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## Financial Statement

**Volume 512: debated on Tuesday 22 June 2010**

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**Mr Deputy Speaker >**

(Mr Lindsay Hoyle)

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Before I call the Chancellor of the Exchequer, it may be for the convenience of hon. Members if I remind them that at the end of the Chancellor's speech, copies of the Budget resolutions will be available to them in the Vote Office. For the benefit of new Members, I add that it is not appropriate, or allowed, to intervene on either the Chancellor or the Leader of the Opposition.

 12.33pm

**The Chancellor of the Exchequer >**

(Mr George Osborne)

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This emergency Budget deals decisively with our country's record debts. It pays for the past, and it plans for the future. It supports a strong, enterprise-led recovery, it rewards work and it protects the most vulnerable in our society. Yes, it is tough, but it is also fair.

This is an emergency Budget, so let me speak plainly about the emergency that we face. The coalition Government have inherited from their predecessors the largest budget deficit of any economy in Europe, with the single exception of Ireland. One pound in every four we spend is being borrowed. What we have not inherited from our predecessors is a credible plan to reduce their record deficit—this at the very moment when fear about the sustainability of sovereign debt is the greatest risk to the recovery of European economies. Questions that were asked about the liquidity and solvency of banking systems are now being asked about the liquidity and solvency of some of the Governments who stand behind those banks. I do not want those questions ever to be asked of this country. That is why we have set a brisk pace since taking office.

In the past seven weeks, we have announced, conducted and completed a review of this year's spending and identified £6 billion of savings. We have announced, established and received the report of the independent Office for Budget Responsibility. The power that the Chancellor has enjoyed for centuries to determine the growth and fiscal forecasts now resides with an independent body immune to the temptations of the political cycle. And we have examined, decided on and in some cases halted the mass of unfunded commitments, IOUs and overcommitted reserves that greeted us on entering office.

This is early, determined action, and it has earned us credibility in international markets. It has meant that our promise to deal decisively with the deficit has been listened to. Market interest rates for Britain have fallen over the past seven weeks, while those of many of our European neighbours have risen. Those lower market interest rates are already supporting our recovery.

But unless we now deliver on that promise of action with concrete measures, that credibility—so hard won in recent weeks—will be lost. The consequence for Britain would be severe: higher interest rates, more business failures, sharper rises in unemployment, and potentially even a catastrophic loss of confidence and the end of the recovery. We cannot let that happen. This Budget is needed to deal with our country's debts. This Budget is needed to give confidence to our economy. This is the unavoidable Budget.

I am not going to hide hard choices from the British people or bury them in the small print of the Budget documents. The British public are going to hear them straight from me, here at this Dispatch Box. Our policy is to raise from the ruins of an economy built on debt a new, balanced economy, where we save, invest and export; an economy where the state does not take almost half of all our

...a new, balanced economy, where we save, invest and export, an economy where the state does not take almost half of all our national income, crowding out private endeavour; an economy not overly reliant on the success of one industry, financial services—important as they are—but where all industries grow; an economy where prosperity is shared among all sections of society and all parts of the country. In this Budget, everyone will be asked to contribute. But in return, we make this commitment: everyone will share in the rewards when we succeed. When we say that we are all in this together, we mean it.

The first challenge for this Budget is to set the fiscal mandate—in other words, our overall objective for the public finances. The previous Government had two fiscal rules, one for debt and one for the current Budget. They were supposed to force Chancellors to set aside money in the good years so that they could borrow sustainably when the economy turned down. They completely failed in that task.

As this is the last Budget in which this golden rule will appear, I would like to be the last Chancellor to report on it. We are set to miss the golden rule in this cycle by £485 billion. We now know the intrinsic weakness in backward-looking fiscal rules: past prudence was an excuse for future irresponsibility; and the judge of the rules was the very same Chancellor they were supposed to be restraining. We propose a more credible approach.

Our fiscal mandate will be forward-looking, and the judge of whether we are on course to meet it will be not the Chancellor, but the independent Office for Budget Responsibility. On behalf of the House, I thank Sir Alan Budd and his fellow committee members, Geoffrey Dicks and Graham Parker, for their highly professional effort. In the space of just seven weeks, I believe we have established the Office for Budget Responsibility as a permanent improvement to economic policy making and the transparency of government. The legislation to put the office on a statutory footing will now be drawn up and I hope it will command all-party support.

I now turn to what that fiscal mandate will be. The view of the international community was clearly expressed at the latest G20 meeting, and we will be taking the same message to the G20 summit in Toronto this weekend. Surplus countries should do more to support global demand. So we welcome China's announcement to come off the dollar peg. At the same time, the international community believes countries with high fiscal deficits need to accelerate the pace of fiscal consolidation. That is precisely what we now propose to do. The formal mandate we set is that the structural current deficit should be in balance in the final year of the five-year forecast period, which is 2015-16 in this Budget. This mandate is structural, to give us flexibility to respond to external shocks; current, to protect the most productive public investment; and credible, because the OBR, not the Chancellor, will decide on the output gap.

