Locally-financed expenditure	-0.1	1.2	1.1	0.2
Central government gross debt interest	0.0	-0.4	0.6	2.9
AME margin	0.0	0.0	0.0	0.0
Accounting adjustments	-0.8	-2.6	2.4	1.5
Public sector current expenditure	**-0.8**	**-3.5**	**14.3**	**16.6**
CAPITAL EXPENDITURE				
Capital Departmental Expenditure Limits	**0.0**	**-0.4**	**3.9**	**1.5**
Capital Annually Managed Expenditure	**-0.6**	**1.5**	**-0.5**	**1.8**
of which:				
National Lottery	0.0	-0.1	0.1	0.0
Locally-financed expenditure	0.4	-0.8	-0.2	0.3
Public corporations' own-financed capital expenditure	-0.4	0.8	0.3	1.6
Other capital expenditure	0.2	0.8	1.0	0.4
AME margin	0.0	0.0	0.0	0.0
Accounting adjustments	-0.8	0.8	-1.8	-0.5
Public sector gross investment	**-0.6**	**1.1**	**3.4**	**3.3**
Less public sector depreciation	0.1	0.1	0.1	0.2
Public sector net investment	**-0.6**	**1.2**	**3.4**	**3.5**
TOTAL MANAGED EXPENDITURE	**-1.4**	**-2.4**	**17.7**	**19.9**
of which:				
Departmental Expenditure Limits	-0.2	-1.4	6.7	3.7
Annually Managed Expenditure	-1.1	-1.0	11.0	16.3

DEL and AME analysis

DEL **C.70** The detailed allocation of DEL is shown in Table C11. In line with previous practice, resource and capital DEL for 2008-09 reflect the latest available information and include an allowance for shortfall reflecting likely underspends against departmental provisions.

C.71 There are a number of changes to DEL budgets since the 2008 Pre-Budget Report:

- adjustments to departments' budgets that reflect additional value for money savings in 2010-11;
- an increase to the Ministry of Defence budget to fund military operations in 2009-10;
- updated budgets for the departments for Business, Enterprise and Regulatory Reform, Environment, Food and Rural Affairs, and Energy and Climate Change, following the machinery of government changes. These update the provisional budgets previously published;
- reprofiling of the devolved administrations' capital DEL to bring forward spending from 2010-11 to 2008-09 and 2009-10; and
- updated to reflect Budget 2009 policy decisions, which are set out in more detail in Chapter A.

C.72 The latest figures also include a number of classification and budgetary changes, which have no impact on National Accounts definitions or TME. The only significant change is the reclassification from DEL to AME of certain transactions relating to Northern Ireland Water.

Table C11: Departmental Expenditure Limits - resource and capital budgets

	Outturn	Estimate	Plans	
	2007-08	2008-09	2009-10	2010-11
Resource DEL[1]				
Children, Schools and Families	44.9	46.8	49.2	51.3
Health	88.4	92.5	99.9	104.0
of which: NHS England	86.4	90.9	98.2	102.3
Transport	6.8	6.5	6.4	6.4
Innovation, Universities and Skills	15.5	16.7	17.2	17.9
CLG Communities	4.2	4.3	4.5	4.5
CLG Local Government	22.8	24.6	25.6	26.3
Home Office	8.6	8.9	9.4	9.5
Justice	8.8	9.3	9.5	9.4
Law Officers' Departments	0.7	0.7	0.7	0.7
Defence	35.7	37.9	38.7	36.7
Foreign and Commonwealth Office	1.9	2.0	2.0	1.6
International Development	4.5	4.8	5.5	6.2
Energy and Climate Change	0.6	1.0	1.1	1.1
Business, Enterprise and Regulatory Reform	1.8	1.6	1.8	1.4
Environment, Food and Rural Affairs	2.7	2.7	2.7	2.7
Culture, Media and Sport	1.6	1.6	1.7	1.7
Work and Pensions	8.1	8.1	9.1	9.9
Scotland	23.8	24.6	25.4	26.1
Wales	12.3	13.0	13.6	14.0
Northern Ireland Executive	7.6	8.1	8.4	8.7
Northern Ireland Office	1.3	1.3	1.2	1.2
Chancellor's Departments	4.8	4.8	4.6	4.5
Cabinet Office	1.8	2.0	2.3	2.4
Independent Bodies	0.7	0.8	0.9	1.0
Moderisation Funding	0.0	0.0	0.3	0.3
Reserve	0.0	0.0	0.7	2.9
Allowance for shortfall	0.0	-0.6	0.0	0.0
Total resource DEL	**309.9**	**324.3**	**342.1**	**352.3**
Capital DEL				
Children, Schools and Families	5.2	5.6	7.2	6.8
Health	3.8	4.6	5.6	4.8
of which: NHS England	3.6	4.4	5.4	4.7
Transport	7.1	7.3	8.3	7.4
Innovation, Universities and Skills	2.1	2.1	2.6	1.8
CLG Communities	6.1	7.1	8.8	6.1
CLG Local Government	0.0	0.1	0.1	0.1
Home Office	0.7	0.9	0.8	0.8
Justice	0.8	1.0	0.8	0.7
Law Officers' Departments	0.0	0.0	0.0	0.0
Defence	7.9	8.6	9.1	8.8
Foreign and Commonwealth Office	0.2	0.2	0.2	0.2
International Development	0.7	0.9	1.4	1.6
Energy and Climate Change	1.5	1.7	2.0	1.8
Business, Enterprise and Regulatory Reform	0.0	0.0	0.3	0.3
Environment, Food and Rural Affairs	0.6	0.6	0.7	0.6
Culture, Media and Sport	0.5	0.8	0.4	0.6
Work and Pensions	0.1	0.1	0.1	0.1
Scotland	3.6	3.3	3.7	3.2
Wales	1.5	1.6	1.7	1.7
Northern Ireland Executive	1.1	1.1	1.1	1.1
Northern Ireland Office	0.0	0.1	0.1	0.1
Chancellor's Departments	0.3	0.3	1.0	0.3
Cabinet Office	0.3	0.4	0.4	0.4
Independent Bodies	0.1	0.0	0.1	0.1
Reserve	0.0	0.0	1.2	2.1
Allowance for shortfall	0.0	-0.2	0.0	0.0
Total capital DEL	**44.1**	**48.3**	**57.7**	**51.6**
Depreciation	**10.8**	**11.9**	**12.4**	**13.4**
Total Departmental Expenditure Limits	**343.2**	**360.7**	**387.3**	**390.5**
Total Education spending[2]	78.1	83.0	88.0	89.2

