
BUDGET 2009 AND LOW EARNERS

Overview

The 2008 pre-budget report (PBR) announced a £25 billion one-off stimulus to the economy and set out a six-year period of tax rises and spending cuts from 2010-11 designed to repair public finances by raising the surplus of government receipts over expenditure to almost £40 billion per year by 2015-16.

Budget 2009 added a further £5 billion stimulus and described a sharper and more prolonged fiscal tightening in the eight years from 2010-11. The additional money raised by this tightening would rise to around £90 billion per year by 2017-18, or £2,840 per UK family in today's money.¹

The more than doubling in the size of the fiscal tightening reflects the sharp deterioration in Treasury estimates of the effect of the credit crunch and recession on public finances. The payment of unemployment benefits, along with reductions in tax revenues from stamp duty, corporation tax and other sources account for some of this deterioration. More seriously, however, HMT believes that the total potential output of the economy has been reduced by 5 per cent: that is, the crisis has punched a permanent hole in the productive capacity of the UK economy.

The tax increases announced in the PBR and in Wednesday's Budget are set to raise just 10 per cent of the total funds required in 2017-18 (and the increase in the top rate of tax to 50 per cent will account for only part of this 10 per cent – the rest will come from increases in broader-based taxes such as fuel duty and National Insurance), meaning that the bulk of the burden of the tightening will fall on users of public services. Announced spending cuts should account for 40 per cent of the total, leaving 50 per cent of funds still to be found. Future chancellors will therefore need to choose between raising taxes further and squeezing public spending more tightly.²

As low earners are more exposed than other members of society to the effects of the recession, the various housing, work and benefit stimulus initiatives announced in the last six months have been of disproportional relevance to the group. The £25 billion stimulus announced in November 2008 was particularly welcome, with Wednesday's £5 billion addition providing further limited support.

However, low earners' position on the cusp of state assistance means that the cuts in public spending that are laid out in the Budget are likely to be of particular concern to the group over the next decade. As such, while Budget 2009 had various measures to cheer for low earners, the path to financial balance set out by the Chancellor represents a serious near- and medium-term threat to the group.

¹ IFS, *Public finances: two parliaments of pain*, 23 April 2009:
http://www.ifs.org.uk/budgets/budget2009/public_finances.pdf

² *Ibid.*

Economic outlook

The Budget forecast that UK GDP would shrink by 3.5 per cent over the course of 2009. However, the Chancellor said that he expects recovery to begin late in the year, resulting in growth of 1.25 per cent in 2010 and 3.5 per cent in 2011.

These forecasts have been criticised by opposition spokespeople as overly optimistic, and are more upbeat than figures produced by the IMF and others.³ However, current forecasts are subject to significant uncertainty, particularly as the effects of the fiscal and monetary expansions introduced since the end of 2008 are only just beginning to be felt.

A return to economic growth should benefit all members of society, including low earners. However, unemployment tends to lag changes in output. As such, even as the economy recovers, it is likely that low earners and others will continue to face difficult times.

Work and skills

The Budget included significant packages for businesses and workers. Given that low earners are more likely than other members of society to be at risk of unemployment (because of their concentration in smaller firms and self-employment and their relatively low levels of skills), less likely than high earners to return to work quickly (because of their lower levels of skills and mobility) and more exposed than high earners to the financial consequences of unemployment (because of their lack of a financial safety net), all of these measures are likely to benefit the group to some extent.

Business

The initiatives announced in the Budget seek to support business in two distinct ways: by improving cash flow and credit availability; and by encouraging investment for future growth.

The 2008 PBR announced a temporary, one-year extension of trading loss carry-back for business from one to three years, for losses up to £50,000. This scheme allows loss-making companies to claim back taxes paid on profits in the last three years. The Budget extended the scheme for a further year to November 2010.⁴ The Budget also announced an indefinite extension of HMRC's Business Payment Support Service, launched in the 2008 PBR, which allows struggling businesses to defer tax payments.⁵

The Chancellor also introduced a 'top-up' trade credit insurance scheme, designed to help UK businesses maintain their finances. Trade credit insurance provides companies that supply other UK businesses with goods and services guarantees that their bills will be paid. Tight credit conditions mean that many companies have faced reduced credit limits, adding pressures on firms and reducing the level of trade. The top-up scheme will allow suppliers to purchase

³ See for example IMF, *World Economic Outlook: Crisis and Recovery*, April 2009, Table 2.1

⁴ HMT, *Budget 2009*, para 4.7

⁵ *Ibid.* para 4.6

six months insurance from the Government if credit limits on their UK customers are reduced.⁶

