Economy Briefing Note: Summer Budget 2015

Overall summary:

- **The Chancellor's Summer Budget was presented to parliament on 8th July 2015, the first all-Conservative Budget since 1996.**
- **The Chancellor's economic ambition for this parliament is to move the UK to a higher wage, lower tax, and lower welfare economy.**
- **The UK growth forecast has been revised down for 2015, but remains stable at approximately 2.4% per annum through to 2020/21.**
- **The Budget sets out a number of measures to reduce the deficit by 2019/20 – a year later than had previously been planned. Measures over the current parliament include: total welfare cuts of £34.9bn; tax increases of £47.2bn (in part through a clamp down on tax avoidance and evasion); and savings of £17.9bn from central government department resource spending and £8.1bn from capital spending.**
- **The Chancellor announced various measures which ought to benefit Devon's businesses; firms should find it easier to hire and train staff and more cost effective to invest in capital equipment, and they will also benefit from reduced rates of corporation tax.**
- **For low paid workers – of which there are many in Devon – the phased introduction of a National Living Wage should be helpful. On the other hand, pay rises for those working in the public sector will be capped at 1% for four years.**
- **Planned changes to inheritance tax should benefit families with significant assets (notably housing).**
- **Working age benefits are to be frozen and the overall cap will be reduced.**
- **For young people, changes to benefits and a new "Youth Obligation" will mean that the clear imperative is to "earn or learn".**
- **Various measures will be introduced to accelerate devolution in England. The primary focus is the city-regions of the north, but there is scope for Devon to propose a devolution deal if it wishes to act quickly.**
- **Vehicle Excise Duty is to be reformed and revenues will be hypothecated to form a new Roads Fund.**

Section A: Forecasts from the Office for Budget Responsibility (OBR)

The OBR published a comprehensive set of forecasts alongside the Summer Budget 2015[1]. Revisions to indicators are presented in relation to the OBR March 2015 forecasts which were published alongside the pre-election Budget. A period of just four months (i.e. between March and July 2015) therefore separates the production of the two sets of numbers; this is a limited time frame in which to observe real change. That said, some very recent developments – notably the Greek debt crisis – are not reflected fully in the OBR's latest forecasts. For both reasons, there are complications and uncertainties.

Nevertheless, based on OBR's July publication, the economic headlines which framed the Chancellor's decisions with regard to spending and taxation are as follows:

- **Forecasts for real UK GDP growth have been revised down marginally to 2.4% in 2015.** This reflects the lower than expected quarterly growth in Q1 2015; 0.7% growth had been expected in March 2015 while

[1] *Economic and Fiscal Outlook, July 2015* Office for Budget Responsibility (Cm 9088)

the outturn was 0.4%. The shortfall is largely explained by weaker net trade (exports less imports) with imports growing faster than exports in Q1 2015. Higher than expected private, household consumption – which remains the anchor of UK GDP growth – partially offsets this weaker overall net trade balance. Beyond 2015, real UK GDP growth is expected to be stable at roughly 2.4% over the forecast period, buoyed by private consumption and investment. There remains significant uncertainty, however, in relation to the potential fallout from the Greek debt crisis; this has not been taken into account in the OBR forecasts.

- **Employment growth remains strong in early 2015.** Total employment increased by 1.8% on a quarterly basis in Q1 2015, 0.3 percentage points higher than had been expected in March 2015. The strong performance reflects higher participation in the labour market. Total employment is forecast to increase by 1.1 million over the next six years, outpacing population growth. The expected unemployment rate in 2015 is largely unchanged from the March estimates at 5.2%. Both the employment and unemployment rate point therefore to the continuing strength of the UK labour market.

- **Productivity – measured on an output per hour basis – again underperformed, rising 0.1% in Q1 2015.** The rise is explained by lower than expected average weekly working hours in Q1, reversing the previous upward trend seen towards the end of 2014**.** The OBR still expects an underlying improvement in productivity growth over the current parliament, and an associated increase in workers' take-home pay.