[1] *RDEL budgets for 2010-11 reflect adjustments as a result of additional value for money savings.*

[2] *The definition of education is now more closely aligned to the UN's Classification of the Functions of Government, including education not definable by level. The total DCSF budget, although reprofiled to bring forwarc capital spending, is unchanged over the 2008-09 to 2010-11 period. Projections also reflect updated information in respect of Devolved Administration and Local Authority spending plans*

AME **C.73** AME spending is forecast on the basis of the economic assumptions set out in Table C1 and the NAO audited assumptions set out in Box C1. The main changes to these assumptions since the 2008 Pre-Budget Report can be attributed to the higher UK claimant unemployment assumption, which affects social security benefit expenditure.

Social security benefits **C.74** The forecast for social security expenditure is higher than at the 2008 Pre-Budget Report, due to a range of factors associated with the economic downturn. The most notable impact is a direct increase to Jobseeker's Allowance, Housing Benefit and Council Tax Benefit costs associated with the higher projections of claimant count unemployment from the NAO audited assumption. The forecast also includes the measures set out in Chapter 5 to support people through the economic downturn, via social security benefits.

Tax credits **C.75** The forecast for expenditure on Child and Working Tax credits has increased since the 2008 Pre-Budget Report, reflecting the impact of the economic downturn. The revised projections reflect revisions in respect of different sections of the population who claim tax credits whilst they are in-work, or while they are out of work. For in-work recipients, the revisions reflect higher than expected entitlements, due to changes in the composition of these recipients, and an increase in people who have reported falls in their income. The forecast also assumes an increase in out of work recipients who claim child tax credits, in line with the higher unemployment claimant count assumption.

Public service pensions **C.76** Net public service pensions are measured on a National Accounts basis, and report benefits paid less contributions received by central government pay-as-you-go public service pension schemes. Forecast expenditure from 2009-10 reflects actuarial advice on the rate and level at which benefits are expected to come into payment, the rate of future employer and employee contributions and the latest information relating to scheme demographics. The increase in the forecast for net public service pensions expenditure since the 2008 Pre-Budget Report is due to higher projections of payments to pensioners. Although lower forecast RPI inflation reduces the uprating of benefits paid, this effect is more than offset by upward revisions to estimated future payments to reflect the latest information on demographics.

National Lottery **C.77** The National Lottery figures reflect the latest view on timing of drawdown by the distributing bodies. Estimated outturn for 2008-09 is broadly unchanged from the projection in the 2008 Pre-Budget Report. The 2009-10 to 2010-11 estimates of drawdown have been revised to take into account the latest information from the distribution funds, and projected revenues from ticket sales.

Other departmental expenditure **C.78** Other departmental current expenditure forecasts for 2009-10 and 2010-11 have increased slightly from the 2008 Pre-Budget Report, reflecting net increases in the forecasts of HRA subsidy, following the decision to reduce guideline local authority rent increases in 2009-10. These increases are largely offset by consequential reductions in the Housing Benefit forecast within Social Security, and by reductions in DELs. The reduction in other departmental current expenditure in 2008-09, since the 2008 Pre-Budget Report reflects the receipts of fees from financial sector interventions. Other capital expenditure is higher than the 2008 Pre-Budget Report forecast mainly because of increases in net lending to public corporations and other bodies. These increases are offset elsewhere in AME, either in public corporations' own-financed capital expenditure (which removes departments' finance to public corporations, as set out below), or in the capital accounting adjustments.

EU contributions **C.79** Net expenditure transfers to EU Institutions, which consist of Gross National Income (GNI) based contributions less the UK abatement, are lower in 2008-09 and higher in both 2009-10 and 2010-11 than estimated at the time of the 2008 Pre-Budget Report. The main factors are the use of the latest available information on the size of the EC Budget for 2009 and the level of UK payments to this Budget, changes in the UK GNI-based contributions resulting

from use of the latest economic assumptions, and changes resulting from new information from the European Commission.

Locally financed expenditure

C.80 Locally financed expenditure mainly consists of local authority self-financed expenditure (LASFE) and Scottish spending financed by local taxation. LASFE is the local authority spending financed by local authorities' own sources of net income, other than central government support. The main determinant of the LASFE forecast is council tax. The council tax projections used to derive current LASFE in 2010-11 are based on stylised assumptions, which are not government forecasts, and are mirrored in the projections for council tax included in current receipts, so that these assumptions have no material effect on the fiscal aggregates. The current forecast also reflects historical information on movements in reserves, interest receipts and debt repayment. Capital LASFE reflects forecasts on the level of capital expenditure financed by the use of capital receipts, revenue sources of capital finance, private sector contributions and self-financed borrowing. Capital LASFE is net of local authority asset sales.

C.81 The increases in current LASFE estimated outturn in 2008-09, and the increases in current LASFE projections for 2009-10 and 2010-11 since the 2008 Pre-Budget Report mainly reflect the impact of higher forecasts for local authorities' net use of reserves to finance current spending. Capital LASFE in 2008-09 is expected to be lower than at the 2008 Pre-Budget report due to lower use of capital receipts. For 2009-10 and 2010-11, the increases in capital LASFE projections are largely due to a further fall forecast in local authority asset sales, particularly in 2009-10.

CG debt interest

C.82 Forecasts for central government gross debt interest payments have been revised in the light of latest economic determinant assumptions. With the exception of 2008-09, the projections for central government gross debt interest payments over the 2007 Comprehensive Spending Review period have increased since the 2008 Pre-Budget Report. Lower forecast RPI inflation have reduced expected debt interest payments on index-linked gilts. Market interest rates have fallen since the 2008 Pre-Budget Report, which has the effect of reducing debt interest payment costs. However, these reductions are more than offset by the effects of the higher central government net cash requirement (CGNCR) in 2009-10 and 2010-11.

