Group Economics

Ulster Bank

Chancellor performs fiscal escapology but austerity isn't over yet

Contact: Richard Ramsey
Chief Economist, Northern Ireland
02890 276354 or 07881 930955

Richard.ramsey@ulsterbankcm.com
www.ulstereconomix.com
Twitter @UB_Economics

The Chancellor has developed something of a reputation for over-promising and under-delivering when it comes to fiscal austerity. He certainly didn't shed this image today in the first all-Conservative Spending Review since the mid-1990s.

It was anticipated that he would be fiscally embarrassed at the despatch box. It was thought borrowing would have to be higher than projected in July, due to tax receipts being lower during recent months. This raised the prospect of him failing to meet some of his self-imposed fiscal rules and compromising a planned £10billion surplus by 2020. He was also under pressure to phase in the cuts in working families tax credits, with the latter potentially being replaced by cuts to welfare elsewhere.

Outside of welfare spending, departmental spending was expected to be subjected to sizeable cuts. However, once again, the Chancellor has embarked on some fiscal escapology, with plans to cut Working Tax Credits shelved altogether. However, the U-turn headline is somewhat overdone as much of the pain on this front has been deferred rather than being reversed completely. Meanwhile the scale of departmental spending cuts, whilst severe for some departments such as Transport, overall were not as bad as anticipated. Of particular note is that police and schools spending is to rise in line with inflation, the health service is to receive additional funding in excess of inflation, and given the Chancellor's emphasis on ensuring national security, defence will receive a cumulative real-terms increase of over 2% in the next five years. On average, departmental spending will fall at less than half the rate of the previous five years.

Meanwhile Northern Ireland departments will see a cumulative decline of 5% over the next four years in their resource budget. Remember this is the fiscal environment within which a corporation tax cut needs to be funded. In terms of capital spending, funding available for infrastructure investment via the block grant through to 2020-21 will rise by 12% in real terms, meaning over £600 million more than if it had been held at 2015-16 levels.

So how did the Chancellor achieve this?

First of all, he had more than a little help from the fiscal anoraks and tax modelling gurus in the Treasury who were able to gift him around £34billion (which equates to the size of the Northern Ireland economy) in additional revenue before he even started. Bear in mind, by way of perspective, the Chancellor's total cuts to departmental budgets came to £20billion and the planned welfare cuts amounted to £12bn.

While the Chancellor was accused of stealing Labour's clothes in the summer Budget with the unveiling of the National Living Wage, some have said that he is now moving even further in their direction, with greater emphasis on raising taxes. Two key tax raising announcements related to the Apprenticeship Levy and Stamp Duty Land Tax. Changes to company car tax are also set to yield valuable tax revenue.

Today, we were provided with detail on the Apprenticeship Levy – which is intended to create 3 million new apprenticeships by 2020. This levy will come into effect in 2017 at a rate of 0.5% of an employer's pay bill. The levy will only be paid on employers' pay bills over £3million, and less than 2% of UK employers will pay the levy. Nevertheless, these employers may see this as corporation tax by the back door, with the Chancellor taking back what he has gifted with the forthcoming cut in corporation tax to 18% by 2018. Indeed The new Apprenticeship Levy charged on business will raise a massive £3billion per annum, which is equivalent to raising corporation tax by almost 4%. And it is a new tax for potential foreign direct investors to Northern Ireland to consider.

The buy-to-let market has attracted the Chancellor's attention again. While the tax credits bombshell has been defused, the Chancellor has dropped another one in its place – Stamp Duty Land Tax. On top of previous measures, a 3% stamp duty increase was announced today to take effect from April next year for people purchasing additional properties such as buy-to-let properties and second homes. If only such a policy was applied to the Northern Ireland property market a decade ago!

This change will take the stamp duty land tax rate to 5% between £125,000 and £250,000; 8% between £250,000 and £925,000; 13% up to £1.5million; and 15% for properties above £1.5million. That would be £300,000 in stamp duty on a £2million second home. Revenue raised by this measure will be used to help those struggling to get on the property ladder; particularity in London.

Today the Chancellor unveiled plans to introduce a Help to Buy equity loan scheme solely for London, which will raise the equity stake from 20% of the home's value to 40%. In London, there is a concerted effort to rebalance the market away from wealthy investors towards those trying to buy their first home.

There has clearly been a marked shift towards raising tax revenue. Indeed, today's announcement hopes to raise £21billion in additional revenue over the next five years. There were also tweaks to some recent policy announcements, such as the free childcare for 3 & 4 year olds for parents working 16 hours per week and earning less than £100,000 per annum. This tightens the eligibility criteria and saves some money in the process.

Pensioners have done well out of the Osborne budgets to date and today proved to be no exception. The state pension is to rise to £119.30 per week by April next year; an increase of £3.35. This will be the highest real-terms increase to the State Pension for 15 years.

Another key theme was the devolving of more powers to the regions, with Cardiff and Glasgow set to secure city deals. Is Belfast or Derry~Londonderry lobbying for the same treatment? If not, why not? Raising revenue at a local level is also a key theme in today's Autumn Statement. Will Northern Ireland's Executive follow the Chancellor's lead and place more emphasis on raising revenue locally too?

While it was thought that the Spending Review would over-shadow the Autumn Statement, in fact the opposite was the case. Indeed it became something of a Taxation Review with the raft of measures to raise revenue. Overall, today's Spending Review, from both a Northern Ireland and UK perspective, was better than anticipated, but the next five years still represent a challenging fiscal environment. Furthermore, it is all based on the assumption that robust rates of economic growth continue. Indeed, any downturns in the global economy will impact on these forecasts and would require corrective fiscal surgery. And the cuts in public spending levels will require further significant reductions in public sector employment. Fiscal austerity wasn't to the fore today, but it certainly isn't over yet. Instead it remains a work in progress.

Richard Ramsey
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