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The UK Autumn Budget 2017





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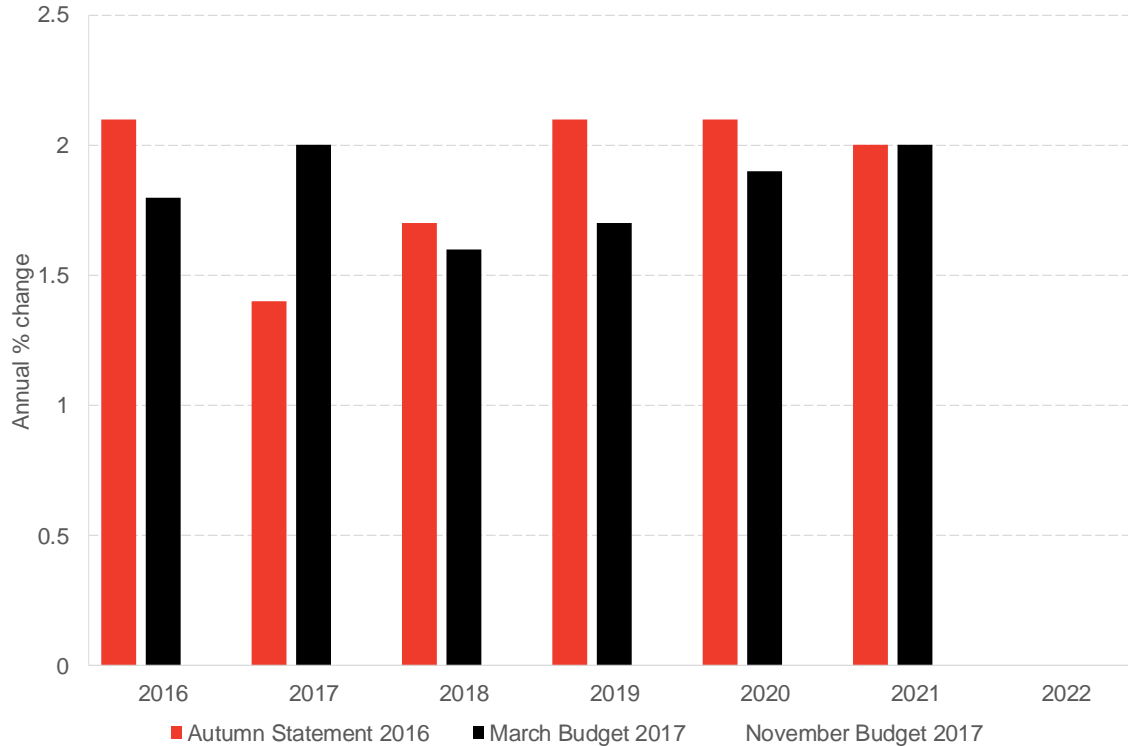
Part 1: The economic context