PC capital expenditure

C.83 Public corporations' own-financed capital expenditure (PCOFCE) measures the total amount of public corporations' net capital expenditure, less the amount of this spending that is financed by central government departments, which is already included in DEL and elsewhere in AME. PCOFCE is higher in all years compared to the 2008 Pre-Budget Report reflecting lower sales of housing from local authority Housing Revenue Accounts, partly offset by reductions to remove higher net lending to public corporations included in other departmental capital expenditure. This offsetting reduction is most prominent in 2009-10.

AME margin

C.84 The AME margin has been reset at £1 billion and £2 billion for the years 2009-10 and 2010-11 respectively.

Accounting adjustments

C.85 The accounting adjustments reconcile the budgeting aggregates DEL and AME with the National Accounts definition of TME, removing items that score in DEL or AME but not in TME, and adding in items included in TME but not in DEL or AME. A breakdown of these accounting adjustments is given in the *Budget 2009: the economy and public finances – supplementary material*. Changes to the current and capital accounting adjustments since 2008 Pre-Budget Report reflect:

- revisions to estimates of current VAT refunds, which affect both current expenditure and receipts and are neutral across the public sector;

- increases in the estimate for defence capital spending, classified as being on 'single use military equipment', which is treated as current spending in the National Accounts and therefore effects current and capital accounting adjustments; and
- increases in the estimates of financial transactions which score as capital expenditure within the budgeting aggregates but not in the National Accounts and are therefore removed as capital accounting adjustments.

FINANCING REQUIREMENT

Central government net cash requirement

C.86 Table C12 presents projections of the net cash requirement by sub-sector, giving details of financial transactions that do not affect net borrowing (the change in the sectors' net financial indebtedness) but do affect its financing requirement.

C.87 The central government net cash requirement (CGNCR) in 2008-09 is £9.5 billion higher than at the 2008 Pre-Budget Report, reflecting higher net borrowing and changes to financial transactions, including net lending to local authorities.

C.88 Financial sector interventions in 2008-09 have added some £84.0 billion to the CGNCR, but substantially less to PSNB as many of the banks concerned are now classified to the public sector, or the payments are regarded for National Accounts purposes as being recoverable and thus offset by imputed receipts. Details of each of the interventions are given in Box C4 below.

Table C12: Public sector net cash requirement

	£ billion 2008-09				£ billion 2009-10			
	General government				General government			
	Central government	Local authorities	Public corporations	Public sector	Central government	Local authorities	Public corporations	Public sector
Net borrowing	**98.9**	**3.1**	**-12.0**	**90.0**	**172.0**	**6.4**	**-3.1**	**175.4**
Financial transactions								
Net lending to private sector and abroad	4.3	0.3	-0.1	4.5	5.5	0.1	-0.3	5.3
Cash expenditure on company securities	26.2	-0.9	-29.0	-3.7	17.0	-0.8	-15.2	1.0
Accounts receivable/payable	13.3	1.2	0.6	15.1	0.6	-0.3	0.3	0.6
Adjustment for interest on gilts	-4.6	0.0	0.0	-4.6	5.1	0.0	0.0	5.1
Miscellaneous financial transactions	24.4	0.4	-66.2	-41.4	18.7	0.0	-17.5	1.3
Own account net cash requirement	162.5	4.2	-106.8	59.9	218.9	5.4	-35.8	188.6
Net lending within the public sector	-0.1	-0.1	0.2	0.0	1.9	-1.2	-0.7	0.0
Net cash requirement[1]	**162.4**	**4.0**	**-106.6**	**59.9**	**220.8**	**4.2**	**-36.5**	**188.6**

[1] *Market and overseas borrowing for local government and public corporation sectors.*

2008-09

C.89 Table C13 updates the financing arithmetic for 2008-09 in line with outturn, and for 2009-10 in line with the updated fiscal forecasts. The outturn for the central government net cash requirement (CGNCR) is £162.4 billion in 2008-09, an increase of £9.5 billion from the 2008 Pre-Budget Report forecast of £152.9 billion. The outturn for the net financing requirement (NFR) is £169.1 billion, an increase of £11.4 billion from the 2008 Pre-Budget Report. It is also £0.6 billion below total financing, resulting in the forecast level of the Debt Management Office's (DMO's) short-term net cash position at end March 2009 rising to £1.1 billion. The Government repaid £3.2 billion of its Ways and Means Advance at the Bank of England in 2008-09.

2009-10 **C.90** The projection for the CGNCR in 2009-10 is £220.8 billion. Gross gilt redemptions are £16.6 billion and National Savings and Investments (NS&I) is not expected to make a net contribution to financing in 2009-10, reflecting a target to maintain broadly the existing level of stock after the high contribution to net financing of £12.5 billion in 2008-09. This projection assumes gross inflows of £13.9 billion. The Government will finance the official reserves by £2.0 billion. The projection for the net financing requirement in 2009-10 is £237.8 billion.

DMO **C.91** The financing requirement will be met by:

- gross gilt issuance of £220 billion;
- an increase in the Treasury bill stock by £21.6 billion to £65.6 billion; and
- a change in the short-term debt level reflecting the Government's decision to repay £3.8 billion of the remaining balance of the Ways and Means Advance at the Bank of England.

C.92 Gross debt issuance is expected to be £241.6 billion, with the additional amount (in excess of the net financing requirement of £237.8 billion) required to meet the further planned repayment of £3.8 billion of the Ways and Means Advance.

C.93 Auctions will remain the Government's primary method by which to issue gilts. However, following a consultation by the Debt Management Office (DMO) the Government has decided to use supplementary methods to issue gilts in 2009-10. In particular, the Government has decided to use syndication, and to extend the use of mini tenders, which were first introduced in October 2008, to issue gilts. Further details on this decision and the amount of gilts to be issued by way of syndication and mini tender can be found in the *Debt and reserves management report 2009-10*.

