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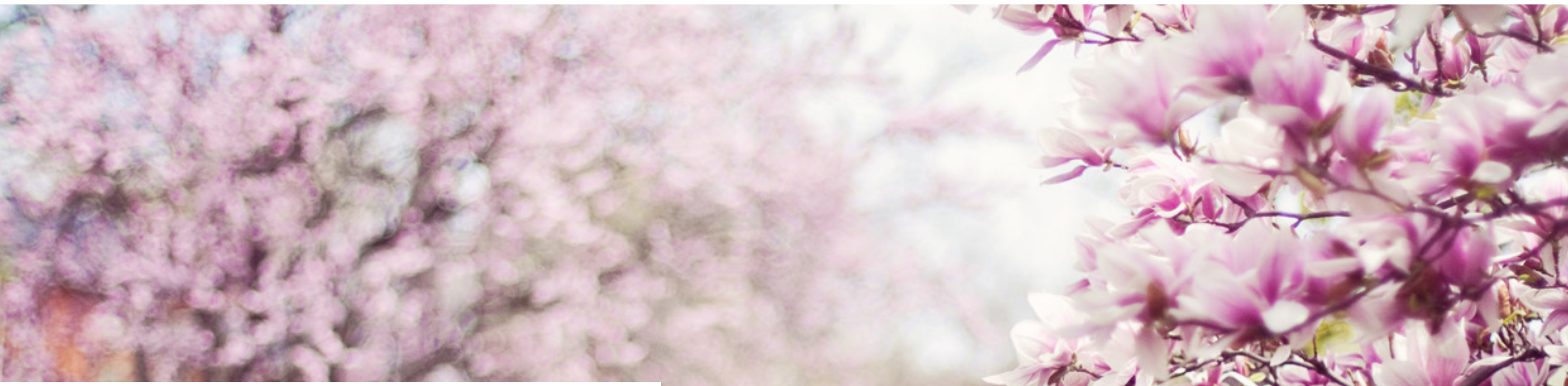
Analysis of the UK’s Spring Budget

March 2017



INTRODUCTION

In the run-up to the Referendum on the UK's membership of the European Union in June 2016, the former Chancellor of the Exchequer George Osborne was perceived to have threatened a 'punishment' Budget in the event of Britain voting to Leave.

It is notable, therefore, that Philip Hammond could today deliver a confident and assured performance with most economic indicators suggesting that the UK was on track to deliver steady (yet moderate) growth in the short term, as reflected by the muted market response, despite the uncertainties once Article 50 is triggered later this month. On a political level, it also indicates that the Government is not planning an election prior to May 2020. The Government has shown this by announcing an increase in National Insurance Contributions (NICs), which the Treasury admits is expected to affect around 1.6m people by an average of £240 per year. It is important to note that this average disguises a 2 percentage point tax rise for the many self-employed who earn over £16,000 a year. It also breaks an election promise and so will be contested strongly.

It is also clear that the detail in the Budget suggests significant challenges ahead. The Office for Budget Responsibility (OBR) - created in 2010 to independently assess the state of the public finances - has made forecasts based upon the UK formally leaving the EU in April 2019, but in the context of a trading regime which is 'less open than before'. That may well seem to be obvious to the well-informed, but it signals how difficult it will be for the Prime Minister to deliver a deal as good as our current membership of the EU.

We need to be mindful that the economic implications of a new arrangement outside of the EU will only become clear once we have formally left, and this could yet have a significant electoral and economic impact further down the track. In the meantime, Hammond worked hard to find plasters to cover up some of the Government's existing sores – most notably alleviating some of the pressure on the creaking NHS (albeit by pledging a relatively modest additional sum); more support to local authorities to meet part of the growing cost of social care; and action on business rates revaluation, arguably the first major domestic policy fumble of 2017.

The key test for a Budget tends not to be in the first hours after the Chancellor has sat down, but rather in the following days as further study is made of the fine detail. With a largely pro-Brexit print media, Hammond will hope that he will get a fair hearing in tomorrow's coverage. However, with a broken manifesto promise to defend, and lots of noise from the aspirational middle-classes, this could yet still unravel, especially given the Government's small majority.

We hope you find this short document to be helpful in making sense of the significant political challenges which lie ahead. The team at Finsbury, with its extensive policy and campaigning experience, would be delighted to provide further, more specific analysis of what is likely to challenge your business in the coming months and years, whether stemming from today's Budget or as Britain begins its slow divorce from the EU.

