

Economy Briefing Note

March 2014 – Budget



1. Introduction

On the 19th March 2014, the Chancellor of the Exchequer delivered his budget, setting out the next steps of the government's long-term economic plan. The Budget is one of two statements that HM Treasury makes each year to Parliament upon publication of economic forecasts, the other being the Autumn Statement. This short paper provides an overview of the key announcements in the Budget and the implications for Devon's residents, businesses and employees, and the county's economic development.

2. The UK Economy and Public Finances

Economic growth – the UK economy has grown at a faster rate than forecast – UK annual GDP growth was 1.8% in 2013 exceeding the Office for Budgetary Responsibility's (OBR) Autumn Statement forecast of 1.4% and significantly higher than GDP growth of 0.6% forecast at Budget 2013. As such, expectations have been revised up by more than any other G7 economy for both 2014 (from 2.4% to 2.7%) and 2015 (from 2.2% to 2.3%). Looking forward, the OBR forecasts a growth in GDP of 2.6% in both 2016 and 2017, and 2.5% in 2018.

Inflation – UK inflation in January was below the 2% target for the first time since November 2009. The target will stay at 2% until 2018, but is dependent upon global economic conditions such as the crisis in Ukraine.

Labour market – forecasts for employment have been revised up, with the OBR expecting a rise of 1 million from 30.4 million in 2014 to 31.4 million in 2018. In terms of unemployment, the OBR revised down its forecast in all years, and expects a rate of 6.8% in 2014, falling to 5.4% in 2018. The Jobseekers Allowance claimant count fell by 327,600 in the year to January 2014, the largest annual fall since March 1998, and is forecast to continue falling, dropping below 1 million for the first time since 2008 by the middle of 2017. The OBR also expects wages to grow above inflation each year until 2018.

Borrowing – the OBR's preferred measure of 'underlying' public sector net borrowing has fallen by a third as a percentage of GDP since 2009-10, and is forecast to have fallen by half a percentage of GDP by 2014-15. It is now expected that the underlying deficit will be £24 billion lower over the forecast period than predicted in the Autumn Statement 2013. Public sector net borrowing is anticipated to reach a small surplus in 2018-19.

3. Key Announcements and Implications for Devon's Residents

Pensions – significant changes to the pension system were announced. In particular, all tax restrictions on pensioners' access to their defined pension contribution will be removed from April 2015 next year. From this point, the rate of tax on pension income will fall from 55% to marginal income tax rates if the whole pension pot is withdrawn. Further, those who want greater control over their finances in the short-term will be able to extract their pension savings in one lump sum

whenever they choose, rather than at retirement age which is the current requirement.

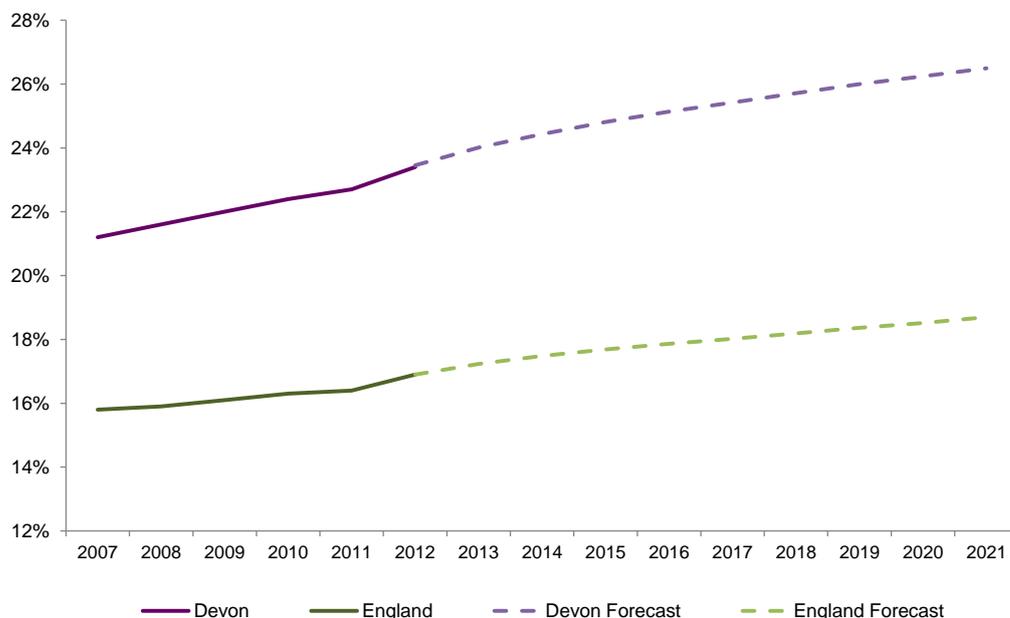
More immediately, from the 27th March should retirees be in “capped drawdown”, and have at least £12,000 a year of secure pension income (including the state pension and annuities), they can move to “flexible drawdown” which provides complete freedom in how much pension is withdrawn. Previously, the requirement was £20,000 a year.