C.94 Gross gilt, issuance is expected to be split as follows:

- short-maturity gilt issuance is expected to be £74 billion (or 34 per cent of total issuance);
- medium maturity gilt issuance is expected to be £70 billion (or 32 per cent of total issuance);
- long-maturity gilt issuance is expected to be £46 billion (or 21 per cent of total issuance); and
- issuance of index-linked gilts is expected to be £30 billion (or 13 per cent of total issuance).

C.95 The planning assumption is that short maturity and medium maturity gilts will be issued at auction only. Long maturity and index-linked gilts will be issued also by way of syndication or mini tender.

Table C13: Financing requirement forecast

	£ billion			
	2008-09			2009-10
	April 2008 Revised Remit[1]	November 2008 Pre-Budget Report	April 2009 Budget	April 2009 Budget
Central government net cash requirement	**59.3**	**152.9**	**162.4**	**220.8**
Gilt redemptions	17.3	18.3	18.3	16.6
Financing for the Asset Purchase Facility	0.0	0.0	1.0	-1.0
Financing for the Official Reserves[2]	2.0	0.0	0.0	2.0
Buy-backs[3]	0.0	0.0	2.4	0.0
Planned short-term financing adjustment[4]	-2.5	-2.5	-2.5	-0.6
Gross financing requirement	**76.1**	**168.7**	**181.6**	**237.8**
Less Assumed net contribution from NS&I	4.0	11.0	12.5	0.0
Net financing requirement	**72.1**	**157.7**	**169.1**	**237.8**
Financed by:				
1. Debt issuance by the Debt Management Office				
(a) Treasury bills	**-0.9**	**14.5**	**26.4**	**21.6**
(b) Gilts	**80.0**	**146.4**	**146.5**	**220.0**
2. Other planned changes in short-term debt[5]				
Changes in Ways & Means[6]	-7.0	-3.2	-3.2	-3.8
3. Unanticipated changes in short-term cash position[7]	**0.0**	**0.0**	**0.6**	**0.0**
Total financing	**72.1**	**157.7**	**169.7**	**237.8**
Short-term debt levels at end of financial year				
Treasury bill stock in market hands[8]	16.7	32.1	44.0	65.6
Ways & Means	0.4	4.2	4.2	0.4
DMO net cash position	0.5	0.5	1.1	0.5

[1] The financing arithmetic in Budget 2008 was revised on 18 April 2008 to reflect outturn data for 2007-08.
[2] The total reflects an additional £2 billion of sterling financing for the Official Reserves.
[3] The total primarily reflects purchases of the near maturity index-linked 2009 stock but also purchases of "rump gilts" which are older, smaller gilts, declared as such by the DMO and in which Gilt-edged Market Makers (GEMMs) are not required to make two way markets. The Government will not sell further amounts of such gilts to the market but the DMO is prepared, when asked by a GEMM, to make a price to purchase such gilts.
[4] To accommodate changes to the current year's financing requirement resulting from: (i) publication of the previous year's outturn CGNCR; (ii) an increase in the DMO's cash position at the Bank of England; and / or (iii) carry over of unanticipated change but the DMO is prepared, when asked by a GEMM, to make a price to purchase such gilts.
[5] Total planned changes to short-term debt are the sum of: (i) the planned short-term financing adjustment; (ii) Treasury bill sales; and (iii) changes to the level of the Ways & Means Advance.
[6] Reflects the Government's decision to repay £3.8 billion of the remaining balance of the Ways and Means Advance in 2009-10. The Government repaid £3.2 billion of the Advance in 2008-09.
[7] A negative (positive) number indicates an addition to (reduction in) the financing requirement for the following financial year.Total planned changes to short-term debt are the sum of: (i) the planned short-term financing adjustment; (ii) Treasury bills
[8] The DMO has operational flexibility to vary the end-financial year stock subject to its operational requirements in 2009-10.

C.96 Full details of the DMO's financing remit including further information on the structure of gilts issuance and the gilt auction calendar for 2009-10 can be found in the *Debt and reserves management report 2009-10* which is published alongside this Budget and is available on HM Treasury's website.

FINANCIAL SECTOR INTERVENTIONS

C.97 The independent Office for National Statistics (ONS) will determine how measures to maintain financial stability and support the effective functioning of the financial sector are classified within the National Accounts and included in outturn data, in consultation with Eurostat (the Statistical Office of the European Union) and statistical offices in other Member States to ensure consistent interpretation of international statistical guidance.

C.98 However the long-term impact on the sustainability of public finances will be determined not by the face value of any liabilities incurred but by any eventual profit or loss that accrues on these interventions, taking account of fees received and the value of investments when they are sold.

C.99 As set out in Chapter 2, the Government will base its assessment of the fiscal position on aggregates that both exclude the temporary impact of any liabilities incurred as a result of these interventions and include an expected level of unrealised losses. The projections set out in this chapter exclude the temporary impact of any liabilities, but do not include the expected level of unrealised losses, as the timing and quantum are uncertain. Any economic profit or loss will be included in the measures used in these projections when that profit or loss crystallises. Consistent with this policy, the projections also do not include the benefit of expected fees or dividends. In practice this means that:

- the forecast does not include any projections of estimated fee income from schemes such as the Asset Protection Scheme, the Credit Guarantee Scheme or the Special Liquidity Scheme;
- no estimates of the potential final net profits or losses from any of the interventions are included in the projections; and
- no account is taken of the net operating profits or losses of banks classified to the public sector except the Bank of England, in the projections of public corporation gross operating surplus.

C.100 Payments and receipts associated with interventions are included in estimated outturn and in the Budget projections where these have already been made, or a firm announcement has been made of a future transaction. The cash raised to finance these payments gives rise to an increase in the Government's debt interest costs which is included in the projections in this chapter.

C.101 Because of the difficulties around estimating the eventual profit or loss on these interventions, the Government is, for fiscal policy purposes, making a provisional estimate of losses on financial sector interventions. This policy decision is covered in more detail in Chapter 2.

