Centre for Policy Studies

Number 76

18 March 2016

Economic Bulletin

BUDGET 2016: CHANCELLOR STILL HAS GET OUT OF JAIL FREE CARD

- Disappointment as OBR borrowing forecasts increase by £56.3 billion over spending review period.
- Budget measures mitigate worsening forecasts, but chances of a budget surplus in 2019-20 are just over 50%.
- ISA reforms have effectively replaced personal pensions for the under 40s.
- Concerns that sugar levy will disproportionally hit the poorest income households.
- Modest unspecified £3.5bn cuts dwarf additional borrowing announced in the Autumn Statement. More measures may be required to meet budget surplus.
- Chancellor still has a number of get of jail free cards. For example, abolishing NICs relief on employer pension contributions could save Chancellor £8 billion a year.

1. MACROECONOMIC PICTURE

The Office for Budget Responsibility (OBR) has revised its borrowing forecasts upwards for the five year spending review period *(2016/17 – 2020/21)* by £56.3 billion since the Autumn Statement. The main driver of the worsening forecast has been the downward revision to the UK's nominal GDP forecast, which has fed through to all the main tax bases, leaving the receipts forecast down by 0.7% of GDP. Without any changes, the Government would have been on course to miss both of its legislated fiscal targets – for the budget to be in surplus from 2019-20 and for debt to fall in relation to GDP every year until then.

The Budget 2016's measures will collectively raise £13.7 billion in 2019-20 and £13.1 billion in 2020-21, broadly offsetting the deterioration in the underlying forecast. This puts the Government back on course to meet the budget surplus target, but the probability of reaching the target is only slightly higher than 50% *(see Figure 1)*.

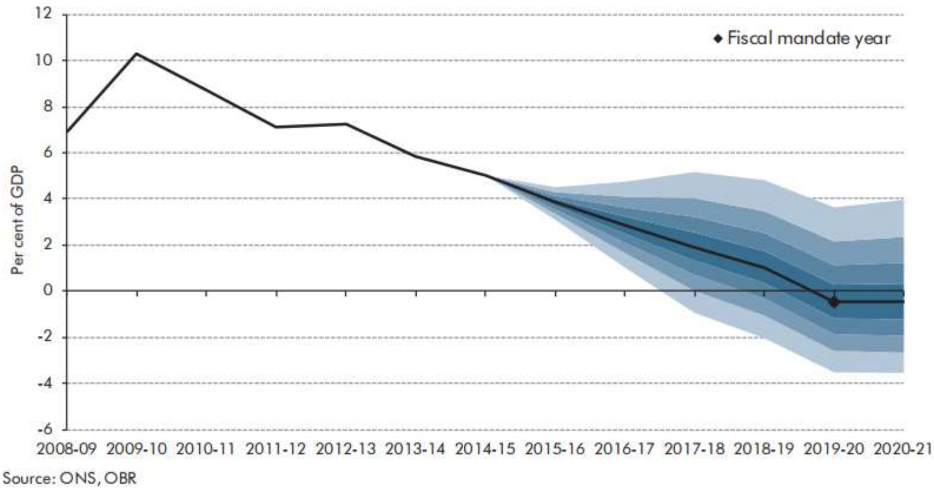
The poorer forecasts for the UK were expected, following reports of a declining global economic outlook since the Autumn Statement. In January, for example, the International Monetary Fund claimed that "risks to the global outlook remain tilted to the downside and relate to ongoing adjustments in the global economy." There are particular concerns about the impacts of a slowdown in emerging market economies, China's rebalancing and lower commodity prices.