- **Estimates of the public sector deficit (i.e. spending less tax receipts and debt interest payments) have been revised down by £1bn to £89.2bn in 2014/15**. In 2015/16, forecasts for the public sector deficit are £69.5bn, £5.8bn lower than expected in March 2015. This reflects higher than expected tax receipts in 2015/16, as well as a significant in-year squeeze on central government department budgets.

- **The Chancellor has published a revised draft fiscal charter. It has implications for the profile of government spending cuts over this parliament.** The fiscal mandate, outlined in the March Budget, required the Government to achieve a budget surplus (i.e. government receipts must exceed government spending) by 2018/19. The timescale for this has been extended by a year reflecting the Chancellor's decision to make less severe cuts to central government departments in 2016/17 and 2017/18. The additional year of cuts to central government budgets still means that public services spending will fall by an average of 1.5% per annum (in real terms) over the course of the parliament; this is similar to the 1.6% per annum achieved over the last parliament. For Devon County Council, the pace of cuts may be a little slower than previously assumed although no firm decisions on allocations will be made until the Spending Review in autumn 2015. The fiscal charter will also include a mandate for future governments to achieve a budget surplus in every year when the economy is not in recession, and a supplementary commitment to reduce public sector net debt as a percentage of GDP in every year of the current parliament.

Framed by this forward look, the Chancellor made a large number of detailed announcements. Some of the key announcements (several of which also appeared in the Productivity Plan) are set out in the pages which follow along with a first-cut assessment of how they might impact on Devon's people, communities and businesses in absolute terms. This is summarised as follows:

⇧ The announcement ought to be beneficial to some or all of Devon's people, communities and businesses	⇔ Within Devon, the announcement will have a neutral or mixed effect;	⇩ On balance, the announcement is likely to impact negatively on Devon's people, communities and businesses

Section B: Announcements affecting Devon's people and communities

The Government will freeze working-age benefits and also reduce the cap on total benefits

(1.152) The commitment is made to freeze working age benefits, and also to reduce the cap on the total amount of benefits that an out of work family can receive. The freeze will apply to tax credits and Local Housing Allowances (1.137) and is forecast to save £4bn per annum by 2019/20. The cap (i.e. the total amount of benefits an out of work family can receive) will be reduced from £26,000 to £20,000 outside London. The intention is to encourage more working-age adults into employment.

Tax credits for a third (or subsequent) child to be removed from 2017

(1.146) As part of the in-scope elements of the welfare cap, tax credits to support families with children will be limited to two children from 2017. A third (or subsequent) child born after this date will no longer be eligible. The announcement does not however affect those who already have three children or more, and who have made plans on the basis of the current system. Child Benefit will continue to be paid at the same level for all children. To some extent, this will be off-set by increases to the lower rate tax threshold (outlined below).

Potential reform to pensions tax relief and annual allowance tapered for high income earners

(1.223, 1.225) A consultation will be launched on the case for reforming pensions tax relief. This could have a really quite significant bearing on the incentives offered to individuals to save over their lifetime. The Chancellor outlined two potential options in his speech: a move to an ISA type system of further tax free interest on savings, and providing government top-ups to pension contributions. The overarching imperative is to encourage individuals to save for their retirement.

In addition, a minor change to the current pension system was announced which will affect higher rate tax payers. From 2016, the government will introduce a taper to the Annual Allowance for those with adjusted annual incomes (including their own employer's pension contributions) of over £150,000. This will affect Devon's most wealthy pensioners only; nationally, it is expected to affect less than 1% of the population.

Reform to inheritance tax on first property

(1.219) The Government will introduce a higher threshold at which households are liable to pay inheritance tax on the main family home. It will see the current tax free threshold of £325,000 rise to £500,000 in 2020-21. This effectively means most families wishing to pass property to direct descendants will do so on a tax free basis; the Government estimates that by 2020/21, only 37,000 estates across the UK will be liable to pay inheritance tax on property. This ought to be beneficial for some families in Devon, given high and rising house prices.