In order to place our fiscal credibility beyond doubt, this mandate will be supplemented by a fixed target for debt, which in this Parliament is to ensure that debt is falling as a percentage share of GDP by 2015-16. I can confirm that, on the basis of the measures to be announced in this Budget, the judgment of the OBR, which we published today, is that we are on track to meet those goals. Indeed, I can tell the House that, because we have taken a cautious approach, we are set to meet them one year earlier, in 2014-15. To put it another way, we are on track to have debt falling and a balanced structural current budget by the end of this Parliament.

At this point in the Budget speech, the Chancellor would normally read out their own set of economic and fiscal forecasts, and they normally tell the House more about the political cycle than the economic one. Those days have gone for good. Instead, I will give the House the latest forecasts from the independent OBR, taking into account the measures in the Budget.

Growth in the UK economy for the coming five years is estimated to be 1.2% this year and 2.3% next year; then 2.8% in 2012 followed by 2.9% in 2013; and then 2.7% in both 2014 and 2015. Consumer price inflation is expected to reach 2.7% by the end of the year before returning to target in the medium term, and let me take this opportunity to confirm that the inflation target remains at 2% as measured on the consumer prices index.

The unemployment rate is forecast by the OBR to peak this year at 8.1% and then fall for each of the next four years to reach 6.1% in 2015. Some have suggested that there is a choice between dealing with our debts and going for growth. That is a false choice. The crisis in the eurozone shows that unless we deal with our debts, there will be no growth. These forecasts demonstrate that a credible plan to cut our budget deficit goes hand in hand with a steady and sustained economic recovery, with low inflation and falling unemployment. What is more, the forecast shows a gradual rebalancing of the economy, with business investment and exports playing a greater role and Government spending and debt-fuelled consumption a smaller role—a sustainable private sector recovery built on a new model of economic growth, instead of pumping the debt bubble back up.

Part of the reason, as we have always argued, is that tighter fiscal policy can enable interest rates to stay lower for longer. As the Governor of the Bank of England confirmed this week at the Mansion House:

“If prospects for growth were to weaken the outlook for inflation would probably be lower and monetary policy could then respond”.

in prospects for growth were to weaken, the cushion for inflation would probably be lower, and monetary policy would then respond.

The subject of interest rates brings me to say this about attempts to compare directly last week's forecasts with this one. As the OBR notes in today's Budget document, any such comparison would be "misleading", because last week's forecast included the lower interest rates that expectations of this week's Budget have already brought about. So, as Sir Alan has written, actually to follow the fiscal path set out by the previous Government

"would lead to higher interest rates and...lower economic activity"

than his forecast showed.

Let me now turn to the measures in the Budget designed to deliver this accelerated reduction in the structural deficit. The coalition believes that the bulk of the reduction must come from lower spending rather than higher taxes. The country has overspent; it has not been under-taxed. Our approach is supported by the international evidence, compiled by the OECD, the International Monetary Fund and others, which found that consolidations delivered through lower spending are more effective at correcting deficits and boosting growth than consolidations delivered through tax increases.

That is the origin of our 80:20 rule of thumb—roughly, 80% through lower spending and 20% through higher taxes. This evidence has been available in the Treasury for some time, but was published only in a redacted form by the previous Government. We intend to follow international best practice and the Treasury's own analysis. My measures today mean that 77% of the total consolidation will be achieved through spending reductions and 23% through tax increases. I believe this gets the balance right.

I now turn to the OBR's fiscal forecasts. As a result of the measures I will announce today, public sector net borrowing will be £149 billion this year, falling to £116 billion next year, £89 billion in 2012-13 and £60 billion in 2013-14. By 2014-15, borrowing reaches £37 billion—exactly half the amount forecast in the March Budget—and in 2015-16, borrowing falls further to £20 billion. As a share of the economy, borrowing will fall from 10.1% of GDP this year to just 1.1% in 2015-16.

We now know, thanks to the OBR forecast, that the structural current deficit is significantly larger than we were told—0.8% of GDP or £12 billion higher next year. Thanks to my action today, the structural current balance will be minus 4.8% of GDP this year. That deficit will then be eliminated to plus 0.3% in 2014-15 and plus 0.8% in 2015-16. In other words, it will be in surplus.

Public sector net debt, as a share of GDP, will be 62% this year, before peaking at 70% in 2013-14. Because of our action today, it then begins to fall, to 69% in 2014-15 and then 67% in 2015-16, whereas under the plans we inherited, debt would have increased in every full year of this Parliament. The House will want to know that, as a result of our measures, debt interest payments will be £3 billion a year lower by the end of this Parliament than they would have been.

