

Briefing Paper

Pre-Budget Report 2009

December 2009

Pre Budget Report Abstract

The Pre-Budget Report is an integral part of the annual Budget process and provides a progress report on what the Government has achieved since the previous Budget, gives an updated assessment of the state of the economy and public finances, and sets out the direction of Government policy in the run up to the spring Budget - and significantly this year, the General Election.

The Pre-Budget Report is intended to stimulate debate in advance of the Spring Budget. It is likely that this year, the Pre-Budget Report may also prompt a number of public consultations on new policy proposals.

This year's Pre-Budget Report is considered to be critical in that it is viewed as an attempt by the Chancellor to set out a strategy for bringing the United Kingdom finances back into kilter and to reduce debt, through amongst other measures a reduction in Government spending on the public sector

Introduction

The Chancellor of the Exchequer, Alistair Darling MP, made a series of announcements based on assumptions about growth and areas of greater efficiency within the public sector as a whole and specifically within local government.

In the 2009 Pre Budget Report the Chancellor announced a cap on teachers' and doctors' pay and raised national insurance contributions as he admitted the recession had hit the British economy harder than had ever been feared.

Alistair Darling told a full house of Commons that:

"The choice facing the country is between securing recovery or wrecking it – between investment to build a fair society where all prosper and a divided society that favours the wealthy few".

He predicted the economy would be back in growth by the end of the year but admitted unemployment would continue to rise. Also, that the country's debt mountain was even bigger than had ever been anticipated and that the government would be in no position to cut spending any time soon.

Mr. Darling also unveiled a punitive super-tax of 50% on the bonuses of tens of thousands of bankers – cash that will go to help the unemployed as Labour seeks to shore up support ahead of next year's election.

The Chancellor's pre-budget report pointed the finger of blame for Britain's gaping budget deficit and sharp economic downturn at the global financial crisis and attempted to set out Labour's plans for long-term growth.

Key Issues & Highlights

On regeneration

The Chancellor announced a joint Communities & Local Government / HM Treasury led exercise to assess the efficiency and effectiveness of capital investment across Government of interventions to tackle worklessness and promote growth and inclusion in deprived areas. Best practice will be captured from case studies, including those led by the Homes and Communities Agency (HCA).

On housing

The Chancellor announced:

- Expanding support for First Time Buyers through HomeBuy Direct
- A consultation document to explore ways to stimulate investment in the Private Rented Sector
- Enhancing the Government's Surplus Public Sector Land Programme and the Homes & Communities Agency's Public Land Initiative to stimulate/speed delivery of new, quality homes on centrally-owned surplus land
- A study of barriers to growth that seeks to understand key future drivers of house building construction and identify steps Government and industry could take to improve diversity and innovation
- An intention to manage regulations on house building so that they do not unduly constrain supply - ensuring that the contributions developers are asked to make for infrastructure and affordable housing are more transparent, proportionate and supported by viability assessments.

Local government efficiency

The Chancellor announced a savings target of £2.6billion from local government by 2012/13.

Local financial freedoms

The Chancellor announced:

- A commitment to examine, subject to the overall fiscal position, further finance mechanisms, powers and flexibilities that could support local authorities to drive growth and innovation

- A commitment to examine the framework and legislative changes that would be needed to implement Tax Increment Financing
- A commitment to examine the scope for local authorities to borrow against future Community Infrastructure Levy (CIL) revenues, Renewable Heat Incentives (RHI) and Feed-In Tariffs (FIT), and revenues from new council house building (where this offers value for money).

Free school meals

The Government will extend free school meals to primary school children in low earning households. This will be rolled out to up to 50% of eligible children in September 2010 and then fully rolled out during 2011. £120million will be provided to Local Authorities in England in 2010/11 as a un-ring-fenced grant by Communities and Local Government.

Business Rates

The Chancellor announced that:

- To support businesses further in the current economic climate, the Chancellor announced an extension and increase of the temporary threshold below which empty properties are exempt from empty property rates
- The Government has also removed the requirement for businesses to re-apply for Small Business Rate Relief (SBRR), which reduces rate bills by up to 50%, in the upcoming new revaluation period. This will remove a layer of bureaucracy from small businesses.

Greater efficiency

Whilst the chancellor has committed to keep the 2010/11 spending plans for local government, the longer term budget position is less clear. Whilst public sector expenditure will grow by an average of 0.8% per year from 2011 to 2015 there has been a commitment to protect specific areas of spending such as the education or training plans for 16 and 17 year olds who want one. This therefore represents a strategy of 'unequal misery' as some services may face much tougher budgetary pressures.

As set out in the final report on efficiencies the chancellor expects to see a series of much deeper efficiencies delivering savings within the public sector including savings from back office, assets and property and procurement and shared services.