The Government will introduce a new Youth Obligation for 18-21 year olds not in work

(1.158) To help young people move into work, the Government will introduce a new Youth Obligation for 18 to 21 year olds on Universal Credit. From April 2017, young people claiming Universal Credit will be made to 'earn or learn'. They will receive an intensive regime of support and after six months, they will be expected to apply for an apprenticeship or traineeship, gain work-based skills or be placed on a mandatory work placement, to help them secure employment. In addition, the Chancellor announced the removal of automatic entitlement to housing support for 18-21 year olds claiming Universal Credit who are out of work. These two reforms will be challenging for some young people, but they are intended to improve overall levels of youth employment.

University maintenance grants to be replaced with loans ⇩

(1.265) In an attempt to put higher education funding onto a "more sustainable" footing, the Chancellor announced a quite substantial revision to maintenance grants for students from low income families. The current grants for families on low incomes – which are paid in addition to the standard student tuition loan – will now be converted into a further loan. These will only be repayable for students who secure employment and start to earn over £21,000 per year. These measures will result in a saving to government of £2.5bn a year. The maximum value of the maintenance loan will also be raised to £8,200 per annum. This will have significant implications for university students from poorer backgrounds, who already will be taking out a student loan of £9,000 per year for tuition.

Reform to Vehicle Excise Duty (VED) and hypothecating the revenue to create a new Roads Fund ⬄

Vehicle Excise Duty will increase on new cars from April 2017 – although it will still be banded to incentivise the cleanest cars. The revenue – which equates to an estimated additional £2.1bn over this parliament – will be hypothecated to create a new Roads Fund focused on the strategic road network. The effect of this process on Devon depends largely on how the new Roads Fund is eventually used. It will be steered by a new Road Investment Strategy and it is probable that this will predominantly respond to congestion-related challenges. In relative terms, these may be more acute close to major urban areas on the strategic road network.

An additional £8bn committed to the NHS by 2020/21 ⇧

(1.76) On top of the £2bn pledged at Autumn Statement 2014, the Government has committed to an additional £8bn of funding for the NHS by 2020/21. This is in line with the funding requirements set out in the NHS 5 year plan. In addition to £22bn in efficiency savings (outlined in the plan), this announcement will ensure the NHS becomes a 7-day service by 2020/21. Hospitals will be appropriately staffed at weekends and access to GP services will be available from 8am to 8pm, seven days a week. This should benefit Devon's residents. However the staffing of this commitment could present some challenges.

The Government will extend the Coastal Communities Fund ⇧

This commitment is couched in cautious terms and the funding linked to it will not be clear until Spending Review 2015 (para 1.290). Nevertheless, given its extensive coastline, the intention to continue to support community-led growth in coastal areas should be broadly helpful in both north and south Devon.

Section C: Announcements affecting Devon's businesses and workers

The Government will limit public sector pay awards to 1% for four years from 2016/17 ⇩

The Summer Budget 2015 is explicit in relation to the continuing constraint which will characterise public sector pay: pay rises will be restricted to 1% for four years (para 1.87). In practice, the impact of this cap will depend significantly on rates of inflation which – currently – are low; if inflation rises, the consequences for public sector workers will be challenging. The settlement may exacerbate recruitment difficulties, particularly in low pay elements of the public sector (e.g. care workers). This announcement might also disproportionately affect local areas in which the public sector is a major employer (such as Exeter and North Devon).

The Government will introduce a new National Living Wage – and consider how the NLW might reach 60% of median earnings by 2020

⇧

The commitment in Summer Budget 2015 is to introduce a new National Living Wage (NLW) for workers aged 25 and above, by introducing a new premium on top of the National Minimum Wage (para 1.121). From April 2016, this equates to an hourly wage of £7.20. This ought to be broadly good news for the many people who are working in low paid jobs in Devon. Nationally, the OBR expect this will lead to a small reduction in total employment and hours worked.

In the medium term, there is also a commitment to raise the NLW to 60% of median earnings; this is estimated to be £9 (per hour) by 2020.

