

# Osborne cooks up a rare July Budget but will the fiscal adjustments be overdone?

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The budget and barbecue seasons don't normally coincide with each other. However, this July we may find ourselves discussing the Chancellor's latest fiscal adjustments over a hot dog and maybe a beer (*for which the Chancellor abolished the duty escalator a couple of years ago*).

Speculation will heat up in the coming weeks as to what measures George Osborne will announce (*alongside the usual stream of choreographed leaks*). Given that the Chancellor now has a 5-year track record of unveiling fiscal measures it is worth reminding ourselves what he has delivered to date.

At a broad level, there are likely to be strong similarities to his approach to date and what lies ahead. Equally, there are likely to be some major differences such as raising revenue from new sources. With the shackles of a Coalition government removed, the Chancellor will be keen to deliver the Conservative's manifesto pledges as he unveils the first Tory Budget since Ken Clarke in November 1996.

Prior to the 2010 General Election we were warned by the Institute for Fiscal Studies that we would have two Parliaments of fiscal pain. As in 2010, a tough multi-year fiscal adjustment is required. Both the 2010 & 2015 General Elections have acted as speed cameras on the pace of austerity.

Looking ahead, the tempo of austerity over the next five years will broadly mirror what we have seen over the last five. The foot will go down hard on austerity accelerator for next 2/3 years before easing off ahead of the next speed camera – the 2020 General Election.

This is because there is a strong political incentive to frontload the most painful and unpopular fiscal measures. The public expenditure cuts will be deepest in the next 2 years with additional in-year cuts announced for the current financial year. Thereafter, the plan is for a return to real terms public expenditure growth in the run up to the next General Election. Meanwhile the government is also likely to accelerate the sell-off of state assets.

The biggest tax changes are expected to be announced sooner rather than later. In June 2010, the "Emergency Budget" that followed the General Election raised the VAT rate from 17.5% to 20%. This was the most significant tax rise of Osborne's tenure to date. The Tories have pledged not to raise the rates of VAT, National Insurance Contributions and Income Tax rates. These three taxes account for over 60% of all revenue.

While the rate of income tax won't be raised there is scope to raise income tax (& other taxes) in other ways. The sustained effort to clampdown on tax avoidance will continue. Meanwhile we are likely to see scores of tax reliefs abolished sooner rather than later. To offset this gloom we are likely to see the introduction of less expensive media friendly reliefs.

One of the most significant changes during the last Parliament was lowering the lifetime allowance for pension tax relief from £1.5m to £1m. What radical tax relief changes could we see going forward? A recent editorial in The Economist magazine railed against the current worldwide reliefs / subsidies on debt. One such example is Buy-To-Let (BTL) landlords can currently offset mortgage interest against tax. Perhaps we could see this scaled back / abolished. BTL landlords are likely to see more downward pressure on rents with further cuts to Housing Benefit payments expected.

Outside of the three biggest revenue generators we can expect to see a return to inflation busting rises on alcohol, tobacco, gambling duties etc. Osborne abolished the fuel & beer duty escalators. However, we are likely to see a return to fuel duty increases in the near future.

There is likely to be more focus on raising revenue from Capital Gains Tax (CGT) and property. Osborne radically reformed the Stamp Duty Land Tax (SDLT) and raised stamp duty on expensive properties. The focus on bringing revenue in from buying property could now switch to the 'sell-side'. Introducing CGT on the primary residence for properties worth say over £1m (*the proposed inheritance tax exemption threshold in the Tory manifesto*) could bring in significant revenue. Politically it is a tax that doesn't jar with the "working people narrative" and is more palatable than Labour's Mansion Tax idea.

2010's Emergency Budget announced multi-year freezes across a number of fronts. Public sector pay (*excluding annual increment pay progression*) was frozen for 2 years (*for those earning more than £21k p.a.*) with a 1% pay cap introduced for the three years that followed. A similar approach was applied across a range of benefits (*e.g. Child Benefit*) with multi-year freezes followed by multi-year caps. Key benefits and tax thresholds were adjusted with a view to reducing public expenditure and / or raising revenue. For example, the threshold for receiving Working Families Tax Credit (WFTC) was lowered from £50k to £40k.

More likely than not we will see another multi-year pay and benefits freeze announced next month with pay and benefits caps for the second half of this Parliament to be announced in subsequent budgets. Budget 2015 confirmed that proposals to abolish progression pay across the Civil Service have been agreed. Further detail on this could emerge on 8<sup>th</sup> July.

Despite the focus on cutting public expenditure and raising revenue over the last five years, there has been a tax cutting agenda too. The rate of corporation tax has been lowered from 28% to 20% and the 50% income tax rate for those earning over £150k p.a. was lowered to 45%. This move actually increased revenue. Meanwhile the personal income tax allowance threshold has been raised progressively from £6,475 in April 2010 to £10,600 in April 2015.

Looking ahead, elements of this tax cutting agenda are likely to continue. Indeed, George Osborne has pledged that next month will see a budget for "working people". In their manifesto the Conservatives have pledged to raise the personal income tax threshold to £12,500 by 2020 and linking the minimum wage to this allowance so that no one on the minimum wage will pay income tax at all.

The Tories are eager to build a reputation as the party of the working people. Alongside this they will want to further develop their image as being tough on welfare spending. The last five years has seen significant welfare reforms and the introduction of a Welfare Cap. A further £12bn of cuts in welfare spending is planned. It is likely that in-work benefits will be further scaled back with the potential for a further lowering of both the WFTC threshold from £40k. Such a move, however, would jar with the budget for the "working people" narrative.

It remains to be seen exactly which cuts, palatable measures and tit bits are thrown on the Emergency Budget barbie. But politically and economically, there's much at stake.

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