In order to encourage business investment for future recovery, the Budget introduced a higher rate of tax relief for firms investing over £50,000 in qualifying plant and machinery in 2009-10.⁷

The Budget also provided details of a £750 million Strategic Investment Fund to support advanced industrial projects of “strategic importance”, including low carbon industries.⁸ The Government is setting aside £50 million of this money to enable the Technology Strategy Board, which supports business innovation particularly among smaller enterprises, to increase its capacity in high potential growth areas.⁹

The unemployed

The 2008 PBR included £1.3 billion to support Job Centre Plus delivery and the January Employment Summit announced a further £500 million package to support jobseekers. Wednesday’s Budget provided an additional £1.7 billion over two years for the DWP to ensure that Jobcentre Plus has the capacity to meet the needs of a growing number, and changing profile, of unemployed and that the Flexible New Deal programme is able to give dedicated support to the long-term unemployed.¹⁰

A range of measures for the long-term unemployed include:

- Funding for local authorities and partners to take forward the creation of 100,000 new jobs in “socially useful” activity; and
- Stipulation that the public sector will ensure that 25 per cent of their external recruitment is targeted at individuals without a job.¹¹

Young members of the long-term unemployed will receive particular assistance:

- A guarantee that everyone aged between 18 and 24 who has been claiming JSA for 12 months will be given 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; and
- Funding for *Care First*, offering 50,000 traineeships for young people in the care sector. Social care providers will receive a subsidy for offering

⁶ *Ibid.* para 4.14

⁷ *Ibid.* para 4.21

⁸ *Ibid.* para 4.37

⁹ *Ibid.* para 4.35

¹⁰ *Ibid.* para 5.25

¹¹ *Ibid.* Box 5.4

sustained employment and training to young people who have been out of work for 12 months.¹²

In addition, to support communities most affected by rising unemployment, there will be additional funding for local authorities to provide a further 50,000 jobs in areas of high unemployment across the country.¹³

Many low earners who face unemployment will also benefit from a one-off increase in the level of statutory redundancy pay, with the weekly rate rising from £350 to £380. The Government is also considering introducing a new “floor” which would set a minimum level for statutory redundancy payment rates.¹⁴

Housing

Low earner homebuyers are more likely than other members of society to be facing negative equity and more likely to be having difficulty meeting mortgage payments. At the same time, non-home-owning low earners still face difficulty joining the housing market (because of the historically high level of house prices and the lack of mortgage availability) but are less likely than members of the benefit-dependent group to have access to social housing.

Sizeable support for homeowners, homebuyers and housing supply was announced in the 2008 PBR and elsewhere at the end of last year. Budget 2009 provided some additional funds. It announced a £20 million fund to enable local authorities to extend small loans to families at risk of homelessness through repossession or eviction and a widening of the eligibility criteria for the Mortgage Rescue Scheme to include households in negative equity.¹⁵

In order to improve access to the housing market for first time buyers, the Budget extended the stamp duty holiday for houses costing up to £175,000 for four months, until the end of 2009.¹⁶ It also included a Government commitment to establish a guarantee scheme for asset-based securities to support the availability of mortgage finance.¹⁷

The Budget also includes details of an additional £600 million fund to stimulate housing development in the short term. The Government expects this to deliver up to an additional 10,000 new homes in England through:

- £400 million to unlock currently stalled housing development, attract private development finance and extend the HomeBuy Direct shared equity scheme; and
- £100 million of new funding for local authorities to deliver new social housing.¹⁸

¹² *Ibid.* Box 5.4

¹³ *Ibid.* Box 5.4

¹⁴ *Ibid.* para 5.27

¹⁵ *Ibid.* para 5.69

¹⁶ *Ibid.* para 5.74

¹⁷ *Ibid.* para 5.73

¹⁸ *Ibid.* para 5.76

Household finances

A number of initiatives announced in Budget 2009 are designed to boost households' ability to manage their finances during recession and beyond, while a number of the public spending plans have potential implications for household budgets.

Money Guidance

The Budget included a commitment to a national Money Guidance Service which will provide access for all UK adults to impartial financial guidance that will help them make informed financial decisions. Roll-out of a national service will begin in 2010, subject to preliminary findings from the pathfinder projects demonstrating that the service can be effective. Dormant account funds for financial capability will be directed to support delivery.¹⁹

Low earners' position in the advice gap between private sector financial advisers and public and third sector organisations means that they are likely to be among the main beneficiaries of this scheme.