It is not clear how the proposals in relation to the NLW will, in practice, fit with the commitment to a 1% cap on public sector pay. Analysis by the Local Government Association suggests that nationally, 93,000 council staff currently earn less than the proposed NLW; this will have implications for council budgets[2].

The Government will raise the personal allowance to £12,500 by the end of the parliament

⇧

The commitment to raising the personal allowance will be implemented gradually – and the plan for 2016/17 is that it is raised to £11,000. This will increase take-home pay. In the medium term, the intention is to align the personal allowance to at least the equivalent of 30 hours work per week on the national minimum wage (para 1.131). How this relates to the proposed NLW (see above) is not explained although the implication of Chart 1.13 is that the allowance will be less than the NLW (so those on the NLW will still pay some income tax). In Devon – where wage levels tend to be low – the increase in the personal allowance will be beneficial.

The Government will raise the threshold for higher rate income tax

⇧

By the end of the parliament, the intention is that the threshold for higher rate income tax should be £50,000 (para 1.133). This will benefit those on higher earnings. The evidence suggests that workplace-based earnings across Devon are relatively low and so this change to the tax threshold will affect relatively few people.

The Government will reduce corporation tax to 19% in 2017, and to 18% in 2020

⇧

(1.239) As part of the Government's core strategy to move the UK to a lower tax society, the Chancellor announced that corporation tax will be cut by one percentage point to 19% in 2017, and to 18% in 2020. These cuts are expected to save businesses £6.6bn by 2021 and make the UK's corporation tax rate the lowest in the G20. Devon's businesses stand to benefit from this tax cut.

Free childcare to increase from 15 to 30 hours a week in 2017

⇧

Although previously announced, the Summer Budget confirmed that, from September 2017, the free childcare entitlement will be doubled from 15 to 30 hours a week for working parents of 3 and 4 year olds. This should help reduce inequality between men and women, both in terms of pay and employment. While Devon historically performs well in terms of the divergence between male and female employment rates (relative to England as a whole, on a residence based measure), this announcement should help close this gap further.

The Government will raise the National Insurance contributions (NICs)

⇧

This measure – which is to be introduced from April 2016 – will benefit smaller employers by raising the NIC Employment Allowance from £2,000 to £3,000 per annum (para 1.127). Nationally, it is estimated that it will reduce employer NICs to zero for 90,000 employers. Given the high

[2] See http://www.local.gov.uk/web/guest/media-releases/-/journal_content/56/10180/7386419/NEWS

Employment Allowance

incidence of small and micro businesses within Devon, this announcement ought to be welcomed.

The Government will raise and extend the SME *permanent* Annual Investment Allowance to £200,000

(1.242) The government is supporting investment by small and medium sized firms through an increase in the *permanent* level of the Annual Investment Allowance (AIA) to £200,000. This is however, actually a fall from the current *temporary* Allowance, set at £500,000, which was due to fall back to £25,000 in 2016. It therefore spells mixed news for SMEs looking to invest in capital infrastructure. The AIA deducts the full value of a capital investment project from business profits before tax, thereby reducing business tax liability and improving cash flow. This ought to benefit Devon's SMEs, particularly in sectors which rely on capital investments (e.g. manufacturing, agriculture, and wholesale and retail).

The Government is inviting bids for a new round of Enterprise Zones

The Summer Budget 2015 includes provision for a new round of Enterprise Zones. Although no further detail is provided, previous rounds have sought to incentivise enterprise by simplifying planning processes and removing business rates for a short period. In the main, existing EZs are focused in – or close to – larger urban areas and Devon has – so far – missed out. The Budget statement makes the point that rural areas will be eligible and it "*encourages towns and districts to work with Local Enterprise Partnerships to develop bids*".

There could, potentially, be some EZ candidates from with Devon. In deciding whether or not to launch one or more bids, issues of potential displacement will need to be taken on board fully. No detail is provided in the Summer Budget (or in the Productivity Plan, "Fixing the Foundations" (published a couple of days after the Budget)) to explain how the new round of EZs will be funded.