Table 1: Changes to Public Sector Net Borrowing Forecast Since Autumn Statement

2016-17	2017-18	2018-19	2019-20	2020-21	TOTAL
+£6.6bn	+£7.2bn	+£12.3bn	+£13.4bn	+£16.7bn	**£56.3bn**

Source: Office for Budget Responsibility link

Figure 1: Public Sector Net Borrowing Projections



Source: Office for Budget Responsibility link

Click here to subscribe to the CPS eNewsletter

2. CHANGES TO PERSONAL TAXATION

The Conservative Party Manifesto pledged to increase the personal allowance threshold to £12,500 and to increase the 40p income tax band threshold to £50,000. The Budget 2016 announced progress towards this goal. By April 2017, the personal allowance is set to increase to £11,500 and the higher rate to £45,000, costing the Exchequer an additional £2 billion in 2017-18.

The personal allowance threshold has grown substantially, rising from just £6,750 in 2010-11. However, the higher rate threshold was cut over the previous parliamentary term. The Institute for Fiscal Studies estimates that there are now 1.7 million more higher and additional rate income taxpayers since 2010 as a result of this policy. Moreover, the concern of 'fiscal drag' is very real. The OBR estimates that an additional 3.5 million people would move into the higher rate tax band by 2033 if the threshold was merely indexed to increasing prices.

Had the higher rate tax band increased in line with inflation since 2010 – as measured by the Consumer Price Index – it would be £50,500 next tax year. This highlights that the proposed £50,000 threshold by 2020 has not kept pace with inflation since 2010.

3. GOOD FOR BUSINESS?

A number of measures were announced to promote business growth, which have been given a cautious welcome from business groups. The British Chambers of Commerce said: *"business wanted a steady, workmanlike Budget, and that's what we got. The Chancellor listened to our calls to avoid higher business taxes and costs – and indeed moved to lower them in a number of areas."* These measures include:

- The business rate relief threshold more than doubling, meaning that 600,000 businesses in the UK will pay no business rates.
- A further cut to corporation tax, which is set to be 17% by 2020. This will be the lowest rate in the G20 of nations.
- Cuts to capital gains tax, which will reduce the basic rate to 10% and the main rate to 20%.
- Abolishing petroleum revenue tax and reducing the supplementary charge for the North Sea oil and gas industry.

However, it is important to note the substantial measures that are geared towards tackling tax avoidance. These measures more than offset the gains to companies from these tax reductions. For example, the measures to tackle corporation tax avoidance are set to raise £8.2 billion over the forecast period, whereas the further cut to headline rates of corporation tax will only reduce business bills by £1.1 billion.

4. MORE AUSTERITY?

For most of the forecast period, the overall fiscal impact of the budget is negligible. In the next financial year the fiscal changes account for just £360 million, which equates to just 0.05% of overall government spending. The majority of the fiscal impact will occur in 2019-20 – the year when George Osborne is trying to achieve a budget surplus *(see Table 2)*.

Table 2: Budget 2016 Total Policy Decisions

	2016-17	2017-18	2018-19	2019-20	2020-21
Total Spending Policy Decisions	-360	-590	-450	+7,620	+3,335

Source: Budget 2016 link

The announced spending cuts of £3.5 billion – which account for only 0.5% of government spending – will only enter into force in 2019-20. The Government is now committed to conducting a departmental efficiency review to achieve these savings, but there is currently no detail on these cuts. It is also notable that these cuts dwarf the additional £18.7 billion of additional borrowing announced at the Autumn Statement.

These very modest spending cuts may not be sufficient for the Chancellor to meet his fiscal mandate – particularly as the OBR has said that the Government only has just over a 50% chance of achieving a surplus by 2019-20.

5. GET OUT OF JAIL FREE CARDS?

As outlined by CPS pensions expert Michael Johnson, the Government could still implement a number of reforms to the UK's tax based incentives for pensions, which cost over £52 billion in 2013-14. The abolition of National Insurance Contribution relief on employer contributions would save the Exchequer £8 billion a year, and the introduction of a flat rate of income tax relief could save more than £10 billion a year. The Chancellor would also have the option of ending the 25% tax-free lump sum, which has an estimated opportunity cost of £4.5 billion per year.

