British finance minister George Osborne produced the harshest budget in a generation on Tuesday, slashing spending, raising taxes and slapping a levy on banks in a drive to cut a record budget deficit to almost nothing in five years.

The 39-year-old Conservative Chancellor of the Exchequer said government spending would fall by around 25 per cent over four years and announced VAT sales tax would go up to 20 per cent from 17.5 next year, with a new £2-billion levy on banks introduced at the same time.

Nearly a million of the poorest paid people will be taken out of the income tax net altogether by raising its starting point and the headline rate of corporation tax will drop by one percentage point to 27 per cent next year and then keep falling.

Gilts rallied on the coalition government’s new plans to cut the deficit which are likely to go some way to assuaging rating agencies’ concern given the sovereign debt crisis spreading through the euro zone.

Rating agencies had warned Britain’s triple-A status could be at risk if Mr. Osborne’s plans to cut the record deficit of 11 per cent, close to that of Greece, were found wanting.

Mr. Osborne said just over three-quarters of the tightening would come from spending cuts and the rest from tax rises. Welfare payments would be targeted and even the expenditure of Britain’s Royal Family will be subject to closer scrutiny.

“When we say that we are all in this together, we mean it,” Mr. Osborne told parliament in his first budget since Britain’s Conservative/Liberal Democrat coalition government came to power last month.

Some economists say heavy fiscal tightening could endanger the recovery out of the worst recession since World War Two.

U.S. President Barack Obama warned fellow G20 leaders last week not to cut stimulus too soon.

“It seems to be a tighter budget than people generally were anticipating. By the look of the borrowing numbers, there’s a bigger squeeze here than most people were expecting,” said Jonathan Loynes, chief UK economist at Capital Economics.

But Mr. Osborne believes there is no time to waste though he admitted that growth will be lower this year and next because of his budget.

The independent Office for Budget Responsibility, established by Mr. Osborne last month, cut its forecast for economic growth to 1.2 per cent this year from 1.3 per cent published last week. GDP growth next year is seen at 2.3 per cent instead of the 2.6 per cent published last month.

Public sector net borrowing is now seen at £149-billion ($230.5-billion), or 10.1 per cent of GDP, this year but this is seen falling to £20-billion– or just 1.1 per cent of GDP – in 2015/16.

The structural deficit, that which is not subject to the vagaries of the cycle, is expected to fall to 0.3 per cent in five years from 7.4 per cent this fiscal year.

A tax on banks had been expected to cost the industry between £1 billion and £5-billion, depending on its structure and scale. Mr. Osborne said it would come into effect at the start of 2011 and will raise about £2-billion.