C.102 The remainder of this section summarises the current impact of the interventions on the projections of key fiscal aggregates. Box C4 provides more detail on these on a scheme-by-scheme basis.

Impact on Public Sector Net Debt

C.103 Since September 2008 the ONS has published estimates of public sector net debt both including and excluding financial sector interventions (initially only the impact of Northern Rock) in the monthly Public Sector Finance statistics releases. Table C14 shows the composition of the difference between PSND including financial sector interventions on a

National Accounts basis and PSND excluding liabilities and unrealised losses from financial sector interventions for 2008-09, 2009-10 and 2010-11.

Table C14: Financial sector interventions - impact on PSND

	£ billion		
	Estimate	Projections	
	2008-09	2009-10	2010-11
PSND excluding liabilities and unrealised losses from financial sector interventions	**609.1**	**792**	**977**
Bank balance sheets[1]	123	123	126
Depositor compensation	9	10	10
Bank of England Schemes	3	3	3
PSND including financial sector interventions on a National Accounts basis	**743.6**	**928**	**1115**

[1] *RBS and Lloyds Banking Group cannot be included until ONS have calculated their specific contributions, this is consistent with ONS' treatment in Public Sector Finances.*

C.104 The main contributions to PSND including financial sector interventions are from the liabilities, net of liquid assets, of the balance sheets of Northern Rock and Bradford & Bingley (B&B) that were classified to the public sector by ONS in 2008. There are smaller contributions from transactions associated with Kaupthing Singer & Friedlander (KSF), Heritable, Landsbanki and London Scottish Bank. The ONS has classified Royal Bank of Scotland (RBS) and Lloyds Banking Group (LBG) to the public sector with effect from October 2008. However, ONS have not yet been able to calculate the impact of these banks' balance sheets on PSND and have said that this may take some time to complete. The Government's purchases of equity in RBS and Lloyds Banking Group are not included in PSND as these are classified by the ONS as intra-public sector transactions.

Impact on the central government net cash requirement

C.105 Cash payments associated with the financial sector interventions increase the CGNCR in the year in which they are made. In 2008-09 the following transactions increased the CGNCR by £84 billion in total:

- the Government loan to Northern Rock, which stood at £14.6 billion at the end of the year on a gross basis;
- £36.5 billion for the cost of share purchases in RBS and Lloyds Banking Group, net of commissions;
- compensation payments to depositors in Bradford & Bingley, including loans to the Financial Services Compensation Scheme (FSCS), totalling £18.6 billion or £18.0 billion, net of the consideration from Abbey, and the provision of a working capital facility of which £6.0 billion had been drawn by the end of the year;
- compensation payments to depositors in KSF, Heritable, Landsbanki and London Scottish Bank, including loans in respect of liabilities borne both by the FSCS and by the Icelandic Depositors' and Investors' Guarantee Fund, totalling £7.4 billion; and
- a £1.6 billion payment to support the restructuring of the Dunfermline building society.

C.106 The CGNCR projections for 2009-10 and subsequent years include:

- expected further loan advances and capital injections to Northern Rock;

- expected further working capital support to Bradford & Bingley totalling £5.5 billion in 2009-10; and
- the maximum of £19 billion capital injection into RBS, announced in February 2009, has been assumed in the projections for 2009-10 and 2010-11.

Table C15: Financial sector interventions - impact on CGNCR

	£ billion		
	Estimate	Projections	
	2008-09	2009-10	2010-11
Net effect of financial sector interventions	**84.0**	**38**	**0**
Loans and equity injections	57	37	0
Depositor compensation	27	1	0

Impact on public sector and general government borrowing

Public sector net borrowing

C.107 The financial sector interventions do not generally affect public sector net borrowing because:

- they take the form of financial transactions, such as loans or share purchases, which do not constitute borrowing (as one financial asset is being exchanged for another);
- they are offset by recoveries imputed in the national accounts, such as for liabilities borne by the FSCS; or
- they are related to banks classified to the public sector and so are classified as intra-public sector flows.

General government net borrowing

C.108 However, there are transactions associated with the interventions which the ONS has classified as scoring in general government net borrowing, and therefore in the Maastricht Treaty definition of the Government deficit:

- the compensation of £4.6 billion paid by the Treasury to depositors in B&B above the FSCS depositor guarantee limit is regarded as a capital grant. For all other bank compensation payments, national accounts score an immediate offsetting claim on the private sector, but this is not the case for B&B, which is a public sector company; and
- capital grants are scored for the purchase of equity in RBS and LBG, equal to the difference between the market value of the shares at the time of purchase and the value based on the agreed purchase price. These total £6.3 billion in 2008-09.

C.109 Similarly general government gross debt, the Maastricht Treaty debt definition, is affected by all of the cash flows that impact on the CGNCR, whether or not they cross the public sector boundary.

Box C4: Impact of financial sector interventions on the public finances projections

This box explains how each intervention has been reflected in the projections on a National Accounts basis.

BANK OF ENGLAND SCHEMES

Special Liquidity Scheme (SLS): This scheme was introduced in April 2008 to provide liquidity support to the banking system. The Government has lent a total of £185 billion of Treasury bills to the Bank of England to run the scheme. The classification of the scheme is a matter for the ONS and until there is a ruling it has been assumed that there will be no impact on PSND as the transaction is back-to-back stock lending and therefore no debt is regarded as having been issued. Fees charged by the Bank of England for use of the scheme are not included in the projections.

Asset Purchase Facility: The Bank of England Asset Purchase Facility Fund Ltd was set up in February 2009. The Fund borrows cash from the Bank of England in order to purchases assets. In the first phase, now suspended, these were private sector assets and the cash used was raised through issuing Treasury Bills and deposited by the Debt Management Office. In the second phase the Bank of England creates central bank money to lend to the Fund which can purchase up to £150 billion of assets of which no more than £50 billion can be private sector. Liquid private sector assets and gilts will broadly net off in PSND. Corporate bonds are regarded as illiquid and so do not net off. The impact of the scheme on PSND at end March 2009 was £2.7 billion, mainly from gilts which are valued for PSND at face value, which was lower than the market price paid. Any eventual profit or loss from the facility will only be included when it crystallises for central government.