The announcements made by the Budget represent a significant reform of pensions and will change the way that many people fund their retirement. They are likely to mean that more people will choose to take greater sums from their pension and avoid purchasing an annuity.

The impact of these changes in Devon is likely to be in excess of those felt nationally given the high proportion of the population aged 65 and over (176,500 in 2012, equivalent to 23.4% of the total population compared to 16.9% nationally). This will continue to be the case going forward. For the local economy, this reform has the potential to increase discretionary spending power amongst the retired population, due to the higher levels of disposable income available. It has also been speculated that this could increase activity in the housing market should pensioners decide that they can get a better financial return from investment in property, thus potentially increasing median house prices and the prevalence of buy-to-let ownership in the county.

As shown below, projections from the ONS suggest that the proportion of over-65s in the county will increase from 23.4% in 2012 to 26.5% in 2021, in contrast to a rise from 16.9% to 18.7% nationally.

Population Estimate and Projection for those Aged 65+, 2012



Source: Mid-Year Population Estimates, 2012 & Sub-national Population Projections, 2012

Savings – From July 2014, the Individual Savings Accounts (ISAs) will be simplified through the creation of the New ISAs (NISA). This will enable savers to transfer funds from stocks and shares ISAs into cash ISAs providing increased flexibility in savings and investments within the overall limit, which has been almost trebled from £5,760

to £15,000. This will increase tax free returns on either cash or shares for savers in Devon.

From 2015-16, the 10% starting rate for savings income tax will be abolished, with the maximum amount of savings income required to qualify for this rate will be extended from £2,880 in 2014-15, to £5,000. This means that residents in Devon that top up modest incomes with interest from savings will pay less tax if they claim a refund from HM Revenues and Customs or register their tax-free status with their bank or building society. Raising awareness of this enhancement will be important as according to HMRC figures, just 540,000 of the 3.6 people eligible for the tax break actually claimed in 2011-12.

Earnings – the government has accepted the recommendations from the Low Pay Commission to increase the rates of National Minimum Wage (NMW). The adult NMW rate will increase by 3% to £6.50 from October 2014, representing the largest cash increase since 2008 and the first real terms increase since 2007. The Budget also announced increases of 2% for the youth and apprentice NMW rates from October 2014. Overall, the OBR predicts that wages will grow above inflation every year until 2018. Devon is typified by a low-wage economy with high levels of employment in sectors (such as accommodation and food) and elementary occupations which are characterised by a high proportion of jobs offering NMW. In 2013, median gross annual pay was 87% of national levels – a gap of £3,595 or 13%. As such, the rise in annual earnings is welcome.

Personal allowance and taxation – tax free personal allowance (the part of earnings on which there is no tax to pay) will be increased to £10,500 a year from April 2015. As a result, HM Treasury estimate that a typical basic rate tax payer will be £62 better off in real terms. This will benefit all tax payers in Devon and is particularly welcome given the prevalence of low annual earnings in the County. The higher rate threshold for income tax will also increase to £42,285 from 2015-16, whilst the basic rate limit will be set at £31,785.