Summary

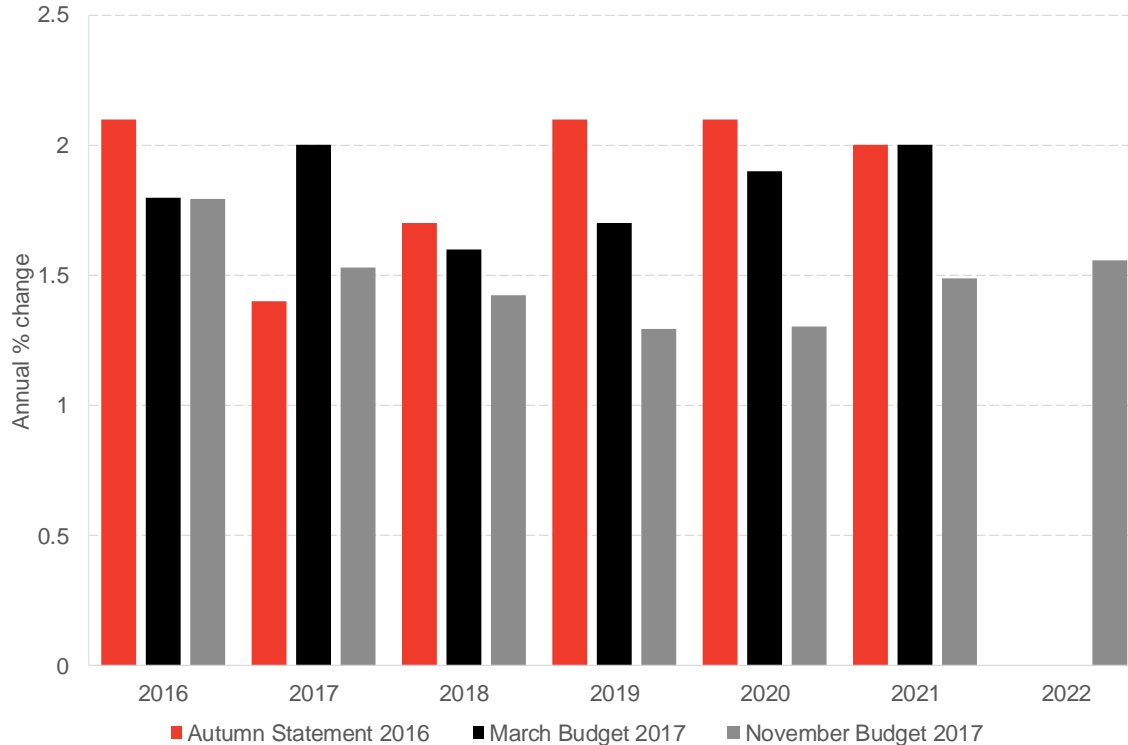
- › Arguably the most significant element to the Budget were the substantial downward revisions to UK growth forecasts for the next few years
 - › OBR has wiped off £60 billion from the UK economy over the next 5 years
 - › Reason is that after consistently assuming (hoping!) that the UK's weak productivity performance would end with growth returning to its pre-financial crisis rates, OBR now believe that shock to productivity may longer be temporary
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Revisions to growth forecasts



As recent as March, the OBR were forecasting that the economy would gradually accelerate over the coming years returning to growth of 2% by 2021.....

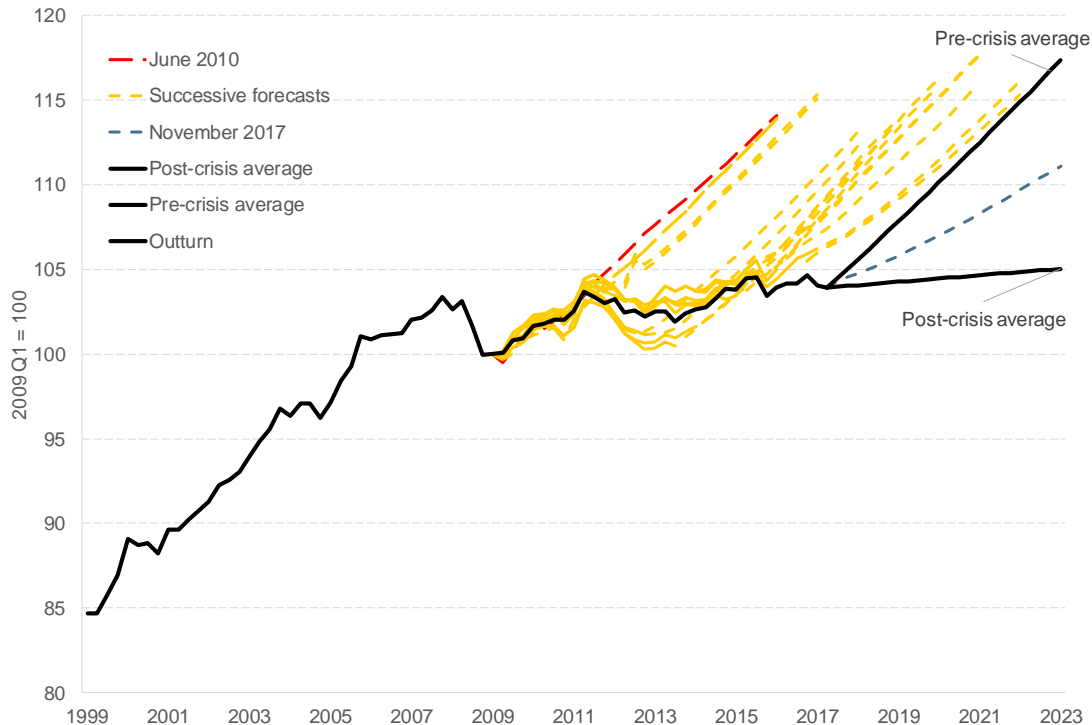
Revisions to growth forecasts



.....but in a major shift in their assessment of the outlook they now forecast growth remaining well below trend until 2022