If the OBR's fiscal forecasts worsen over the coming years, the Chancellor could implement these measures to ensure he hits his budget surplus target by 2019-20.

6. SPECIFIC MEASURES

Lifetime ISA for Under 40s

The Chancellor has announced a Lifetime ISA from April 2017, which follows the structure and terminology outlined in a Centre for Policy Studies paper by Michael Johnson last October. The Lifetime ISA will allow under 40s to save £4,000 a year and get a maximum of a £1,000 bonus. These savings can be used for a first-time property purchase or for retirement. This offers the under 40s identical tax relief enjoyed by standard rate taxpayers on their pension contributions, but with the ISA the income being tax free. This effectively replaces personal pensions for the under 40s with a simpler, more flexible and effective system.

In response to the Budget's announcement, CPS Pensions expert Michael Johnson has said: *"The next step is to introduce the Workplace ISA, to be housed within the Lifetime ISA. In time, all other ISAs will disappear leaving everyone with a single savings vehicle to serve from cradle to grave."*

Sugar Levy
According to the National Health Service, the UK has the highest level of obesity in Western Europe and obesity levels have more than trebled in the last 30 years. There is therefore a strong rationale behind the implementation of a sugar levy, which is due to come into force in two years' time.

However, there are a number of concerns relating to this sugar levy on fizzy drinks. The levy will be similar in nature to Value Added Tax by acting as a regressive tax, where poorer households spend a greater proportion of their incomes. The Government estimates that the levy will bring in £520m, which will come disproportionately from people on low incomes if the costs are passed onto consumers. The implementation of this could also provide a worrying precedent, leading to further levies or taxes on other products containing sugar, or other out of favour foods.

7. CONCLUSION

George Osborne's commitment to further spending cuts along with changes to the personal allowance and 40p tax thresholds is welcome. Some of the Budget's tax proposals will also undoubtedly help boost British enterprise, particularly announcements on business rate relief, corporation tax and tax cuts for the offshore oil and gas industry. It is also welcome that a new Lifetime Savings ISA will be introduced, which was influenced by the proposal from CPS Research Fellow Michael Johnson.

However, the Chancellor has unfortunately ducked some of the more major reforms needed. His announcement on tax simplification, for example, falls far short of what is required. As highlighted by CPS Research Fellow David Martin, the UK's burdensome tax code has nearly doubled in length since 2010, and there is nothing in the Budget to reverse this worrying trend. The Office for Tax Simplification recently announced a radical simplification measure, calling for an alignment of income tax and national insurance – a measure proposed by the Centre for Policy Studies last month. It is disappointing that this was not mentioned in the Budget – given that it is always best to pursue radical reform early in the electoral cycle.

The main fiscal impact of this Budget will only be felt in 2019-20 – the year when George Osborne needs to achieve a budget surplus. Furthermore, the spending cuts announced for this year are very modest compared to the giveaways at the Autumn Statement. Given the OBR still believes there is a high chance of George Osborne missing his budget surplus, more reforms may be required in the future.

George Osborne does, however, have a get out of jail free card reform of pension based tax reliefs. The abolition of National Insurance Contribution relief on employer contributions would save the Exchequer £8 billion a year, and the introduction of a flat rate of pension tax relief could save more than £10 billion a year. Both reforms would be consistent with the Chancellor's clear preference for an ISA savings environment, over a pensions environment.

If the OBR's fiscal forecasts worsen over the coming years, the Chancellor will be even more tempted to implement these measures to ensure he hits his budget surplus target by 2019-20.

Daniel Mahoney and Tim Knox
Centre for Policy Studies

DISCLAIMER: The views set out in the 'Economic Bulletin' are those of the individual authors only and should not be taken to represent a corporate view of the Centre for Policy Studies

Follow us on:

Twitter **Facebook**

Forward to a friend

Click here to subscribe to the CPS eNewsletter