The Budget stated an increase in transferable tax allowance for married couples and civil partners, from that announced in the Autumn Statement. From April 2015, married couples and civil partners, where one person earns less than the personal allowance, will now be allowed to transfer up to £1,050 (10%) of their unused allowance to their partner, so long as the higher income adult is a basic rate tax payer. Again, due to the prevalence of low annual earnings in the County, this announcement is welcome and will benefit residents in Devon.

For the self-employed, National Insurance contributions have been simplified and from April 2016 will be collected through self-assessment. Within Devon, levels of self-employment are higher than the national average. In Oct 2012-Sep 2013, there were 63,200 individuals in Devon aged 16+ who were self-employed, equating to 17.9% of employment, compared to 14.5% nationally. Looking forward, the simplification of national insurance contributions for the self-employed may make this a more attractive route for others.

In terms of inheritance tax, as announced at Budget 2013, the government will extend the freeze of the inheritance tax threshold at £325,000 until 2017-18.

Benefits and welfare – the tax free child care costs cap, against which eligible parents can claim 20% support, will be increased from £6,000 to a maximum of £10,000 a year for each child. This means that the maximum tax benefit for each child will increase from £1,200 to £2,000 from autumn 2015. Tax free childcare will

be rolled out to all eligible families with children under 12 within the first year of the scheme's operation. This is designed to benefit around 100,000 parents reducing childcare costs.

The 2011 Census revealed that 54,770 families in Devon had at least one dependent child aged 0-11, and could therefore be potential beneficiaries to the scheme. However, it is not known what proportion of these households will meet the eligibility criteria.

Transportation – as cited in the Autumn Statement, the planned September rise in fuel duty has been cancelled, with HM Treasury estimating that this will save the average motorist £11 every time they fill up their tank by 2015-16. Scrapping the fuel duty rise is particularly good news for commuters – the 2011 Census revealed that over a third (36.7%) of Devon residents aged 16-74 drive a car or van to work, compared to 34.9% for England.

Further, the government has submitted an application to the European Commission for 17 of the most rural areas in mainland UK to receive a 5 pence per litre (ppl) fuel duty discount. For Devon, this application includes Lynton and Lynmouth in North Devon. A final decision on the areas in the scheme and the price discount is expected from the EC later this year.

Vehicle Excise Duty (VED) rates for cars and motorcycles, and the main rates for vans will increase by RPI from April this year. With specific regard to VED, motorists will now be able to pay by direct debit annually, biannually or monthly (although this will incur a 5% surcharge), whilst paper tax discs will no longer be issued and required to be displayed on a vehicle windscreen.

Energy – the government announced a £7 billion package to cut energy bills, which includes an £18 per ton cap on carbon price support (the carbon tax paid by electricity generators which raises the cost of electricity). For medium sized manufacturers, this is anticipated to save £50,000 a year by 2018-19, whilst for the average household, the anticipated saving will be £15 over the same period. In 2011, 49,073 households (10%) in Devon were classified as being in fuel poverty. Under government measures, this is defined as a household with required fuel costs that are above the national average and, were they to spend that amount, they would be left with a residual income below the official poverty line. A reduction in energy bills therefore represents welcome support for households in Devon.

Leisure – the rate of bingo duty will reduce to 10% from June 2014. In terms of alcohol consumption, the duty on general beer will be reduced by 2% in March 2014, whilst the duty on high strength beer will be reduced by 6%. In addition to consumer savings, this may also bring some benefit to the large number of microbreweries within Devon as well as the local pubs. Duty will be frozen in cash terms on spirits and most ciders, whereas for wine and high-strength sparkling cider it will increase by RPI. For smokers, duty rates on tobacco products will increase by 2% above inflation from March 2014, with annual duty increases of 2% above inflation until the end of the next Parliament.