This in turn significantly weakens the fiscal position – by reducing revenue forecasts – and household incomes

Substantial revision to productivity

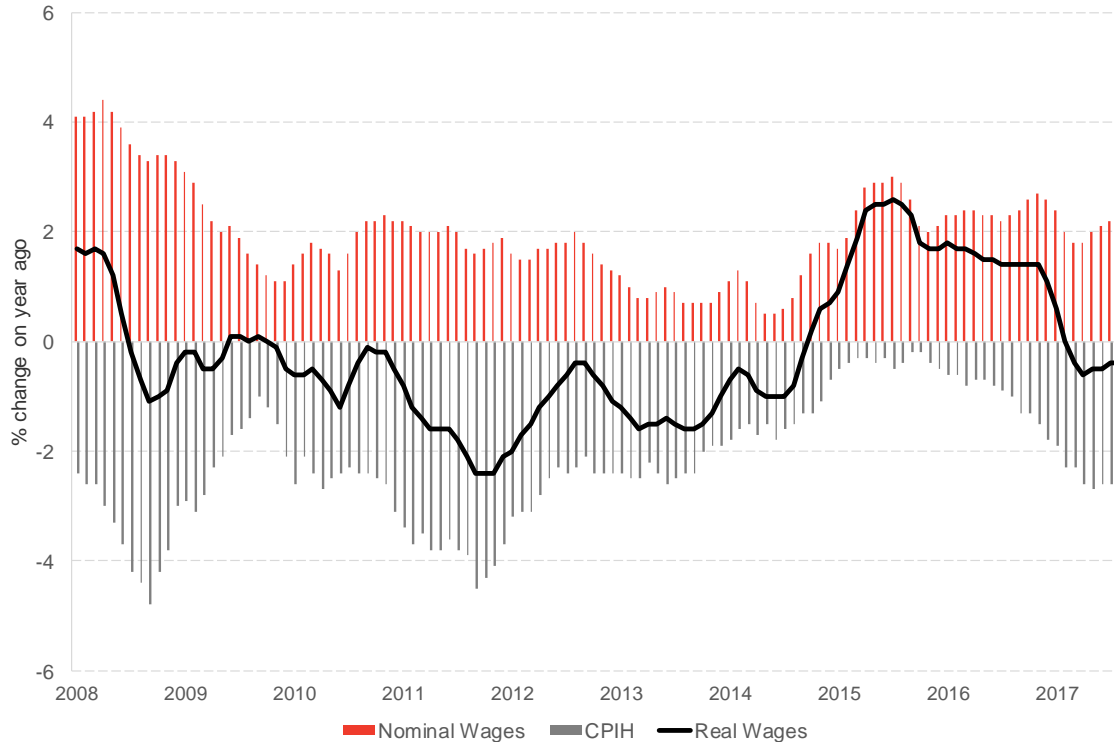


The key reason for this downward revision was the major shift in the OBR's outlook for productivity

In the past, their prediction was that productivity growth would return to pre-crisis rates.....

.....but now they believe that the slowdown is evidence of structural weakness

Which will lead to weak earnings....