The Government will introduce a levy on large UK employers to fund new apprenticeships

In order to reverse a downward trend in the number of employees attending off the job training, new measures will be introduced to incentivise larger employers to engage actively in training provision. Previously, the government committed to raising the number of apprenticeships to three million. In order to help finance this, the Summer Budget 2015 includes provision for a levy on large employers; the rationale is that "*firms that commit to training will be able to get out more than they put in*". It does not define "large" and further details about the whole exercise are promised following the Spending Review. However a commitment is made to "*formal engagement with business on the implementation of the levy*". Devon has relatively few large employers and hence the cost of the levy will be relatively greater elsewhere. It will be important that more young people in Devon are encouraged to become apprentices, whether within large employers or smaller ones.

The Government will introduce Science and Innovation Audits

Although very little detail is provided (and more is promised at the Spending Review), the commitment is made to a series of audits through which "*the government will invite universities, cities, LEPs and businesses to map strengths and identify potential areas of strategic focus*". Although the detail is scant, this could be an opportunity for Devon, particularly given the specialist strengths of the University of Exeter and its (already strong) links to the local economy, and Rothamsted Research in North Wyke.

Section D: Announcements which may affect Devon's wider economic prospects

The Government will introduce a new approach to station redevelopment and commercial land sales	⇔	Based in large part on the success of some major London schemes, the Budget sets out a commitment to realise value from public land and property in the rail network. This chimes with a growing recognition of the economic importance of railway stations and the high property values that are achievable in the vicinity of them (particularly in the greater south east). The extent to which this may benefit Devon depends crucially on land ownership patterns around the major railway stations in larger urban areas.
The Government will work towards further devolution deals	⇔	The Summer Budget 2015 gives prominence to a number of English devolution deals. Uppermost amongst these is that for Greater Manchester, but reference is also made to a number of other northern city-regions. The commitment is made that "*if agreement is reached, including on an elected mayor working with local leaders to oversee new powers devolved from ministers, these city regions will be granted significant additional powers and the opportunity to take control of their own affairs to support economic growth*" (para 1.283). More generally, the door is left open to work with other "towns and counties" in striving towards devolution deals to boost growth, although the available window appears to be a short one: the statement is made that deals should be concluded ahead of the Spending Review (para 1.287). Reference is also made to the progress that has been achieved in respect of a deal for Cornwall. For Devon, the potential impacts of the devolution process are difficult to judge. Devon may – or may not – choose to go down this route, and deals are a "something for something" arrangement. However in reality, it seems probable that available discretionary resource is steered towards those areas that are willing to engage. A generous deal for Cornwall could be something of a threat for Devon.
The Government will invest in six Next Generation Digital Economy Centres	⇩	Government has committed to investing £23m in six Next Generation Digital Economy Centres. Of these, none are in Devon and the one that is geographically closest is in Bath. Given that the purpose of these Centres is to "*exploit opportunities across sectors of the digital economy including the creative industries, finance, healthcare and education*", Exeter ought to have been a candidate. The basis on which the six Centres were chosen is not explained.
The Government will support the development of the business case for improvements to the North Devon Link Road	⇧	This announcement features in a modest package of measures relating to the South West; it is the only announcement in the Summer Budget that relates explicitly to transport in Devon. The commitment is to support the development of a business case and this in itself brings no guarantee of funding downstream. However improvements to the North Devon Link Road could be important for the northern part of the county. The intention to work on the business case should be welcomed as a first step.
The Government will allocate up to £10m to the broadband programme in the	⇧	Within Summer Budget 2015, there is a commitment to make available "*up to £10m*" for local projects in the South West which are seeking to deliver ultrafast broadband. Limited detail is provided, but awards will be made on a competitive basis (although whether the competition is run

South West

nationally or sub-nationally is unclear). This should present an opportunity for local areas in Devon, although strong arguments will need to be marshalled in the context of really quite limited resources and a process which is – as yet – unclear.

For more information, please contact:

Edward Cross, Assistant Economic Development Officer, Devon County Council
email: edward.cross@devon.gov.uk