4. Key Announcements and Implications for Devon's Businesses and Employees

Employment Allowance – a new National Insurance Contributions (NICs) employment allowance of £2,000 begins in April. This will remove the first £2,000 from the NI bill for all businesses and charities that pay Class 1 NICs – this covers

the large majority of the national business base. If a business pays less than £2,000 a year, they will not have to pay any NICs. It is expected that it will lift 455,000 employers out of NIC altogether.

The large majority of the business base in Devon will benefit from this allowance and with micro businesses employing less than 10 people and the self employed being highly represented in the County, it is likely that there will be a reasonably high proportion of businesses that become exempt from NIC when compared to other parts of the Country. There is also potential for the allowance to support the creation of additional jobs, due to the lower levels of NICs that would be incurred.

Apprenticeships – support for 16-24 year old apprenticeships will be boosted by an extra £85 million in both 2014-15 and 2015-16 to fund over 100,000 grants under the Apprenticeship Grants for Employers Scheme. Eligible businesses will receive a grant of £1,500 per qualifying apprentice, up to a maximum of 10 grants over the lifetime of the initiative. As indicated by the Department for Business, Innovation and Skills¹ there are a number of potential businesses benefits in taking on an apprentice, including improvements to productivity, staff retention, and products or services; and the introduction of new ideas to the organisations.

While apprenticeships are very popular and successful in Devon with 7,200 apprentice starts in 2012/13, the Confederation for British Industry's (CBI) Education and Skills Survey 2013 found that national involvement in apprenticeships amongst SMEs is limited. Given the dominance of SMEs within Devon's business base (with 39,500 in 2012 accounting for 99.7% of the total business base); this additional support has the potential to further boost apprentice numbers and opportunities. However, this will only be the case if there is a further push from central government alongside this grants scheme, to encourage apprenticeship take up specifically amongst SMEs.

In addition, the government will provide £20 million over two years to support degree and Masters level apprenticeships. Securing this funding in Devon will help to diversify and increase the number of higher quality employment and higher education opportunities available to local residents, as well as improve the skills levels and employment prospects of the workforce. It is also expected that employers will have greater control over the content of courses to ensure that they equip apprentices with the right skills. Whilst the proportion of Devon's working age population qualified to NVQ Level 4+ is broadly in line with national levels, there is significant variation in attainment across the districts and there are pockets where skills levels fall below the national average. If targeted well, this funding has the potential to narrow some of the disparities experienced across the county. Further, support for higher level skills could also support a narrowing of the earnings gap between Devon and national comparators.

Both of these measures have the potential to reduce unemployment amongst Devon's 20-24 year olds, which stood at 15.7% between October 2012 and September 2013.

Help for Social Enterprises – in order to encourage new investors to put money into social enterprises, the government will provide Social Investment Tax Relief at a set rate of 30% - the rate for the Enterprise Investment Scheme and the Venture Capital Trust scheme. The rate will offer income tax relief to those making unsecured investments in charities, community interest companies, community benefit societies

¹ BIS (2012) Evaluation of Apprenticeships: Employers

and social impact bonds. Eligible social enterprises, which have a maximum of 500 employees, will be able to receive up to £290,000 over three years under the scheme which commences on the 6th April 2014. Devon has a high density of social enterprises and these changes could stimulate increased investment within the sector.

Exports – the government have announced an ‘overhaul’ of UK Export Finance’s (UKEF) direct lending programme - which aims to help UK firms win contracts and expand overseas. The programme is being doubled to £3 billion and the interest rates will be cut to the lowest permitted levels. UKEF’s remit will be changed to allow support in both developing the UK-based supply chains of exporters and in intangible exports, whilst its marketing will also be ‘stepped up’.

In 2013, the South West had one of the lowest levels of exports of all the English regions². Data from the 2013 Heart of the South West Business Survey³ indicated that just 21% of respondents traded internationally, whilst less than half (42%) of businesses trade outside of the region. Underpinning the value of the direct lending programme, the most frequently stated type of assistance that would encourage survey respondents to explore wider trading was finance.