Retail Financial Services Forum

The Retail Financial Service Forum (RFSF) was established in the 2008 PBR to champion retail financial consumers' interests and help restore confidence in financial services. Budget 2009 stated that the RFSF would act as a steering group for the development of the national Money Guidance service.²⁰

In addition, the Budget said that the RFSF would be asked to support a number of other Government aims, including:

- Confident and capable consumers, able to exert competitive pressure on the industry;
- Access for all citizens to simple, transparent, value for money products which meet their needs;
- Appropriate levels of consumer protection; and
- Swift redress if things do go wrong.²¹

Household savings

In response to the detrimental effect of low interest rates on savings, the Budget announced changes to Individual Savings Accounts (ISA) limits. With immediate effect, the annual ISA investment limit will increase for people aged 50 and over in order to enable those who have retired or are beginning to prepare for retirement to move taxed savings into a tax-advantaged ISA. From April 2010, the limit will increase for all adults, in order to encourage saving more generally.²²

The Government is also seeking to incentivise saving among people with lower incomes by introducing the Saving Gateway in 2010. The Gateway will contribute 50 pence for every pound invested and will be available to those in

¹⁹ *Ibid.* Box 5.5

²⁰ *Ibid.* paras 3.58-3.59

²¹ *Ibid.* paras 3.58-3.59

²² *Ibid.* paras 5.42-5.44

receipt of income-related benefits including some tax credits. While the Bill is already before Parliament, the Budget announced a Government amendment that would extend eligibility to recipients of the Carer's Allowance.²³

While low earners typically have relatively small levels of savings, these changes will benefit those members of the group who have built-up modest savings, particularly those facing lower than expected incomes in retirement.

The Budget also detailed an additional £270 million for the Social Fund over the next two years to provide interest free credit to vulnerable people.²⁴ While the majority of loans are available to those on income-related benefits, an increasing number of low earners who lose their jobs are likely to become eligible for support.

Cost of living

While the Budget forecast that CPI inflation will continue to ease through 2009 and remain below its 2 per cent target in 2010, increases in fuel duty are likely to have an impact on the spending power of all households, including low earners.

The Budget announced 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 2013.²⁵ These increases will push the real-terms fuel duty back to the peak levels experienced in 1999-2000.²⁶ Given that low earner households spend nearly all of their disposable income each week, with transport costs accounting for 12 per cent of their total expenditure,²⁷ fuel price increases are likely to cause significant financial pressures. If low earners react by reducing the amount they travel, their geographical mobility and ability to progress in the labour market could be affected.

The Budget also introduced a temporary vehicle scrappage scheme. The initiative is designed primarily to assist the car industry and should provide some support for low earners working in this area. However, the impact on low earner consumers is unclear.

The scheme provides a discount of £2,000 to consumers buying a new vehicle in the period to March 2010 to replace a vehicle more than ten years old which they have owned for at least 12 months.²⁸ The Government will provide half of the subsidy and the industry will provide the other half. The £300 million earmarked by the Government will therefore mean that a maximum of 300,000 transactions will take place under the scheme. As such, it will benefit a limited number of consumers, many of whom may have traded their car in without any

²³ *Ibid.* para 5.47

²⁴ *Ibid.* para 5.35

²⁵ *Ibid.* para 7.51

²⁶ IFS, *Indirect taxes and environmental measures*, 23 April 2009:

<http://www.ifs.org.uk/budgets/budget2009/indirect.pdf>

²⁷ Analysis of ONS, *Family Spending: A report on the 2007 Expenditure and Food Survey*, 26 November 2008, Tables 3.2E & 3.3E and ONS, *The effects of taxes and benefits on household income, 2006/07*, Table 14

²⁸ *Ibid.* para 4.16

incentive. In addition, it could serve to reduce the supply of second-hand vehicles on the market and could therefore push up the price faced by those consumers, including low earners, who want to buy a cheap car.

Benefits and tax credits

Low earners have been among the biggest beneficiaries of tax credits. Changes announced in the Budget are therefore of particular relevance to the group.

The Budget revealed that HMRC will begin new research-driven marketing to extend take-up among the half a million people who stand to gain most from Working Tax Credit (WTC), with PAYE records being used to identify and contact potentially eligible people.²⁹

The Budget also set out above-inflation increases in Child Tax Credit from April 2010 onwards³⁰ and one-off increases in Winter Fuel Payments in 2009 of £100 for households with someone aged over 80 and £50 for household with someone aged over 60.³¹

It is also welcome that the Government used the Budget to re-assert both its commitment to a minimum 2.5 per cent increase in the basic State Pension in April 2010 even if inflation in the economy is at a lower level and its commitment to the introduction of the earnings uprating in 2012-13.³² Some older low earners may also benefit from the increase in the capital disregard in Pension Credit, although this is likely to be of more relevance to members of the benefit-dependent group.³³

The Budget announced that eligibility for the Basic State Pension would be widened to enable 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 able to gain National Insurance credits from April 2011.³⁴ This move will benefit those in low earner households who struggle to balance childcare with working.