I have one further announcement to make regarding macro-economic policy. I can confirm that, as set out in the coalition agreement, the Government will not be joining the euro in this Parliament. I have therefore abolished the Treasury's Euro Preparations Unit—yes, one does exist—and the official concerned has been redeployed to more productive activities.

Let me now turn to my other decisions on public spending. The state today accounts for almost half of all national income, which is completely unsustainable. All parties in the House now accept that spending needs to be cut, and we have made a start, but we need to go much further if we are to meet our fiscal mandate and see debt falling by the end of this Parliament. Today we are setting out the overall path of public spending that will achieve that.

Let me begin with current spending. Current expenditure will rise from £637 billion in 2010-11 to £711 billion in 2015-16. Although this is an increase, the House should remember that we inherit a rapidly rising bill for debt interest—a bill that will not start falling until the debt itself starts to fall. Debt interest payments alone will cost the taxpayer a quarter of a trillion pounds over this period. One of my predecessors used to call this spending the costs of social failure, but I say it is the price of economic failure. Compared with the plans set out by the previous Government, I am announcing today additional current expenditure reductions of £30 billion a year by 2014-15. The plans for public investment we inherit from our predecessors envisage a steep drop from £69 billion last year to £46 billion in 2014-15.

After the initial in-year reductions, the question we have been faced with is how much further to go on capital spending. Well-judged capital spending by Government can help provide the new infrastructure our economy needs to compete in the modern world. It supports the transport links we need to trade our goods, the equipment we need to defend our country and the facilities we need to provide quality public services. I think an error was made in the early 1990s when the then Government cut capital spending too much—perhaps because it is easier to stop new things being built than to cut the budgets of existing programmes.

We have faced many tough choices about the areas in which we should make additional savings, but I have decided that capital spending should not be one of them. There will be no further reductions in capital spending totals in this Budget, but we will make

careful choices about how that capital is spent. The absolute priority will be projects with a significant economic return to the country. Assessing what those projects are will be an important part of the autumn spending review.

The Government can also dispose of assets that should rightly be in private ownership. Yesterday, we launched the sale of High Speed 1. We will look at how to dispose of our shareholding of NATS, the air traffic control services. We will aim to sell the student loan book and look at options around early repayment for individuals, and we will resolve the future of the Tote—at last. My right

hon. Friend the Secretary of State for Business, Innovation and Skills will also facilitate a private capital injection into the Royal Mail Group, something that has been long overdue.

Before I turn to discuss departmental budgets, I need to say something first about another area of spending—the civil list. The civil list is the Government's support for Her Majesty the Queen in her duties as Head of State, and I am sure that everyone in this House will want to join me in recognising the Queen's loyal service and immense contribution to public life. The amount provided by the civil list has remained unchanged over the past 20 years, at £7.9 million. This has required careful management. Because of inflation, the annual payment is today worth only a quarter of what it was 20 years ago. I can announce that, with the full agreement of the Queen, the civil list will remain frozen at £7.9 million for the coming year, and I will propose a new means of consolidated support for Her Majesty for the future at a later date.

In addition, the royal household has agreed that, in future, civil list expenditure will be subject to the same audit scrutiny as other Government expenditure, through the National Audit Office and the Public Accounts Committee of this House of Commons. I believe that this will mean clear accountability in this House and that it will strengthen public confidence.

Let me turn now to my decisions on departmental expenditure limits. In recent years, Chancellors have been reluctant to explain what their total spending projections will mean for Whitehall Departments, and that is entirely self-defeating. It normally takes people at the Institute for Fiscal Studies less than 24 hours to work it out for themselves and let the public know the truth. I will save them the effort.

We have inherited from the previous Government spending plans to cut departmental budgets by £44 billion a year by 2014-15. This implies an average real reduction for unprotected Departments of 20%—not that this was ever said, or a single pound of cuts to programmes even identified. Because the structural deficit is worse than we were told, my Budget today implies further reductions in departmental spending of £17 billion by 2014-15. We have committed to providing the NHS with real increases throughout the Parliament, and we will honour our international aid obligations to the poorest in the world. Once these are taken into account, the Budget figures imply that other Departments will face an average real cut of around 25% over four years. Clearly, if we can find any additional savings to social security and welfare beyond those that I will outline shortly, then that will greatly relieve the pressure on these Departments and that 25% figure.

Of course, not all Departments will receive the same settlement. I recognise, for example, the particular pressures on our education system and on defence. Final departmental settlements, and the final split between departmental expenditure and annually managed expenditure on welfare, will be set in the spending review. Rather than follow the usual practice of keeping the date of that review a secret until a few weeks before it happens, let me tell the House that it will be presented on Wednesday 20 October.