With a continued focus on export led recovery, increasing the take up of such support and enabling the county’s businesses to export will help to increase the number of market opportunities available to local businesses and in turn benefit the local economy.

Business Tax – the Annual Investment Allowance - which provides businesses with up-front relief on qualifying capital investment - is being doubled to £500,000 from April 2014 until the end of 2015. Three quarters of the companies that are expected to benefit will be outside London and the South East, with agriculture and manufacturing particularly likely to gain. Businesses in Devon should be well placed to secure a proportion of this investment. According to the latest Inter-Departmental Business Register statistics approximately 19% of Devon’s businesses in 2013 were based in agriculture compared to 4% nationally and there are strong concentrations of manufacturing in certain parts of the county including Mid Devon, North Devon, Torridge and South Hams.

Energy – as cited earlier, the Carbon Price Support will be capped at £18 from 2016-17 to 2019-20 in order to reduce business energy costs, particularly in manufacturing. In addition, Combined Heat and Power (CHP) plants will be eligible for an exemption from the Carbon Price Floor (CPF) - a tax on fossil fuels used to generate electricity. There are nine CHP plants in the South West which will be eligible for the exemption, delivering average savings of around £74,000 in 2018-19. This should include the CHP plant at the Exeter and East Devon Growth Point.

Energy intensive industries will also benefit from compensation for the cost of the CPF, whilst the EU emissions trading system will be extended to 2019-20. There are currently six Energy Intensive Installations within the South West which are eligible for compensation under this scheme, which could save an average of £779,000 in 2018-19.

Business Finance – the Seed Enterprise Investment Scheme (SEIS) - which offers tax relief to individual investors who purchase new shares in small, early stage

² HMRC Regional Trade Statistics, Third Quarter 2013

³ SERIO (2013) Heart of the South West Business Survey

companies - will be made permanent, alongside the capital gains tax 50% reinvestment relief. This move is designed to ensure venture capital schemes effectively support such businesses.

The government are also planning to change the eligibility criteria of the Enterprise Investment Scheme – which focuses on more mature businesses than the SEIS – and the Venture Capital Trust scheme – which incentivises indirect investment in small higher-risk trading companies. The criteria is being changed to avoid subsidising low-risk activities that already benefit from existing government programmes, and the government will also be considering options for these tax reliefs to apply where individuals make investments in the form of convertible loans. The DCC Strategy for Growth 2013-2020 identified a significant gap in productivity between Devon and national levels. As such, ensuring sufficient levels of investment in small and growing businesses that undertake more innovative, and therefore more high-risk activities, will be important in addressing this gap.

ISA eligibility will be extended to peer-to-peer loans. The Federation of Small Businesses has welcomed this move which, it believes, will encourage more investment into small firms seeking alternative means to access finance. In addition, the government will shortly launch a consultation on whether, and if so how, to legislate to help match SMEs rejected for finance with alternative lenders.

R&D and the Knowledge Economy – Research and Development (R&D) tax credits for loss making SMEs who usually cannot afford to invest has been extended. The rate of payable credit will rise from 11% to 14.5% from April 2014 in a bid to support innovative start-ups and early stage companies to invest in R&D. In 2011/12, 810 R&D tax credit claims were made by South West SMEs with a total value of £32m. Maximising take up in Devon will increase overall levels of research and development in the County, with the potential for the resulting products, services and processes to increase productivity levels – a key challenge for the Devon economy as noted above.

Renewable Energy Tax Relief Changes - in an effort to reduce the use of multiple tax relief benefits the government has excluded companies which already benefit from the Renewables Obligation Certificates (ROC) and/or the Renewable Heat Incentive scheme from the EIS, the VCT scheme and the SEIS tax relief schemes. ROCs are issued to operators of accredited renewable generating stations and play an important role in supporting investments in renewable technologies, while the Renewable Heat Incentive scheme encourages the uptake of renewable heating amongst businesses.

