

## UK Budget 2002...The Tax Man Cometh

Chancellor of the Exchequer Gordon Brown delivers his sixth annual budget to the House of Commons on Wednesday, April 17 at 14.30 GMT. The key focus is how much are taxes going to rise with both the Chancellor and the Prime Minister Tony Blair strongly hinted that revenue will have to rise to in order to pay for increased spending on the National Health Service. With the government in office for less than a year this is probably the most ideal time, in terms of the political cycle, to raise taxes. There has been a marked deterioration in the public finances over the last year with the PSNBR expected to show only a modest surplus for the 2001-2002 fiscal year.

The general expectation is for a Stg4-5 billion rise in tax revenue, 0.6-0.7% of disposable income. This will not only raise extra funds for public spending but will also take some of the pressure off the Bank of England to tighten monetary policy in order to slow the consumer. Sterling is likely to be on the defensive in the run up to the Budget with the scale of the expected tax increases the main focus of attention. Sterling is likely to fall back against both the dollar and euro if the degree of fiscal tightening turns out to be worse than expected. Confirmation of fiscal tightening should also encourage a rally in short sterling futures.

**The following is a full list of expected measures:**

### **Income Tax**

As one of the government's promises at last year's election was not to raise the standard or higher rates of this tax, currently at 22 and 40% respectively, Mr. Brown must find other ways of raising revenue. There are a number of suggestions as to what he will do:

#### **...National Insurance**

Abolish the upper earnings limit for National Insurance, which is currently set at Stg30,000 per annum. While this should not be ruled out the choice would be an unpopular one. More likely is an alignment of the top limit for NI with the starting point for paying the top rate of tax. This would raise about Stg1 billion. This could be combined with a rise in employee contributions from the current 10% to 11%, raising another Stg3.3 billion, and possibly an increase in the lower threshold so that the worst off are compensated. The attractions of raising National Insurance are that it was originally introduced to pay for health and state pensions so could be presented as the best way to fund the NHS.

#### **... VAT**

Currently set at 17.5%. There has been talk of raising this to the EU average of around 19%. A 1% rise would bring in about Stg3.7 billion. As well as raising revenue this could have the added benefit of helping to dampen rampant consumer spending, though a rise in VAT could be politically difficult.

#### **... Tax Allowances**

While the government is constrained by its manifesto not to raise the headline income tax rates, under-indexation of the thresholds is an option. Normally they rise in line with inflation. He could also restrict the personal tax allowance to the basic rate. The latter would raise about Stg 2.6 billion and only hit the better off, an attractive option for Mr. Brown.

... **Duties**

A hike in petrol duties seems unlikely given the recent increase in oil prices and the fuel protests of 2000. Stamp duty on higher house prices could be raised with over-indexation of tobacco also an option. However, this has limited revenue generation potential. There is some talk of a one percent tax on credit card transactions. That would raise a billion pounds straight off.

**Government Spending**

Spending plans for key areas like health and education, as well as transport, will govern how much Mr. Brown needs to raise in taxes. Key will be whether health spending will continue to rise at 6.4% in real terms, to meet the government's pledge to raise health spending to the EU average. Mr. Brown will publish alongside the budget a key report on the future of funding for health put together by former banker Derek Wanless.

**Business Tax Credits**

Mr. Brown has already outlined a number of changes to help large firms, such as an R+D tax credit, which will benefit big business to the tune of up to Stg500 million a year. He will give more details in the budget.

**Child Tax Credits**

More details are expected, and possibly costings, of the planned merging of the current children's tax credit and elements of the working families tax credit into a new child tax credit from 2003. Apart from money to finance more health spending, paying for them is one of the key reasons Brown will need to raise taxes.

**Economic Forecasts**

In November's pre-budget report, Brown forecast economic growth of 2.0-2.5% for this year and 2.75-3.25% for 2003. He forecast an overall budget deficit of Stg2.5 billion for the fiscal year just ended (2001/02), with this widening to Stg12 billion in the current year and Stg15 billion in 2003/04. We expect few changes to the growth forecasts, though the public finances should perform better than forecast, with Mr. Brown deliberately making cautious assumptions in his projections.

**Pensioners**

Last years decision to only raise the state pension in line with a very low inflation rate, proved to be very unpopular. Since then, Mr. Brown has been generous to OAPs and further benefits are expected on Wednesday.