A further way that we can ease the pressure on public services is to agree that we need to restrain public sector pay in these difficult times, and we need to do something about the spiralling costs of public sector pensions. Many millions of people in the private sector have in the past couple of years seen their pay frozen, their hours reduced and their pension benefits restricted. They have accepted that, because they knew that the alternative in many cases was further job losses. The public sector was insulated from those pressures but now faces a similar trade-off. I know that there are many dedicated public sector workers who work very hard and did not cause this recession, but they must share the burden as we pay to clean it up. The truth is that the country was living beyond its means when the recession came, and if we do not tackle pay and pensions, more jobs will be lost.

That is why the Government are asking the public sector to accept a two-year pay freeze, but we will protect the lowest paid. In the past, I have said that we would be able to exclude the 1 million public sector workers earning less than £18,000 from a one-year pay freeze. Today, because we have had to ask for a two-year pay freeze, I extend the protection to cover the 1.7 million public servants who earn less than £21,000 a year. Together, they make up 28% of the public sector work force. They will each receive a flat pay rise worth £250 in both years, so that those on the very lowest salaries will get a proportionately larger rise. In recognition of our armed services who are risking their lives for us all in Afghanistan, we have also doubled the operational allowance to £4,800. We have asked Will Hutton to draw up plans for fairer pay across the public sector without increasing the overall pay bill, so that those at the top of organisations are paid no more than 20 times the salaries of those at the bottom. The culture of excessive pay at the very top of the public sector simply has to end.

We also need to deal with the cost of public service pensions. This is one of the greatest long-term pressures facing our nation's finances. The OBR today publishes figures showing that by 2015-16 we will be spending over £10 billion a year simply to meet the gap between pension contributions and payments to the unfunded pensions that they support. That is why I have asked John Hutton to carry out an investigation. As the Work and Pensions Secretary in the previous Government, he brings experience and an unbiased approach. He will provide an interim report in September this year to help inform any decisions required for the spending review, and a full report in time for next year's Budget.

The Government will also accelerate the increase in the state pension age to 66. A call for evidence will be launched later this week, and we will consult on whether to phase out the default retirement age.

Let me now address the largest bill in Government—the welfare bill. It is simply not possible to deal with a budget deficit of this size without undertaking lasting reform of welfare. It has been a key component of most successful fiscal consolidations elsewhere in the world and, around Europe, countries are now tackling their benefits bill. Germany has already announced €30 billion-worth of cuts to welfare spending, and others are taking similar steps.

Here in Britain, the explosion in welfare costs contributed to the growing structural budget deficit in the middle part of this decade. Total welfare spending has increased from £132 billion 10 years ago to £192 billion today. That represents a real-terms increase of a staggering 45%, and it is one of the reasons why there is no money left. It has also left an increasing number of our fellow citizens trapped on out-of-work benefits for the whole of their lives. A greater proportion of our children grow up in workless households than any other country in Europe. We are wasting the talents of millions, and spending billions on it in the process, so we will increase the incentives to work, and reduce the incentives to stay out of work. We will focus our benefits more towards those in need, and we will end some one-off payments that the country cannot afford any more.

First, we need to put the whole welfare system on a more sustainable and affordable footing. So from next year, with the exception of the state pension and pension credit, we will switch to a system where we uprate benefits, tax credits and public service pensions in line with consumer prices rather than retail prices. The consumer prices index not only reflects everyday prices better, but it is of course now the inflation measure targeted by the Bank of England. This will save over £6 billion a year by the end of the Parliament. I believe that this is a fairer approach than a benefits freeze. In time for the next Budget, we will also publish proposals to move the indexation in the tax system from RPI to CPI in a way that protects revenues.

Tackling spiralling welfare costs means also addressing the bill for tax credits. Spending on tax credits has increased from £18 billion in 2003 to £30 billion this year, and that is an unsustainable rise. There are over 150,000 families with incomes over £50,000 receiving tax credits. Taking into account the various disregards means that families earning up to £83,000 are eligible for this means-tested benefit. The country simply cannot afford this any more.

We need to target tax credits on those who need the help most, so we will reduce payments to families earning over £40,000 next year and then align the thresholds for the child and family element. We will increase the taper rate at which awards are reduced, and remove the baby element for new children from April 2011. We will remove the one-off payment to new workers over 50 from April 2012, and reduce the income disregard from £25,000 to £10,000, and then to £5,000. We will introduce an income disregard for income falls, reduce backdating from three months to one month, and we will not introduce the pre-election promise of a new tax credit element for infants.

Sadly, there are further benefits that this country cannot afford. We will abolish the poorly targeted health in pregnancy grant from April 2011. At the same time, we will restrict the Sure Start maternity grant to the first child only, and we will expect lone parents to look for work when their youngest child goes to school. We have decided that we simply cannot afford to extend the saving gateway, and we have also had to take a difficult decision about child benefit. I have received many proposals about this benefit. Some have suggested that we means-test it; others that we tax it. All these proposals involve issues of fairness.