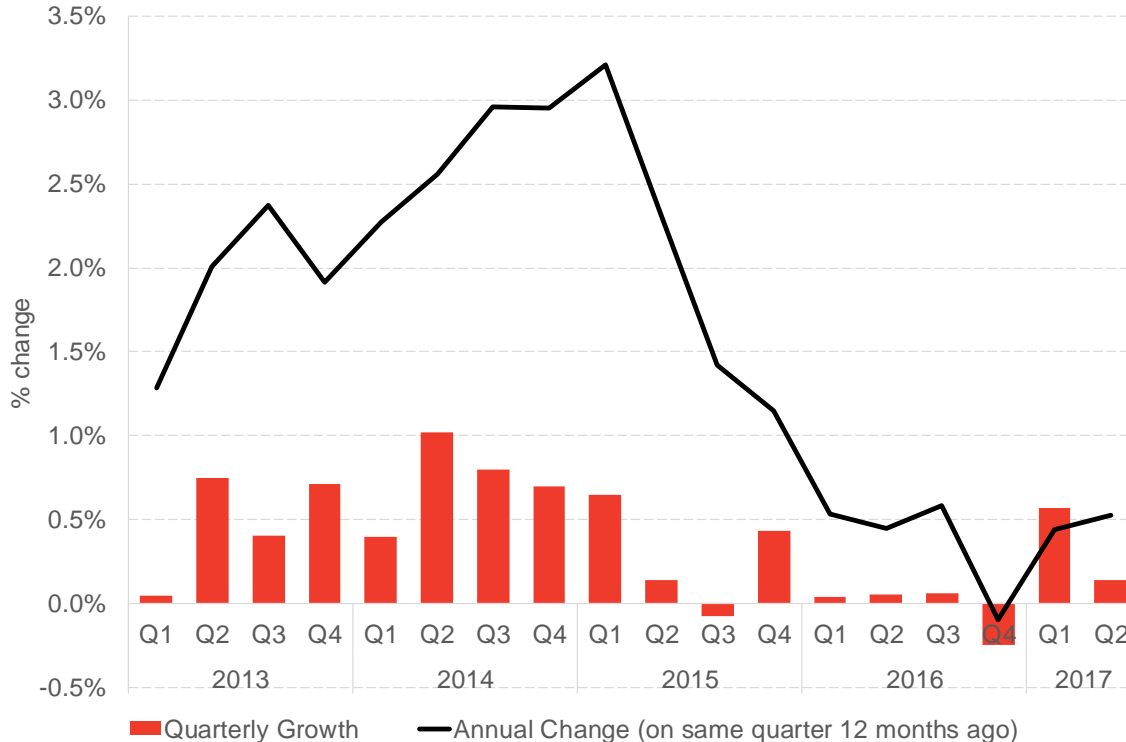


Weak productivity growth will do nothing to help the squeeze on earnings

Wages had been picking up, but inflation has more than offset cash increase

Coupled with (albeit modest) rising interest rates, the outlook for household incomes remains nothing short of dismal

What does this mean for Scotland?