The Government states that it will continue to support and invest in frontline public services that people rely on as the economy recovers. But it has been said that it is important to live within our means in the medium term.

Waste and Refuse Collection and Carbon Reduction Initiatives

The Pre-Budget Report announced proposals that Councils will need to reduce their waste collection and disposal costs to help deliver efficiency savings worth £550million a year by 2012/13.

The Government plans refer to the need to 'deliver services in a more effective way'. However the statement is lacking in detail. Whilst many authorities have looked to increase recycling, to minimise landfill tax costs, increased recycling can of itself have an impact on the cost of the service - collections increasing, for example, to cope with more recycling streams and hence potential increases in service costs.

Performance data shows in fact a positive approach to cost containment and performance improvement in refuse collection services.

This shows that front line services have coped well with the conflicting demands of waste minimisation, diversion of waste from landfill, and increased collection of recyclables.

The average cost of the refuse collection service per household has shown a steady increase from £40.01 in 2002/03 to £69.02 in 2008/09.

However, this investment in the service has shown a corresponding increase in the percentage of total domestic waste collected which is sent for recycling from 11.2% in 2002/03 to 37.1% in 2008/09 – more than triple that of six years ago.

Tonnage of waste being recycled per household has increased by 16% in the last year. Local authorities are also introducing new recycling collection streams such as food waste to improve their performance on recycling.

Introducing such schemes and the investment needed in equipment, transport and staff time also impacts on the costs of the service.

This is also evidenced by statistics that show that transport costs have increased over the past few years and now reach 25% of total expenditure.

The increase in Transport costs is due to a number of issues including fuel price inflation, that local authorities can do little to control, as well as investment in new vehicles to facilitate increased recycling activity.

Within the Budget for 2009 Government launched a consultation on reforms to landfill tax legislation to 'ensure the tax remains robust in the long term and continues to reduce the amount of waste sent to landfill'. Over 100 responses were received and a summary of responses was published on 4th December 2009.

The Government has now committed to undertake further discussions with landfill operators on the proposals. Further details are due to be outlined next spring.

Consistent with the overall strategy to support new and green technologies the Chancellor also announced that the Government will be introducing a boiler scrappage scheme to help the environment and manufacturing industry.

This scheme will offer £400 for up to 125,000 households to upgrade their old boilers to the latest efficient models with a 'greener boiler incentive' and extra resources will also go into household insulation schemes.

In December 2008, the British Retail Consortium, on behalf of leading supermarkets entered into a voluntary agreement to reduce the number of single-use carrier bags that are distributed by 50%. In July 2009, retailers reported a 48% reduction. The Government and retailers aspire to a 70% reduction over the longer term.

Progress will be reviewed in summer 2010. Waste minimisation is supported by councils but these measures alone do not address the critical issue of excessive packaging which is a continuing cause for concern amongst member authorities attempting to reduce waste.

Households and businesses generate around 100 million tonnes of waste each year. Just over half of this ends up in landfill.

The Pre-Budget report reiterated that the government had provided £10million additional funding to divert waste from landfill through increased take-up of anaerobic digestion and in-vessel composting. Half of this funding has already been committed to projects that together will divert 200,000 tonnes of waste from landfill.

Housing and Regeneration

The chancellor identified savings of £160million from clamping down on fraudulent access to social housing tenancies, and rationalising smaller Communities and Local Government (CLG) funded community programmes as well as ending time-limited schemes in Communities & Local Government.

These savings are against a framework of capital investment in housing and community amenities which has risen from £2.7billion in 1998/99 to £11.3billion in 2008/09 (annual average real growth of 12.8%).

A £33billion investment has been used to reduce the number of social homes not meeting the Decent Homes standard by one million. Housing and regeneration capital funds brought forward will bring an additional 10,000 council homes up to the Decent Homes standard in 2009/10 and as announced in Budget 2009, £600million of new investment to move forward stalled housing projects and kick-start house building will remain unaffected by the Pre-Budget Report.

The '*Building Britain's Future*' report included an additional £1.5billion to deliver 20,000 more affordable homes. The Government's aim is to deliver over 55,000 affordable homes this year and over 56,000 in 2010/11.

There have in the last few years been many campaigns for greater freedoms and financial flexibility to allow councils to build new council homes and some of the measures partially support this aim.

It is a widely held view that savings in the area of housing will be difficult to achieve in the current environment where demand is outstripping supply on top of the housing waiting lists burden that most councils face.