The benefit is usually claimed by the mother. To tax it would mean that working mothers received less than the non-working partner of higher earners. To means-test it, we would have to create a massively complex new system to assess household incomes. I do not propose to do those things. I know that many working people feel that their child benefit is the one thing that they get without asking from the state. So instead, to control costs, we have decided to freeze child benefit for the next three years. This is a tough decision, but I believe that it strikes the right balance between keeping intact this popular universal benefit, while ensuring that everyone across the income scale makes a contribution to helping our country reduce its debts.

That brings me to another universal benefit: disability living allowance. It is right that people who are disabled are helped to lead a life of dignity. We will continue to support them, and we will not reduce the rate at which this benefit is paid. However, three times as many people claim it today than when it was introduced 18 years ago, and the costs have quadrupled in real terms to more than £11

billion a year, making it one of the largest items of Government spending. We will introduce a medical assessment for DLA from 2013, which will be applied to new and existing claimants. For people with disabilities, that will be a simpler process than the complex forms that they have to fill out at present. That way, we can continue to afford paying this important benefit to those with the greatest needs, while significantly improving incentives to work for others.

Spending on housing benefit has risen from £14 billion 10 years ago to £21 billion today. That is close to a 50% increase over and above inflation. The costs are completely out of control. We now spend more on housing benefit than we do on the police and on universities combined. Among these enormous numbers for total spending, there are some equally enormous individual claims. Today there are some families receiving £104,000 a year in housing benefit. The cost of that single award is equivalent to the total income tax and national insurance paid by 16 working people on median incomes. It is clear that the system of housing benefit is in dire need of reform.

We will introduce that reform by resetting and restricting local housing allowances; uprating deductions; reducing certain awards; re-adjusting support for mortgage interest payments; and limiting social tenants' entitlement to appropriately sized homes. Lastly, we will for the first time introduce maximum limits on housing benefit, from £280 a week for a one-bedroom property to £400 a week for a four-bedroom property or larger. Our package today will reduce the costs of housing benefit by £1.8 billion a year by the end of the Parliament—or by just 7% of the total budget—but it will improve incentives to work. At the same time, we will target more resources at those who need them most by increasing the budget for discretionary housing payments to deal with hardship cases by £40 million, and from now we will cover the cost of an additional room for those claimants with a disability who need a carer.

Taken together, all those measures to control the costs of welfare will save the country £11 billion by 2014-15. Governments in the past have said that they were going to get to grips with welfare and to reward work. We are delivering. My right hon. Friend the Secretary of State for Work and Pensions will bring forward proposals to further reform the benefits system as a tool to support work and encourage aspiration in time for the autumn spending review.

But as I said right at the start of this speech, this Budget is not just about paying for the bills of the past; it is also about planning for the future. It is my deeply held belief that a genuine and long-lasting economic recovery must have its foundations in the private sector. That is where the jobs will come from, and we will do absolutely everything to support their creation. We argued that imposing a jobs tax was the last thing that Britain needed in a recovery, and the businesses of the country agreed with us, so we will adopt a different approach. We will make it cheaper for companies to employ people. From April 2011, the threshold at which employers start to pay national insurance will rise by £21 a week above indexation. The cost of hiring people on incomes lower than £20,000 will be less than it is today; and in one move we will have lifted 650,000 employees out of this tax altogether.

But if we are to have a sustained, job-creating recovery, we need more than that. We need to see growth not just in one corner of our country, nor in just one sector, for we live in a world where the competition for business is growing ever more intense. I want a sign to go up over the British economy that says “Open for business”, and this is how I propose to do it. Corporation tax rates are compared around the world, and low rates act as adverts for the countries that introduce them. Our current rate of 28p is looking less and less competitive, so we will do something about it. Next year we will cut corporation tax by 1%, to 27p in the pound, the year after we will cut it again by 1%, and again the year after, and again the year after that—four annual reductions in the rate of corporation tax that will take it down to just 24%. That will give us the lowest rate of any major Western economy, one of the lowest rates in the G20 and the lowest rate that this country has ever known.

At the same time, we will agree with businesses a long-term approach to the taxation of foreign profits, the treatment of intellectual property and the proposals from James Dyson on research and development. We will also reduce the small companies tax rate. The previous Government were planning to increase that tax rate next year to 22%, at the very time when we should be encouraging small businesses to grow. Instead, we will cut the rate to 20%, which will benefit some 850,000 companies. And because small businesses are struggling to obtain credit at the moment, I will extend the enterprise finance guarantee scheme, which supports small and medium-sized businesses' access to lending. Those changes will benefit at least 2,000 small businesses.