HM TREASURY SCHEMES

Credit Guarantee Scheme (CGS): This scheme was introduced in October 2008 as an insurance contract to repay new senior bank debt should the participating bank default. ONS have indicated that generally guarantees are contingent liabilities of government and so do not score in the accounts unless the guarantee is called. The fees charged for the scheme are not included in the projections.

Asset Protection Scheme: Under the scheme, the Government provides protection against future credit losses on certain assets in exchange for a fee. The Royal Bank of Scotland and Lloyds have both announced their intention to participate in the scheme. RBS intends to protect £325 billion worth of eligible assets, and Lloyds intends to protect £260 billion of eligible assets. A 'first loss' remains with the institution. RBS will bear a first loss amount of £42.2 billion in relation to protected assets. Lloyds will bear a first loss amount of £35.2 billion in relation to protected assets. The Government protection will cover 90 per cent of the credit losses exceeding this amount, with the participating institution retaining the residual exposure. It is not currently possible to produce a robust estimate of the scale or profile of losses, as the scheme is providing protection in respect of assets which the market cannot value at the moment and around which there are very significant uncertainties. Therefore no estimate of losses from the scheme nor benefit from fees has been included in these projections as there are very significant uncertainties over the scale and profile of losses.

Asset Backed Securities (ABS) Guarantee Scheme: The scheme, announced in this Budget, makes available guarantees for residential mortgage-backed securities. The guarantees are contingent liabilities of government, and therefore do not impact on the public finances unless the guarantee is called. The fees charged for the scheme are not included in the public finances projections.

DIRECT SUPPORT FOR BANKS

Northern Rock and Bradford & Bingley together accounted for around £123 billion of PSND including financial sector interventions at the end of 2008-09. The forecast includes projections of the rate at which government loans to these banks will be made and paid back on the basis of their published business plans. Northern Rock announced in February 2009 that it would increase mortgage lending by up to £14 billion over the next two years and restructure the company. In addition the Government has announced that it will be strengthening Northern Rock's capital base in 2009-10 by up to £3 billion, the full amount has been assumed in the projections. CGNCR is also increased by compensation payments to depositors in Bradford & Bingley and the provision of a working capital facility.

Royal Bank of Scotland and Lloyds Banking Group: ONS announced on 19 February 2009 that both RBS and the LBG would be classified to the public sector but that it may take some time to complete their incorporation into data for the public sector. The Government's purchase of equity in these banks in 2008-09 was scored in the CGNCR, and a portion of the cost scored in the Treaty deficit. The projections of the CGNCR for 2009-10 and 2010-11 include estimates of further capital injections announced in February 2009 for RBS. No projections for net operating profits or losses from these banks are included in the forecast.

Icelandic banks: Kaupthing Singer & Friedlander (KSF) and Heritable were taken into administration in October 2008, adding £3.3 billion to CGNCR through transactions associated with transfer of retail deposits to ING Direct. Much of this represents a Government loan to cover the liabilities borne by the FSCS, but the final allocation is not settled. Payments totalling £4.0 billion were also made in 2008-09 to compensate retail depositors, both those with Icesave accounts at Landsbanki, and those with KSF and Heritable whose accounts were not transferred to ING Direct. Further compensation payments to these retail depositors are included in the projections for 2009-10. The payments in respect of Icesave accounts are eventually expected to add around £4.5 billion to CGNCR, £3.8 billion of which represents loans to cover the liabilities borne by the FSCS and by the Icelandic Depositors' and Investors' Guarantee Fund.

Dunfermline building society: This was restructured in March 2009 with the retail and wholesale deposits, branches, head office and originated residential mortgages (other than social housing loans and related deposits) transferred to Nationwide supported by a payment by HM Treasury of £1.6 billion. Dunfermline's social housing portfolio has been placed into a bridge bank, under the control of the Bank of England, along with a small element of related deposits from social landlords. The remainder of the business has been put into administration under the Building Society Special Administration Process. CGNCR in 2008-09 is increased by the payment made.

ADDITIONAL ANALYSES

C.110 Historical series for the main fiscal aggregates are included in Table C16. Further information on general government transactions and more detailed breakdowns of the public sector are included in *Budget 2009: the economy and public finances – supplementary material*, along with a detailed description of the conventions used in presenting the public finances.