Capital Projects and 'Infrastructure UK'

Alistair Darling also announced the establishment of 'Infrastructure UK' which will be tasked with helping major infrastructure projects, including waste. Government has suggested that this new agency will help to '*Prioritise 'Government's investment in infrastructure, identify and address major cross-cutting issues affecting UK infrastructure and improve the way the Government supports the delivery of infrastructure projects and programmes.'*

The funding of major infrastructure schemes has been the subject of debate with Private Finance Initiative (PFI) schemes, in particular, being adversely affected by the recessionary environment with finance not being available from the private markets to support Private Finance Initiative debt. In Budget 2009 measures were taken to lever in Government money to Private Finance Initiative schemes. This was to ensure that Private Finance Initiative projects continued as planned despite financial market conditions.

To assist with project funding the Infrastructure Financing Unit (TIFU) was established to lend to Private Finance Initiative projects that were unable to raise sufficient debt finance. Through the Infrastructure Financing Unit, 23 Private Finance Initiative projects involving some £3.7billion of finance reached financial closure, compared to less than £1billion for Private Finance Initiative projects in 2007/08.

Whilst the Infrastructure Financing Unit is hailed as a success (by Government) it defeats to a degree one of the primary purposes of the Private Finance Initiative that was to lever in private finance on major schemes, without the accountancy illusion of a burden on public accounts.

With changes to accountancy practices on public debt (being on or off balance sheet) there seems to be a lack of logic in putting public money into Private Finance Initiative schemes – it certainly creates a misnomer in the case of the Private Finance Initiative.

'Infrastructure UK' will not be an elected body and it remains to be seen what accountability there will be for the public purse on this new agency. It also remains to be seen how an all encompassing approach to capital infrastructure projects will provide the desired speed and innovation to 'kick start' projects that would in turn support economic recovery.

Public Sector Pay and Pensions

Public sector workers' pay rises will be capped at 1% from 2011 for a period of two years. Managerial appointments above £150,000 will need to be 'publicly justified' and bonuses in excess of £50,000 will be treated in the same way with the involvement of the Secretary of State.

Employer contributions to the local government pension scheme will be capped and with cost increases below the cap shared equally between employers and employees and those above the cap to be met solely by the employee.

The statement on pensions was however otherwise unclear in that it stated:

“Public pensions need to be in broadly in line with those offered in the private sector. So by 2012 contributions by the State to public pensions for teachers, local government, NHS and the Civil Service will be capped saving around £1billion a year. Public sector workers will make a greater contribution to the increasing value of pensions, with those earning over £100,000 paying more.”

‘Broadly in line with those offered in the private sector’ could be viewed as a move towards defined contribution schemes as opposed to a defined benefit schemes and as such would de facto mean the closure of the current local government scheme to new starters.

This would be likely to create huge industrial unrest since the local government scheme is one that is funded within local government. In recent years a number of changes to enable the long term sustainability of the scheme have been agreed between employers and the trade unions.

In addition poverty in retirement for the many low paid workers within local government will be seen as simply shifting the burden towards top-up state benefits in retirement rather than a secure retirement pot, built up through contributions made during the working life of a pensioner.

More details are awaited on this issue and in particular how a ‘cap’ on costs would work and what cost would in future potentially be passed on to employees.

Announced in the Pre Budget Report was a full basic State Pension increase by £2.40 to £97.65 per week in line with the Government’s commitment to uprate basic State Pensions by at least 2.5% even though the retail price index is negative.

Effect on Scotland

The Pre Budget Report announces an additional £23million for the Scottish Executive as a consequence of increases for UK government departments.

The Government is also continuing to deliver on climate change measures taken at the Pre Budget Report in November 2008 and Budget Report earlier this year in April.

This year’s Pre Budget Report builds on new policies announced since last autumn to increase United Kingdom investment in the low carbon and energy sector, including through an additional £150million funding for low-carbon technologies through the Strategic Investment Fund and a proposed £100million investment in the 2020 European fund for Energy, Climate Change and Infrastructure. This potentially benefits investment in Scotland with wide opportunities.

Liam Byrne, Chief Secretary to the Treasury said:

“This Pre Budget Report will help lock in Britain’s recovery, protecting families and businesses in Scotland through the downturn and accelerating growth. By taking tough action on tax and spending, we’ll halve the deficit in four years, and promote future growth in Scotland.”

However, Scottish Building Federation (SBF) Chief Executive, Michael Levack said:

"The pre budget announcement offers Scottish construction firms not a single drop of Christmas cheer as they ponder what 2010 may have in store for them.

"We have campaigned for Value Added Tax on home building repairs and improvements to be cut to 5% but once again this call has gone unheeded. While I welcome the new boiler scrappage scheme, it will have a far more modest impact on cutting carbon emissions than would have been achieved by a substantial cut in Value Added Tax on home building repairs and improvements.

"Instead, the failed 2.5% cut in the standard rate of Value Added Tax disappears from the 1st January having provided little or no benefit to the overall economy."