My right hon. Friend the Secretary of State for Business, Innovation and Skills will come forward in the summer with further proposals on expanding the availability of credit, to ensure that the economic recovery is properly financed. Also, there are many small businesses in the tourism industry today. To help them, I am reinstating the favourable tax rules for furnished holiday lettings, which our predecessors had planned to repeal. I can also announce that there will be measures to cancel certain backdated business rates bills, including for many businesses in ports.

In the current climate, with the deficit the size that it is, all those reductions in tax must be more than paid for by other changes to

business taxation, so we will not go ahead with the poorly targeted tax relief for the video games industry. There will be a small reduction in the rates for capital allowances, which will remain broadly in line with economic depreciation. For the majority of plant and machinery assets, the rate of the allowance will fall from 20% to 18%, while the allowance for longer-lived assets will fall from 10% to 8%. In other words, businesses will still receive full tax relief on their qualifying expenditure, but over a longer time frame.

I have also decided to reduce the annual investment allowance to £25,000 a year, to ensure that support is focused on investment by smaller firms. Over 95% of businesses will continue to have all their qualifying plant and machinery expenditure fully covered by this relief. Manufacturing as a whole will pay less tax. I have listened to the argument that changing those crucial allowances during the early stages of the economic recovery could be disruptive, so I will delay the reductions in capital and investment allowances to April 2012. That will give businesses the extra early advantage of the tax cuts, which will start to come in from next year.

Our reforms today will also mean a greater contribution from the banking sector—one that far outweighs any benefit that it will receive from the lower tax rates that I have just announced. In putting the nation's finances in order, we must remember that this was a crisis that started in the banking sector. The failures of the banks imposed a huge cost on the rest of society, so I believe that it is fair and right that in future banks should make a more appropriate contribution, reflecting the many risks that they generate. Such an approach has already been recommended by the International Monetary Fund. We are exploring the costs and benefits of a financial activities tax on profits and remuneration, and we will work with international partners to secure agreement, but today the British Government take the initiative in this global debate about the appropriate risks and rewards in international banking.

From January 2011, we will introduce a bank levy. It will apply to the balance sheets of UK banks and building societies, and to the UK operations of banks from abroad. There will be deductions for tier 1 capital and insured retail deposits, and a lower rate for longer maturity funding. Smaller banks with liabilities below a certain level will not be liable for the levy. Once fully in place, we expect the levy to generate over £2 billion of annual revenues.

There are those who have argued whether we should wait until every country in the G20 introduces a bank levy. I believe that is not reasonable or fair. Indeed, I can tell the House that the French and Germans have joined the UK today in committing to introduce a bank balance sheet levy. In a joint statement, our three Governments have pledged to ensure our banks make a fair contribution to reflect the risks they pose.

The message I hear from those in the business community is unequivocal: they want certainty and stability from Government so that they can start the long process of rebuilding their businesses. Today, I am offering them just that—a five-year plan to reform the corporation tax system, with lower rates, simpler rules and greater certainty. It provides the most fundamental and far-reaching reform of our corporate tax regime in generations. It offers a stable and consistent platform for a private sector recovery. It is a balanced package, which will send a clear signal that Britain is open for business. It will help companies invest, attract foreign investment and boost growth. Above all, it will help create jobs. By increasing the amount of business investment by an additional £13 billion between now and 2016, these reforms will help rebalance the economy away from household debt and Government consumption.

We will also take forward our plans to create a green investment bank, bringing forward private investment in clean energy and green technologies; and we will also need investment in our digital infrastructure. But the previous Government's landline duty is an archaic way of achieving this, hitting 30 million households who happen to have a fixed telephone line. I am happy to be able to abolish this new duty before it is even introduced. Instead, we will support private broadband investment, including to rural areas, in part with funding from the digital switchover underspend within the television licence fee.

Over the past decade, the British economy has become deeply unbalanced, and nowhere are those disparities as marked as between the different regions of Britain. Between 1998 and 2008, for every private sector job generated in the north and the midlands, 10 were created in London and the south. We need a new approach—one that empowers local leadership, generates local economic growth and promotes job creation in all parts of the country, including Wales and Scotland. We will publish a White Paper on how we intend to deal with these issues later in the summer, followed by a consultation paper on rebalancing the economy of Northern Ireland.

As a step towards rebalancing our economy, we are today announcing the support for those regions more dependent on the public sector. First, even when money is so short, we will commit to the following important regional transport projects: the upgrade of the Tyne and Wear metro; the extension of the Manchester Metrolink; the redevelopment of Birmingham New Street station; and improvements to the rail lines to Sheffield and between Liverpool and Leeds.

Secondly, we will create a large regional growth fund to provide finance for regional capital projects over the next two years. We will

announce the details shortly, but priority will be given to projects that have the greatest impact on improving innovation and creating jobs.