HISTORICAL SERIES

Table C16: Historical series of public sector balances, receipts and debt

	Per cent of GDP								
	Public sector current budget	Cyclically-adjusted surplus on current budget	Public sector net borrowing	Cyclically-adjusted public sector net borrowing	Public sector net cash requirement[1]	Net taxes and national insurance contributions	Public sector current receipts	Public sector net debt[1,2]	Public sector net worth[3]
1970-71	6.8		-0.6		1.2	36.3	43.3		
1971-72	4.2		1.1		1.4	35.0	41.5		
1972-73	2.0		2.8		3.6	32.6	39.0		
1973-74	0.4	-0.7	4.9	6.0	5.8	31.9	39.5		
1974-75	-0.9	-2.5	6.5	8.1	8.9	34.5	42.1	52.1	
1975-76	-1.4	-1.6	7.0	7.2	9.2	35.3	42.8	53.8	
1976-77	-1.1	-0.6	5.5	5.0	6.3	35.1	43.2	52.3	
1977-78	-1.3	-1.2	4.3	4.1	3.6	34.1	41.4	49.0	
1978-79	-2.5	-2.3	5.0	4.8	5.2	33.1	40.1	47.1	
1979-80	-1.8	-1.7	4.1	4.0	4.6	33.5	40.6	43.9	
1980-81	-2.9	-1.5	4.8	3.4	5.1	35.5	42.2	46.0	
1981-82	-1.3	2.5	2.3	-1.5	3.3	38.0	45.5	46.2	
1982-83	-1.4	2.9	3.0	-1.4	3.1	38.2	45.2	44.8	
1983-84	-1.9	1.8	3.7	0.0	3.1	37.7	44.1	45.1	
1984-85	-2.1	0.9	3.6	0.6	3.0	38.2	43.9	45.3	
1985-86	-1.2	0.6	2.4	0.6	1.6	37.4	42.7	43.5	
1986-87	-1.4	-1.2	2.0	1.9	0.9	37.0	41.9	41.0	
1987-88	-0.4	-1.7	1.0	2.2	-0.7	36.8	40.6	36.8	73.0
1988-89	1.6	-1.0	-1.3	1.3	-3.0	36.1	40.2	30.5	78.2
1989-90	1.4	-1.4	-0.2	2.6	-1.3	35.4	39.4	27.7	70.1
1990-91	0.3	-1.2	1.0	2.6	-0.1	34.9	38.4	26.2	59.8
1991-92	-2.0	-1.5	3.7	3.3	2.3	33.8	38.1	27.4	52.6
1992-93	-5.6	-3.7	7.4	5.5	5.8	32.7	36.3	31.4	40.1
1993-94	-6.3	-4.0	7.7	5.4	6.9	31.8	35.4	36.5	29.6
1994-95	-4.8	-3.3	6.2	4.7	5.2	33.0	36.4	40.1	28.8
1995-96	-3.3	-2.4	4.7	3.8	4.2	33.6	37.2	41.9	21.5
1996-97	-2.7	-2.2	3.4	2.8	2.9	34.0	36.4	42.5	17.7
1997-98	-0.1	-0.1	0.7	0.6	0.1	35.1	37.5	40.6	15.3
1998-99	1.2	0.9	-0.5	-0.2	-0.7	35.6	37.7	38.4	14.4
1999-00	2.2	1.7	-1.6	-1.1	-0.9	35.5	37.9	35.6	17.4
2000-01	2.4	1.6	-1.9	-1.1	-3.7	36.3	38.6	30.7	23.0
2001-02	1.2	0.9	0.0	0.2	0.4	35.8	37.8	29.7	29.6
2002-03	-1.0	-0.7	2.3	2.0	2.2	34.3	36.3	30.8	28.2
2003-04	-1.5	-1.3	2.9	2.7	3.3	34.3	36.5	32.2	28.5
2004-05	-1.6	-1.5	3.3	3.2	3.2	35.2	37.3	34.1	28.6
2005-06	-1.1	-1.0	3.0	2.8	3.2	36.0	38.4	35.4	28.6
2006-07	-0.4	-0.3	2.3	2.3	2.6	36.2	38.6	36.0	29.2
2007-08	-0.4	-0.7	2.4	2.7	1.5	36.3	38.6	36.5	28.9

[1] *Excluding liabilities and unrealised losses from financial sector interventions.*

[2] *At end-March; GDP centred on end-March.*

[3] *At end-December; GDP centred on end-December.*

Table C17: Historical series of government expenditure

	£ billion (2007-08 prices)				Per cent of GDP			
	Public sector current expenditure	Public sector net investment	Public sector gross investment[1]	Total Managed Expenditure	Public sector current expenditure	Public sector net investment	Public sector gross investment[1]	Total Managed Expenditure
1970-71	190.2	36.3	58.1	248.3	32.7	6.2	10.0	42.7
1971-72	199.4	31.6	54.5	254.0	33.4	5.3	9.1	42.6
1972-73	207.6	30.4	54.3	261.9	33.2	4.9	8.7	41.9
1973-74	228.0	34.1	60.8	288.9	35.0	5.2	9.3	44.3
1974-75	251.4	36.6	64.7	316.1	38.7	5.6	10.0	48.6
1975-76	256.7	35.9	64.2	320.9	39.7	5.6	9.9	49.7
1976-77	263.7	29.4	58.8	322.5	39.7	4.4	8.8	48.5
1977-78	260.1	20.1	49.7	309.8	38.3	3.0	7.3	45.6
1978-79	268.0	17.6	47.8	315.8	38.2	2.5	6.8	45.1
1979-80	274.6	16.4	47.0	321.6	38.1	2.3	6.5	44.6
1980-81	282.5	13.1	44.3	326.8	40.6	1.9	6.4	47.0
1981-82	294.9	7.0	37.9	332.8	42.3	1.0	5.4	47.7
1982-83	301.7	11.1	41.1	342.8	42.3	1.6	5.8	48.1
1983-84	311.2	13.5	43.4	354.6	42.0	1.8	5.9	47.8
1984-85	319.3	11.9	40.3	359.6	42.2	1.6	5.3	47.5
1985-86	319.3	9.2	35.3	354.6	40.5	1.2	4.5	45.0
1986-87	324.5	5.6	31.8	356.3	39.7	0.7	3.9	43.6
1987-88	327.8	5.0	29.8	357.6	38.1	0.6	3.5	41.6
1988-89	320.6	3.1	27.9	348.5	35.8	0.3	3.1	38.9
1989-90	322.9	11.3	35.7	358.6	35.3	1.2	3.9	39.2
1990-91	325.1	12.3	34.6	359.7	35.6	1.3	3.8	39.4
1991-92	344.6	16.1	34.9	379.5	38.0	1.8	3.8	41.9
1992-93	361.9	16.8	35.2	397.1	39.8	1.8	3.9	43.7
1993-94	372.0	13.3	31.5	403.5	39.7	1.4	3.4	43.1
1994-95	383.4	13.6	31.8	415.2	39.3	1.4	3.3	42.6
1995-96	388.6	13.7	31.4	420.0	38.7	1.4	3.1	41.8
1996-97	387.6	7.1	23.2	410.8	37.6	0.7	2.3	39.9
1997-98	386.5	6.1	21.6	408.1	36.2	0.6	2.0	38.2
1998-99	388.2	7.4	22.4	410.6	35.1	0.7	2.0	37.2
1999-00	395.7	6.7	21.7	417.5	34.4	0.6	1.9	36.3
2000-01	416.0	6.2	21.3	437.3	35.0	0.5	1.8	36.8
2001-02	428.0	14.0	29.4	457.4	35.3	1.2	2.4	37.7
2002-03	447.8	15.7	31.6	479.5	36.0	1.3	2.5	38.6
2003-04	470.8	17.4	33.5	504.3	36.8	1.4	2.6	39.4
2004-05	492.2	22.2	38.5	530.7	37.7	1.7	2.9	40.6
2005-06	511.8	24.8	41.8	553.5	38.2	1.8	3.1	41.3
2006-07	521.4	26.7	44.1	565.4	37.7	1.9	3.2	40.9
2007-08	535.6	29.3	47.1	582.7	37.7	2.1	3.3	41.0