There is considerable potential for renewable energy development in Devon, for example on the North Devon and Torridge coast. However there is concern that the tax relief changes announced in the Budget may discourage the launch of Venture Capital Trusts in renewables. This is because companies which already benefit from ROCs will not benefit from the VCT scheme, therefore limiting future investment in the sector.

5. Key Announcements and Implications for Economic Development in Devon

Funding for Flood Defences - £140 million of new funding has been announced to repair and restore the condition of vital flood defences that have suffered damage, following the £2.3 billion of capital funding allocated to flood defences in the Spending Round 2013. The government will be publishing a long-term plan in autumn 2014 outlining how it will direct this investment.

A study by SQW on flooding in Devon and Somerset, commissioned in response to the 2012 floods, estimated that the floods had cost businesses in the sub-region £5.2 million with acute levels of damage to agriculture. More recently the winter storms of January and February 2014 revealed the vulnerability of some of the county's coastal settlements and transport links to coastal flooding. Consequently it will be important to ensure that some of this investment is directed towards the county.

Help for Enterprise Zones – in a move to further incentivise businesses to locate in Enterprise Zones the government will extend, by three years until March 2020, the period in which enhanced capital allowances and business rate discounts are available. Devon does not yet have an Enterprise Zone, the nearest being close to Newquay in Cornwall. Although DCC is currently undertaking a marketing campaign to encourage inward investment, there is a risk that the county may be passed over by businesses when making location decisions.

Transport – the scope of the Regional Air Connectivity Fund will be extended to include start-up rates for new routes from regional airports, with funding increasing to £20 million per annum. A Treasury spokesman has since clarified that this will be available for airports with less than 3 million annual passengers. In 2013, out of the 56 UK airports which are monitored by the Civil Aviation Authority Exeter airport was one of 40 airports with less than 3 million passengers. Consequently, the Fund may provide an opportunity for further expansion at Exeter Airport which is already increasing its passenger facilities as part of the Exeter and East Devon Growth Point.

In terms of roads, a £200m fund for pothole repairs was announced. This will involve a competitive bidding process which Devon County Council will have option to enter.

Science and Technology – a new £42 million Alan Turing Institute will be established to help enable Britain to lead the way in 'big data' and algorithm research. Universities are being invited to bid for funding and the right to host the institute. Meteorology is a major area where 'big data' is an issue and there may be scope for the Met Office, in Exeter, to work with the new Institute.

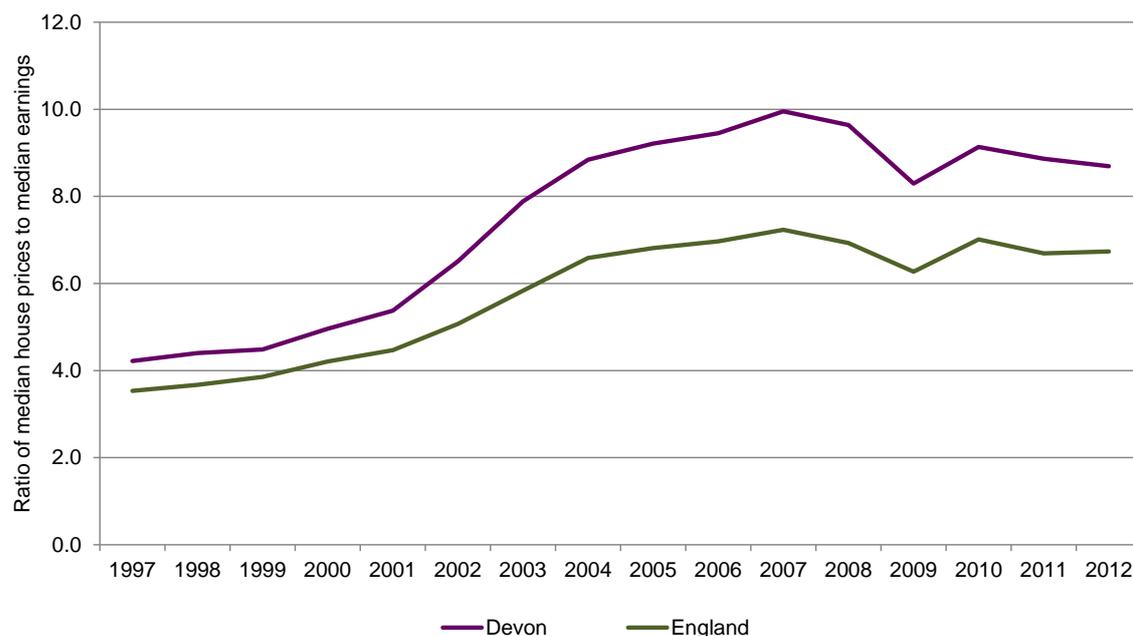
The Budget also revealed that £106 million over five years will be invested in 20 new Centres for Doctoral Training, while £74 million will be provided for a new Cell Therapy Manufacturing Centre and Graphene Innovation Centre, as an expansion of the UK's existing network of catapult centres – physical centres which bring together businesses, scientists and engineers to improve innovation in specific areas. Other technological announcements include £60 million for new low-carbon innovation to support carbon capture and storage technologies.