Thirdly, we will shortly announce a new tax scheme to help create new businesses in those regions where the private sector is not nearly strong enough. For the next three years, anyone who sets up a new business outside London, the south-east and the eastern region will be exempt from up to £5,000 of employer national insurance payments for each of the first 10 employees hired. We aim to

have the scheme up and running by September, but any qualifying new business set up from today will also receive help. The Treasury estimates that some 400,000 new businesses will benefit, ensuring all parts of our country contribute to a more balanced and sustainable economic future.

Let me turn now to some further decisions we have made on taxation. I am someone who believes in the virtues of lower taxation, but the only sustainable route to lower taxes is by first achieving sound public finances. The sovereign debt crisis means we need to reduce the deficit even more quickly in order to protect our economy. The Office for Budget Responsibility has revealed the size of the structural deficit to be even larger than we feared—£12 billion larger next year.

As a result, this Budget announces a further fiscal tightening of £40 billion a year by the end of this Parliament, including welfare and spending measures, over and above the previous Government's plans. To achieve that additional tightening while maintaining the right "four-to-one" balance between spending and taxation means that I have to announce further tax rises today.

On 4 January next year, the main rate of VAT will rise from 17.5% to 20%. *[Interruption.]* The years of debt and spending make this unavoidable. This single tax—*[Interruption.]*

#### Mr Deputy Speaker >

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Order. Will hon. Members calm down? It is important to Members on all sides of the House that they can hear, but more important, the country takes this Budget very seriously, so I call for more calm and a little more restraint.

#### Mr Osborne >

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The years of debt and spending made this unavoidable. This single tax measure will by the end of this Parliament generate over £13 billion a year of extra revenues. That is £13 billion that we do not have to find from extra spending cuts or income tax rises. I can also give this House a commitment that we will keep everyday essentials such as food and children's clothing, as well as other zero-rated items like newspapers and printed books, exempt from VAT over the course of this Parliament. In line with the increase in the main rate of VAT, the higher rate of insurance premium will also rise from 17.5% to 20%, while the standard rate will increase from 5% to 6%.

Let me turn to my decisions on duties. The March Budget included substantial increases in those, and I can tell the House that my Budget includes no new increases in duties on alcohol, tobacco or fuel. We will report back in the autumn on the scope for targeting alcohol duty at the products most associated with binge drinking and under-age consumption. We will explore changes to the aviation tax system, including switching from a per-passenger to a per-plane duty, and consult on major changes. This will help us to reduce our carbon emissions. We are examining the impact of sharp fluctuations in the price of oil on the public finances to see if pump prices can be stabilised, and we will also look at whether a rebate for remote rural areas could work.

I have one final announcement on duties. We have decided to reverse the previous Government's plans to increase the duty on cider by 10% above inflation and the reduction will come into effect at the end of this month—just in time to celebrate England's progress to the quarter finals, or else to drown our sorrows.

That brings me to council tax. At times like this when money is short, we think all parts of government should work hard to keep costs down, and we want to give councils every incentive to do just that. So we will offer a deal to local authorities in England: if they can keep their cost increases low, then we will help them to freeze council tax for one year from next April. That will mean that the average family will be some £35 better off next year, and every year thereafter. It will be one less rising bill for families to worry about, and it will drive value for money throughout all levels of government.

One of the most chaotic areas of tax that the new Government inherited from their predecessor is the capital gains tax regime. Some



of the richest people in this country have been able to pay less tax than the people who clean for them. That is not fair, and it stems from the avoidance activity that has exploited the wider gap between the rate of capital gains tax and the top rates of income tax. Those practices are costing other taxpayers more than £1 billion every year.

It is therefore right, as set out in the coalition agreement, that capital gains tax should increase in order to help create a fairer tax system. I have listened carefully to everyone's views and considered all the options. My concern has been to balance the competing demands of fairness, simplicity and competitiveness—and I believe my decision gets that balance right. Low and middle-income

savers who pay income tax at the basic rate make up over half of all capital gains taxpayers. They will continue to pay tax on their capital gains at 18%. From midnight, taxpayers on higher rates will pay 28% on their capital gains. I have also decided that the annual exempt amount for capital gains tax will remain at £10,100 this year, and will continue to rise with inflation in future years.

I am acutely aware of how important it is to protect the incentives to succeed in business and to innovate, so to promote enterprise, the 10% capital gains tax rate for entrepreneurs, which currently applies to the first £2 million of qualifying gains made over a lifetime, will be extended to the first £5 million of lifetime gains. I asked the Treasury to examine what would have happened if we had increased the rate much further beyond 28%, and its dynamic analysis showed that that would have resulted in smaller total revenues. I also considered in great detail the options presented to me for introducing tapers or indexation allowances, and concluded that the complexity and administration involved would have been self-defeating.

The changes that I have made mean that the capital gains of the majority of taxpayers are protected; that we have a top rate that is in line with those of our international competitors; that we keep the system simple and easy for any taxpayer to understand; and that we reduce the incentives to convert income to capital gains. It is revealing that the great majority of the almost £1 billion of extra receipts that we expect to see as a result of this change will come from additional income tax payments. I believe that that is the right way in which to reform the taxation of capital gains.