[1] *Net of sales of fixed assets.*

LIST OF ABBREVIATIONS

AEF	Aggregate External Finance
AME	Annually Managed Expenditure
AMLD	Amusement Machine Licence Duty
APD	Air passenger duty
APR	Annual Percentage Rates
BCC	British Chamber of Commerce
BERR	Department for Business, Enterprise & Regulatory Reform
BRE	Better Regulation Executive
CAP	Common Agricultural Policy
CBI	Confederation of British Industry
CCAs	Climate change agreements
CCL	Climate change levy
CCS	Carbon capture and storage
CERT	Carbon Emissions Reduction Target
CGT	Capital Gains Tax
CGNCR	Central government net cash requirement
CHP	Combined Heat and Power
CIPFA	Chartered Institute of Public Finance and Accountancy
CO2	Carbon dioxide
CPI	Consumer Prices Index
CSR	Comprehensive Spending Review
CTC	Child Tax Credit
CTF	Child Trust Fund
CVS	Corporate Venturing Scheme
DCMS	Department of Culture, Media and Sport
DCSF	Department for Children, Schools and Families
DEFRA	Department for Environment, Food and Rural Affairs
DEL	Departmental Expenditure Limit
DfES	Department for Education and Skills
DFID	Department for International Development
DfT	Department for Transport
DH	Department of Health
DIUS	Department for Innovation, Universities and Skills
DMO	Debt Management Office
DTI	Department of Trade and Industry
DVLA	Driver and Vehicle Licensing Agency
DWP	Department for Work and Pensions
EC	European Communities
ECA	Enhanced Capital Allowance
ECF	Enterprise Capital Fund
EEA	European Economic Area
EEC	Energy Efficiency Commitment

EFSR	Economic and Fiscal Strategy Report
EIS	Enterprise Investment Scheme
EMI	Enterprise Management Incentive
EPC	Economic Policy Committee
ESA	Employment and Support Allowance
ESA95	European System of Accounts 1995
EU	European Union
EU ETS	EU Emissions Trading Scheme
FDI	Foreign direct investment
FE	Further Education
FRS	Financial Reporting Standard
FSA	Financial Services Authority
FSBR	Financial Statement and Budget Report
G7	A group of seven major industrial nations (comprising: Canada, France, Germany, Italy, Japan, UK and US).
G8	The G8 is an informal group of eight countries: Canada, France, Germany, Italy, Japan, Russia, the UK and the US.
G20	A group of twenty Finance Ministers and Central Bank Governors representing nineteen countries plus the European Union
GAAP	Generally Accepted Accounting Practices
GAD	Government Actuary's Department
GCSE	General Certificate of Secondary Education
GDP	Gross Domestic Product
GGNB	General government net borrowing
GLA	Greater London Authority
GNI	Gross National Income
GVA	Gross Value Added
HB	Housing Benefit
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IAS	International Accounting Standards
IB	Incapacity Benefit
IFRS	International Financial Reporting Standards
IFS	Institute for Fiscal Studies
IHT	Inheritance Tax
ILO	International Labour Organisation
IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
ISA	Individual Savings Account
ISB	Invest to Save Budget
JSA	Jobseeker's Allowance
LASFE	Local authority self-financed expenditure
LATS	Landfill Allowance Trading Scheme
LFS	Labour Force Survey

LHA	Local Housing Allowance
LIBOR	London Inter-Bank Offered Rate
LTCS	Landfill Tax Credit Scheme
LTPFR	Long Term Public Finance Report
MDRs	Marginal deduction rates
MIG	Minimum Income Guarantee
MoD	Ministry of Defence
MORI	Market and Opinion Research International
MPC	Monetary Policy Committee
MTIC	Missing Trader Intra-Community
NAO	National Audit Office
NHS	National Health Service
NICs	National Insurance Contributions
NIESR	National Institute of Economic and Social Research
NMW	National Minimum Wage
NVQ	National Vocational Qualification
ODPM	Office of the Deputy Prime Minister
OECD	Organisation for Economic Cooperation and Development
OFCOM	Office of Communications
OFGEM	Office of Gas and Electricity Markets
OFT	Office of Fair Trading
OGC	Office of Government Commerce
ONS	Office for National Statistics
OPEC	Organisation of Petroleum Exporting Countries
PAC	Public Accounts Committee
PAYE	Pay As You Earn
PBR	Pre - Budget Report
PCOFCE	Public corporations' own financed capital expenditure
PCT	Primary Care Trust
PEP	Personal Equity Plan
PFI	Private Finance Initiative
PGS	Planning-gain Supplement
PSA	Public Service Agreement
PSNB	Public sector net borrowing
PSNI	Public sector net investment
R&D	Research and Development
RDA	Regional Development Agency
REITs	Real Estate Investment Trusts
RES	Regional Economic Strategy
RPI	Retail Prices Index
RPIX	Retail Prices Index excluding mortgage interest payments
RTFO	Renewable Transport Fuels Obligation
SBRI	Small Business Research Initiative
SDLT	Stamp Duty Land Tax

SDRT	Stamp Duty Reserve Tax
SERPS	State Earnings Related Pension Scheme
SFLG	Small Firms Loan Guarantee
SME	Small and medium-sized enterprise
STEM	Science Technology Engineering and Mathematics
TME	Total Managed Expenditure
TSB	Technology Strategy Board
UKFI	United Kingdom Financial Investments
VAT	Value Added Tax
VCT	Venture Capital Trust
VED	Vehicle excise duty
WGA	Whole of Government Accounts
WTC	Working Tax Credit

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