Asia Times

The Budget and the Purdah

Is Britain about to slip into a full blown economic slump-
Because it lacks leadership?

The Chancellor is now facing on of the most difficult dilemma's, any chancellor has had to face in the last decade. He is faced with an economy which needs a miraculous impetus to turn the elusive green shoots of economic recovery into full grown trees and with the mutually exclusive need to raise taxes and not lower them.

The Chancellor must feel that he has now approached a cross-roads with the fork to the left, pointing to higher taxes and the one to the right requiring lower taxes. Going down any one road exclusively will spell disaster for the economy.

Faced with a budget deficit of £100 billion and rising unemployment. This is the Blair/ Brown legacy. Unless and until the banking and finance lobby's hold on the cabinet is shaken, for a new emphasis on manufacturing industry, the next recession in the year 2008 plus will mean official unemployment of 3.5 million to control the mirage of low inflation.

Clearly, this Chancellor unlike his predecessors, who went through earlier financial upheavals does not have the option of using North Sea Oil funds. In addition, the scope to limit the budget deficit by spending cuts in no longer viable. The planned annual average increase in government spending is only between 1-2 per cent over the next three years.

The only option is to raise taxes. Failure to do so, will necessitate another run on the pound, as the markets realise that the Chancellor is merely delaying the inevitable.

The Chancellor has to encourage economic growth and at the same time raise £ billions. But it is likely that he will increase taxes by only £2-3 billion in the hope that this will be enough to convince the money markets. At the same time, he will probably announce new measures to tackle long-term unemployment. The long term hope is that economic recovery will eventually provide the taxes required to reduce the deficit. More likely it will have to look of the big spending departments to obtain the huge savings required.

Deficit

But the deficit is so huge that unless some action is taken now, public debt will rise to such proportions that it will place an unacceptable burden on future tax payers. In addition, it will ensure that the government's finances will be in the red for the foreseeable future, even if there is an eventual recovery.

Politically, with another two years to go before the next general election and the financial markets in turmoil, now is not the most opportune moment to raise taxes.

Due to the political desire of lowering direct taxation, it is unlikely that the basic rate of income tax will increase. But there is a possibility that personal allowances will not be fully indexed and there will be further sleath taxes.

VAT

The focus can now move to indirect taxation, such as VAT, which may increase to 20 per cent or alternatively the scope may be extended to zero-rated goods such as children's clothes, newspapers, books and food. The cost of the various zero-rated goods is an astonishing £18 billion, of which nearly half is accounted for by food. The move towards EEC harmonisation requires a standard rate of 15 per cent and a zero rate which will have to be abolished. But the political sensitivity of this subject, means that the government is unlikely to have the stomach to make anything, but a gradual move over the next few years. Other candidates for increases are excise duties on beer and whisky no doubt to be passed of as an socially friendly move.

Purdah

Predicting any budget is always difficult due to a chancellor's cherished right to purdah. The Chancellor seems to be relishing this period, much to the annoyance of his critics, who have been unable to confront him for what seems to be months. The length of the coming purdah in will be the longest in history, with several months off. But one has to seriously contemplate the increasing possibility, that the Chancellor who comes out of purdah, will not be the current incumbent.