Let me say something about the previous Government's policy to reduce pension tax relief for people on high incomes, due to come in next year. Many businesses are alarmed at the complexity that it will introduce. I have listened to those concerns; however, I must also protect the £3.5 billion of revenues that the policy was set to raise from high-income people. I will therefore work with industry on alternative ways of raising the same amount of revenue, potentially by reducing the annual allowance.

Let me now turn to income tax. A responsible society is one that rewards the efforts of those who choose to work. The income tax system—in particular, the abolition of the 10% rate of income tax—has meant that many people on lower incomes face higher average tax rates. I believe that it is important to lift people out of the income tax system and allow them to keep more of their hard-earned money. It is especially important to make progress in this Budget, in which we are asking so much of so many, and this demonstrates that the coalition Government put fairness first.

In the current system, everyone under the age of 65 is eligible for a tax-free personal allowance of £6,475. That means that many thousands of people have their income taken away from them in tax, only to have to apply to get it back in benefits. That does not reward work. So today I can announce that we will increase the personal allowance by £1,000 in April. People will be able to earn £7,475 before they have to start paying income tax, 23 million people who are basic-rate taxpayers will each gain by up to £170 a year, and 880,000 of the lowest-income taxpayers will be taken out of tax altogether. Higher-rate taxpayers will not benefit from the change, and the higher-rate income tax threshold will have to remain frozen until 2013-14. Our long-term objective remains to increase the personal allowance to £10,000, as set out in the coalition agreement, and we will take real steps towards achieving that objective during the rest of this Parliament.

I do not disguise from the House that the combined impact of the tax and benefit changes that we make today are tough for people. That is unavoidable, given the scale of the debts that our country faces and the catastrophe that would ensue if we failed to deal with them. My priority in putting together this Budget has been to make sure that the measures are fair: that all sections of society contribute, but that the richest pay more than the poorest, not just in terms of cash but as a proportion of income as well. That is far from straightforward when the deficit is this high, and when the burden of reduction must rightly fall on Government spending.

Too often, when countries undertake major consolidations of this kind, it is the poorest—those who had least to do with the cause of the economic misfortunes—who are hit hardest. Perhaps that is a mistake that our country has made in the past. This coalition Government will be different. We are a progressive alliance governing in the national interest, and that requires us to make two final decisions.

First, we will provide lasting help for pensioners. The earnings link was broken by the last Conservative Government, and was never restored through 13 years of a Labour Government. That meant that each year more and more pensioners were drawn into the means test, which punished those who had done the right thing and saved for their retirement. I can announce today that from April next

year we will re-link the basic state pension to earnings. Now pensioners can save with confidence. They will also be protected by our new triple lock, which will guarantee each and every year a rise in the basic state pension in line with earnings or prices or a 2.5% increase, whichever is the greater. There will be no more 75p increases in the basic state pension. With this coalition Government, pensioners will have the income to live with dignity in retirement.

Secondly, we will provide additional support for families in poverty. They are among the most vulnerable people in our society, and they need our help. I have decided to increase the child element of the child tax credit by £150 above indexation next year. That is a £2 billion a year commitment to low-income families, and we make it even now, in these difficult times. I can tell the House that the policies in this Budget, taken together, will not increase measured child poverty over the next two years. Overall, everyone will pay something, but the people at the bottom of the income scale will pay proportionally less than the people at the top. It is a progressive Budget.

Today we take decisive action to deal with the debts that we inherited, and confront the greatest economic risk facing our country. We have been tough, but we have also been fair. We have set the course for a balanced budget and falling national debt by the end of this Parliament. We have insisted that four pounds of every five needed to reduce our deficit will be found from Government spending. We have protected capital investment from additional cuts, and have got to grips with the soaring costs of welfare. We have provided the foundations for economic recovery in all parts of our nation, and have given our country some of the most competitive business taxes in the world. We have taken almost a million people out of income tax and half a million people out of national insurance, and we have done all that without increasing child poverty.

Sadly, in this unavoidable Budget we have had to increase taxes. We have had to pay the bills of past irresponsibility. We have had to relearn the virtue of financial prudence. But in doing so, we have ensured that the burden is fairly shared. Today we have paid the debts of a failed past and laid the foundations for a more prosperous future. The richest paying the most and the vulnerable protected: that is our approach. Prosperity for all: that is our goal.

I commend this Budget to the House.

**Mr Deputy Speaker >**

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I now call on the Chancellor of the Exchequer to move the motion entitled “Capital Gains Tax (Rates)”. It is on that motion that the debate will take place today and on succeeding days. The questions on the remaining motions will be put at the end of the Budget debate on Monday 28 June.