Higher Education - the government announced that it will be investigating options to support increasing participation in postgraduate studies and will outline its ideas in the 2014 Autumn Statement. This may provide opportunities for expanding higher education within Devon.

Housing – a series of measures were announced that are expected to support building of 200,000 new homes. This included a £500 million 'Builders Finance Fund' which will be created to provide loans to SME developers to unlock 15,000 housing units which have stalled due to difficulties in accessing finance. This will help to increase the share of new homes built by small and medium sized builders, which has fallen significantly in recent years. The CBI feels that this will support new entrants into the market.

The Help to Buy equity loan scheme, which supports households in buying new-build homes, is being extended to March 2020, with the objective of stimulating the construction of an additional 120,000 homes. The government will also create another £150m fund to kick start the regeneration of large social housing estates and will consult on a new 'Right to Build' scheme which would give custom builders a right to buy a plot from councils. Government will test the new model with a small number of councils. As shown below, housing affordability is a major issue in Devon with the ratio of median house prices to median earnings consistently above that of the England average. Consequently increasing the supply of homes within the county is of critical importance.

Ratio of Median House Prices to Median Earnings, 2012



Source: DCLG, 2012

The announcements will also provide a boost to the local construction sector.

Public Estate Rationalisation – the Government Property Unit will be increasing its work with local areas to promote opportunities for cross public sector working, efficiency and growth. Exeter currently hosts offices for the DVLA, the Highways and Environment Agencies and the Met Office, in addition to the County Council. Consequently the scope for public sector efficiency gains in the area is considerable. In addition, Exeter's central location within the wider South West and good levels of connectivity make it a possible site for future public estate rationalisation from further afield.

Local Government Funding – while the Budget did not contain any further announcements on cuts to local government funding, the Institute for Fiscal Studies (IFS) has warned that the tax cuts included within the Budget will be funded in part through further cuts to 'unprotected' government departments. This will include the Department for Communities and Local Government (DCLG). The Institute for Public Policy Research has forecast that DCLG will lose a total £3.6 billion over the first four years of the next Parliament if current projections for protected departments remain; meaning further cuts to local authority budgets.

Local Government Financing – in order to help local authorities borrow from the Public Works Loan Board (PWLB), the government will take the legal powers needed

to increase the PWLB lending limit from £70 billion to £95 billion. This will provide more scope for councils to borrow money to invest in local infrastructure.

Support for the Creative Sector – a new theatre corporation tax relief will be introduced in September 2014 at 25% for qualifying touring productions and 20% for other productions. The government also confirmed the 2013 Autumn Statement announcement on film corporation tax relief. Such measures may benefit the creative industry in the county, which was identified as a priority sector in the recent Sector Research commissioned by Devon County Council⁴.

⁴ SERIO (2013) Sectors Research