...the National Insurance rise to 10% next year and 11% in 2019 should be seen for what it is – a £1 billion tax hike on those who set themselves up in business.

Mike Cherry, National Chairman at the Federation of Small Businesses (FSB)

WINNERS

Compared to previous Chancellors who used every Budget to announce large reallocations of taxes and spending, Philip Hammond has chosen only to increase spending by £5 billion over five years – about 0.014% more than current total government spending.

So the Budget `winners' won't have money for new initiatives or higher salaries, but the increases should help to stop the political pain Government MPs are experiencing thanks to crowded schools, cancelled operations, a social care system unable to meet rising demand and small business owners facing very steep rises in business rates.

Social Care is the largest winner, with an extra £1.2 billion this year alone. More money is likely in future years, but decisions on how to fund that have been delayed again and will be part of yet another consultation. All agree extra money is needed, but there are sharp disagreements about from where. Plus ça change...

The NHS will receive an extra £250 million this year. Philip Hammond is likely to spend future budgets allocating any additional money to the NHS as it continues to struggle to manage a rising and, crucially, an ageing population.

Winners

Schools

Business rate payers

Social care

Sterling and FTSE100
UNCHANGED

Schools receive only £20 million this year, but their future year funding will rise by £1.3 billion in the subsequent four years. Most of this will enable an expansion of free schools – government-funded schools that are free of local government control. Theresa May is determined that this expansion be coupled with the ability of these schools to select students on the basis of their academic ability. This is anathema to the Opposition and to many Tory MPs, so the measure will have a hard time going through Parliament.

Business rates has become a political issue after a delayed revaluation of all business properties was about to cause very steep rises for some businesses – largely those in London and the South East where property prices have soared. Although the rise in rates was offset by falls elsewhere, the screams of those losing something is always higher than those who are grateful for something new. The pressure was becoming intolerable so Philip Hammond has found £230 million for this year to delay or reduce the rises. Notably, he will have markedly less money in future years. He is hoping this issue goes away which seems rather hopeful.

The UK needs 'an economy that encourages self-employment'.

Jacob Rees-Mogg, Conservative MP

LOSERS

Like George Osborne's fiscal statements, Philip Hammond's Budget maintained the principle that every tax cut or spending increase should be paid for elsewhere with a tax rise or spending cut – not with extra borrowing. At the heart of the revenue raisers in this Budget is the Government's intention to correct the difference in tax treatment of employees and the self-employed.

In the hours following the Budget, the Government has come under severe media and political fire for breaking its 2015 general election promise not to raise National Insurance.

National Insurance rise for the self-employed

The main revenue raiser is an increase in National Insurance Contributions (NICs) for the self-employed. The Class 4 rate of NICs will rise by 2 percentage points – to 10% from April 2018 and then to 11% in April 2019. Philip Hammond stated that those earning less than £16,000 will be unaffected.

Philip Hammond claimed this measure will raise £145 million per year. But this was a sleight of hand as he was counting the previously announced abolition of Class 2 NICs which lowers the net revenue raised. In fact, the Budget scorecard shows that the rise in

Losers

Company directors

Self-employed

Class 4 NICs rates will bring in over half a billion pounds in revenue by 2020 – a significant tax rise on working people. After the statement, the Treasury briefed journalists that 1.6 million self-employed people will pay an average of £240 a year more in tax.

The Chancellor argues that this increase is needed to reflect the changing nature of work as more and more people work for themselves. He said that the National Insurance system needed to catch up with this new reality as somebody who is self-employed currently pays a significantly lower level of National Insurance than an employee.

However, with its tiny Commons majority, there is a real risk that the Government will not be able to pass this measure. First, this tax rise is a clear breach of the Conservative Party 2015 Manifesto commitment not to raise "rates" of National Insurance. Second, this tax rise will predominantly affect the Conservative Party voter base. Finally, Labour have opposed this measure following the Budget statement, making it harder for the Government to get it through.

Dividend tax free allowance cut by 60%

The tax-free dividend allowance will be reduced from £5,000 to £2,000 from April 2018. This will raise almost £1 billion per year for the Government by 2020.

The Chancellor claims that this will reduce the tax differential between employees and those working through a company. The Treasury claims that 80% of general investors will not pay any dividend tax.

Again, this is a measure that will hit the Conservative Party voter base. The Government may face a tricky time persuading Conservative MPs to vote for it.

We have long argued for a clampdown on bogus self-employment but today the Chancellor seems to have put the burden on self-employed workers instead.

Labour Leader, Jeremy Corbyn MP

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