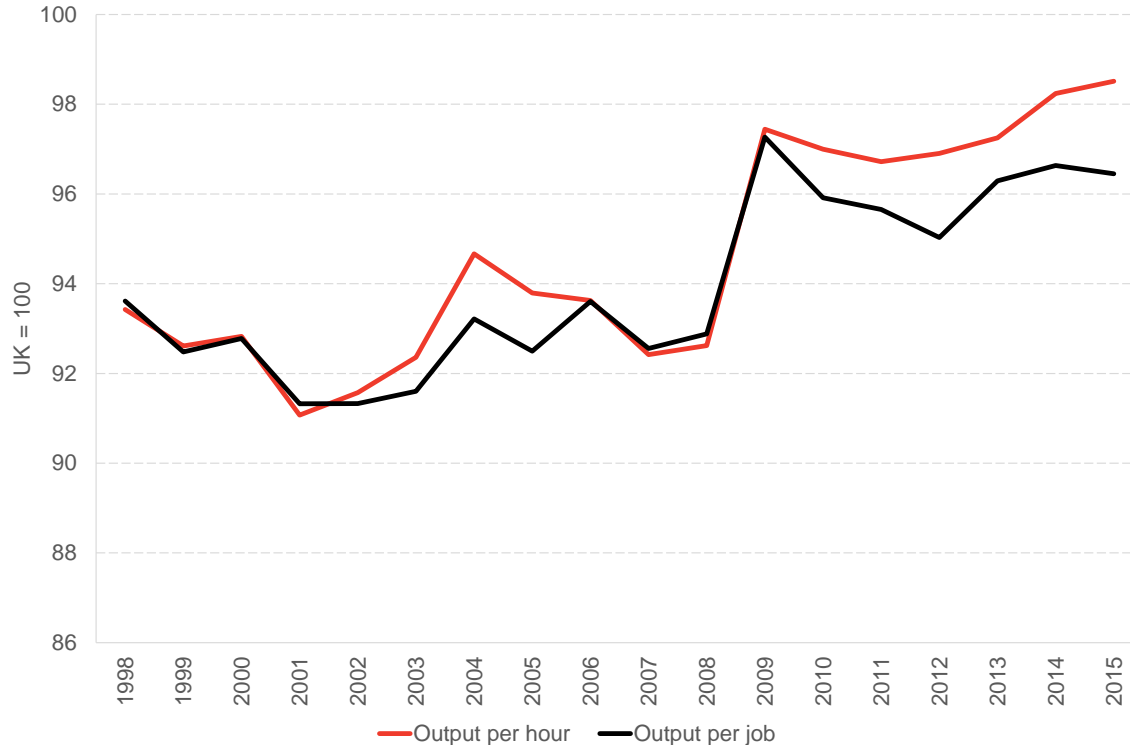


If you accept the OBR's argument, then little to suggest that Scotland will be immune from such pressures.....

..... with Scotland lagging behind the UK in recent times

Of course, what matters now is the SFC's view of the world – which is likely to be just as (if not more) pessimistic than OBR

Scottish productivity – better off than the UK?



Scotland has been catching up with the UK to 2015.....

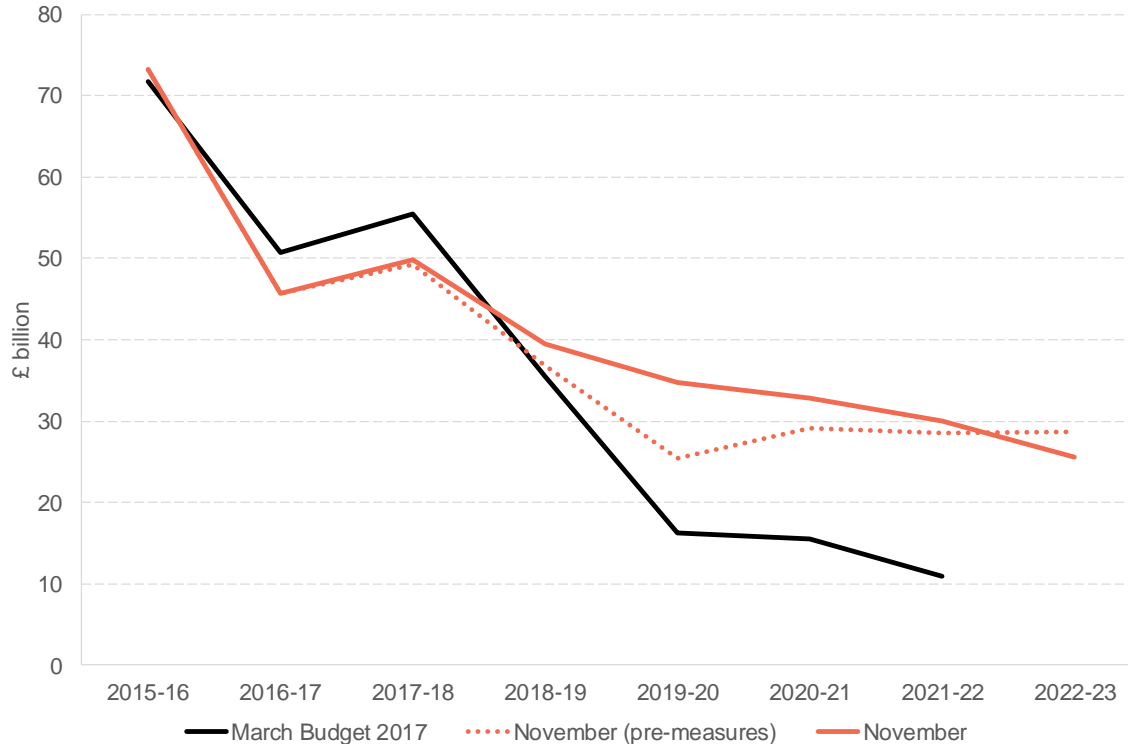
.....but since Q4 2015, output per hour is down nearly 4% in Scotland