Social care

The Budget detailed plans to launch the adult social care Green Paper in June 2009 to consult 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”.³⁵

Low earners are particularly affected by the inefficiency and unfairness of the current long-term care system: they are often too rich to be eligible for state assistance with funding but too poor to access a good range of self-funded solutions. In addition, low earners are more likely to be informal carers and to be members of the social care workforce.

²⁹ *Ibid.* para 5.7

³⁰ *Ibid.* para 5.13

³¹ *Ibid.* para 5.57

³² *Ibid.* paras 5.3 & 5.62

³³ *Ibid.* para 5.58

³⁴ *Ibid.* para 5.61

³⁵ *Ibid.* para 5.60

Since 2008, long-term care has been the Foundation's primary workstream. We have published a number of reports and continue to work in this area. We will respond to the Green Paper when it is published.

Public finances

Recession is set to increase the Government's spending to levels not experienced since the early 1980s while at the same time cutting tax revenues to mid-1990 levels. As such, public sector net borrowing (PSNB) is due to rise to its highest post-war level (£175 billion or 12.4 per cent of GDP in 2009-10), with public sector net debt (PSND) expected to increase from below 40 per cent of GDP in 2007-08, to nearly 80 per cent of GDP in 2013-14. Based on the path set out by the Chancellor in the Budget, the IFS forecasts that PSND will remain above the ceiling that Gordon Brown introduced as Chancellor (40 per cent of GDP) until 2032.³⁶

However, low interest rates mean that the burden of that debt could remain relatively low by historical standards, with interest costs rising to similar levels inherited by the Labour Government in 1997 (3 per cent of GDP) in the period to 2017-18 before falling thereafter. Increases in interest rates would obviously increase this burden, though it is likely to remain within historical boundaries.³⁷

There may therefore be some scope for considering whether the period over which the debt is repaid can be extended. It is important that restoration of public finance balance appears credible to investors in order to allow the Government to continue to borrow at low interest rates. However, it is likely that this credibility will rest more on the description of a realistic path than on a commitment to the most rapid readjustment. The Budget's emphasis on eight years simply reflects the Government assessment of the "appropriate pace" of consolidation of public finances.³⁸

Following announcements made in the Budget, the real terms increase in Government spending over the 2007 Comprehensive Spending Review (CSR), period (2007-08 to 2010-11) is set to be 4.6 per cent. The fiscal tightening set out on Wednesday means that total spending will be cut by 0.1 per cent in real terms in the period from 2011-12 to 2013-14. Such a low level of growth over three years was last experienced in 1996-1997 to 1998-1999 when the Labour Government adhered to tight spending plans set out by the previous Conservative administration.³⁹

The 0.1 per cent real-terms cut in Government spending in the period 2011-12 to 2013-14 will have a more significant effect on discretionary departmental expenditure. Unavoidable increases in debt interest payments, social security, tax credits and other annually managed expenditure (spending outside of government control) mean that the amount left over for departments to spend could actually fall by 2.3 per cent per year in real terms.⁴⁰

³⁶ IFS, *Public finances: two parliaments of pain*, 23 April 2009:

http://www.ifs.org.uk/budgets/budget2009/public_finances.pdf

³⁷ *Ibid.*

³⁸ HMT, *Budget 2009*, para 2.66

³⁹ IFS, *Public spending*, 23 April 2009: http://www.ifs.org.uk/budgets/budget2009/public_spending.pdf

⁴⁰ *Ibid.*

The Budget set out the size of further fiscal tightening in the period from 2014-15 to 2017-18, but not the split between tax rises and spending cuts. If the required receipts were funded entirely by spending cuts, then Government spending would increase by 0.5 per cent per year in real terms, representing the lowest seven-year period of growth since 1985-86 to 1991-92.⁴¹

It is also worth noting that still tighter spending cuts could be required if the Government's forecasts for the pace of economic recovery or the revenue-raising capacity of the announced tax increases prove to be incorrect.

This squeezing of public finances could have a very significant impact on the wellbeing of those at the threshold of state assistance – low earners. However, while the Budget details a path for repairing public finances, it includes no details of how spending cuts will be shared across government departments. The distribution of these cuts across and within departments will therefore be of crucial importance to low earners.

The Foundation will seek to influence decisions about this distribution via the *Through the adjustment* programme of work.

27 April 2009

⁴¹ *Ibid.*