On the issue of capital spending, Mr. Levack added:

"With no additional money committed from the United Kingdom Treasury, a gaping black hole in capital investment in next year's draft Scottish budget remains.

"This can come as no surprise to the Scottish Government, given the currently parlous state of the public finances. But it does mean that the Scottish Futures Trust must act urgently to source significant quantities of private capital to make up the shortfall. If that means resurrecting Private-Public Partnerships (PPP) then so be it."

Analysis and Comment

Prior to the Pre-Budget report the Chancellor announced that Britain's net debt would rise to 78% of Gross Domestic Product (GDP) by 2014/15, before falling back.

New announcements however have revealed that the picture is slightly worse than expected. For public finances this now means a deficit of £178billion this year compared to the £175billion previously predicted.

In wider terms the economy was predicted to shrink by 3.5% on forecast figures but in fact was more badly affected at 4.75% this year. There is therefore a serious impact on public sector finances.

Conservative Shadow Chancellor George Osborne accused Alistair Darling of having "ducked" the crucial decisions to get Britain's stretched public finances back on track. He said:

"They have lost all moral authority to govern today... Every family in the country is going to be forced to pay for years for this prime minister's mistakes. No one will ever believe a word they say on the economy again."

While Scottish National Party (SNP) MSP, Kenneth Gibson said:

"Alasdair Darling has turned his back on Scotland's builders and Scotland's housing industry. The Scottish Government has invested in recovery protecting jobs and building record numbers of affordable homes.

"While the SNP has put housing at the top of the ladder, Labour in Scotland concentrated on a train line and Labour in London simply concentrated on themselves. It is wrong of Labour to cut spending in the face of recession.

"Scotland's house builders, the construction industry and those waiting for new affordable homes have been let down by Labour"

Further to the Pre Budget Report Jonathan Fair, Chief Executive of Homes for Scotland stated that:

"At a time when the number of new homes being built in Scotland is at an all-time low, it is simply baffling why the Chancellor did not take firm action to ensure early signs of stabilisation were maintained in a sector which is so vital not only to the economy but also our social wellbeing.

"Refusing to extend the temporary easing of the stamp duty threshold to £175,000 will put further pressure on Scottish First Time Buyers who are already facing significantly tightened lending criteria and reduced loan to value ratios. This vital group represents the industry's lifeblood; with every such sale resulting in an estimated further six transactions up the ladder.

"Despite United Kingdom Government rhetoric on getting banks to increase lending levels in the mortgage markets, there is precious little evidence of this being translated into tangible results. Now it appears the Chancellor simply prefers to gamble on the future health of the home building industry. Does he really think the social consequences of failing to provide enough homes for the people of Scotland a risk worth taking?"

Liberal Democrat Shadow Chancellor Vincent Cable also gave his parties position in the wake of the Pre Budget Report:

"Never before has the British Government run up a deficit like this. We need a sensible and coherent plan for dealing with it, yet the Chancellor ducked the hard choices on spending and cuts.

"Instead of making the tax system fairer, people on middle incomes will be paying more tax while those at the top enjoy their loopholes. The hidden costs of this budget will be borne by low paid workers who face a cut in real wages because of the 1% pay rise - which is lower than inflation.

"In a time of tough demands on government spending it is important we protect frontline public services and the people who work in them. This means there will have to be discipline over pay. That is why I have suggested that there should be a maximum pay rise of £400 a year throughout the public sector. That would mean that workers at the lower end of the pay scale would see a real increase but not those at the top.

“The Tories would freeze the salaries of millions of teachers, police officers, nurses and firemen while cutting taxes for millionaires. But our proposals would ensure pay rises for key frontline services that are fair and economically realistic. Many public sector workers will also benefit from our £700 income tax cut for people on low and middle incomes.

“Our proposals would limit the growth of the public sector pay bill while ensuring fairness for teachers, nurses, police officers and other public sector workers. They will save taxpayers about £4billion a year while reducing pressure on front line services and protecting jobs.”

It is clear that none of the other main stream parties agreed with all of the proposals in the Pre Budget Report.

Conclusions

There is little doubt that some measures within the Pre-Budget Report will be welcomed in the public sector with a commitment to stick to the short term spending plans for 2010/11.

However medium term forecasts are difficult to gauge with detail yet to be fleshed out. What is clear is that the commitment to reduce public sector debt will lead to an austere financial environment with pressure on local councils and other public bodies to deliver more for less at a time when demand on services is increasing.

Local councils, police and fire authorities will be left with some harsh choices and should rely upon the sharing of innovation and best practice to ensure service continuity.

Service transformation will be a critical approach helping to develop better ways of delivering services more efficiently and with greater effectiveness.

The emphasis should not however be about crude service cuts or simply about lowest price. Effective performance management, including the sharing and dissemination of performance data will be essential.

Adam M. Waite
December 2009