And much of the catch-up can be explained by the UK creating jobs at such a pace that this has outstripped their faster growth

Reasons for weak productivity

- › Why is productivity so weak – and looking ahead is Scotland different?
 - Labour hoarding: Scotland appears not to have created the same number of low productivity jobs but we too have close to record employment (despite slow growth);
 - Investment: In Scotland, flat for best part of 10 years (down 15% latest year);
 - The financial system: Banks could be less efficient in reallocating capital from low productivity firms to high-productivity businesses. Not helped by low interest rates;
 - Labour market slack: Cycle of weak earnings = cheap labour = sub low cost labour rather than invest;
 - Weak vs. high productivity sectors/firms: Immediate challenge given the high productivity of the oil and gas supply chain.
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The public finances continue to weaken

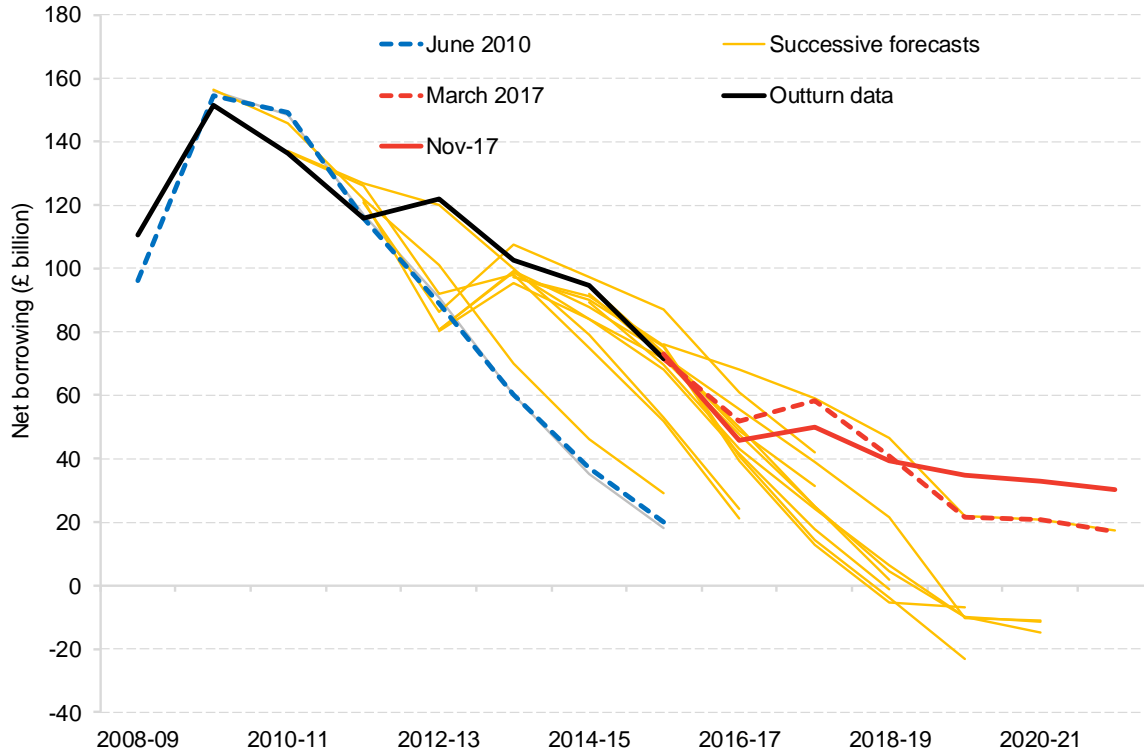


For 2017/18, the public finances are actually in better shape than predicted in March –in part due to buoyant tax receipts.....

.....but this will not last

Even before Wednesday's announcements the weaker economic outlook was expected to force the Chancellor to borrow £36bn more by 2021-22 than he had planned

With consolidation likely to continue....

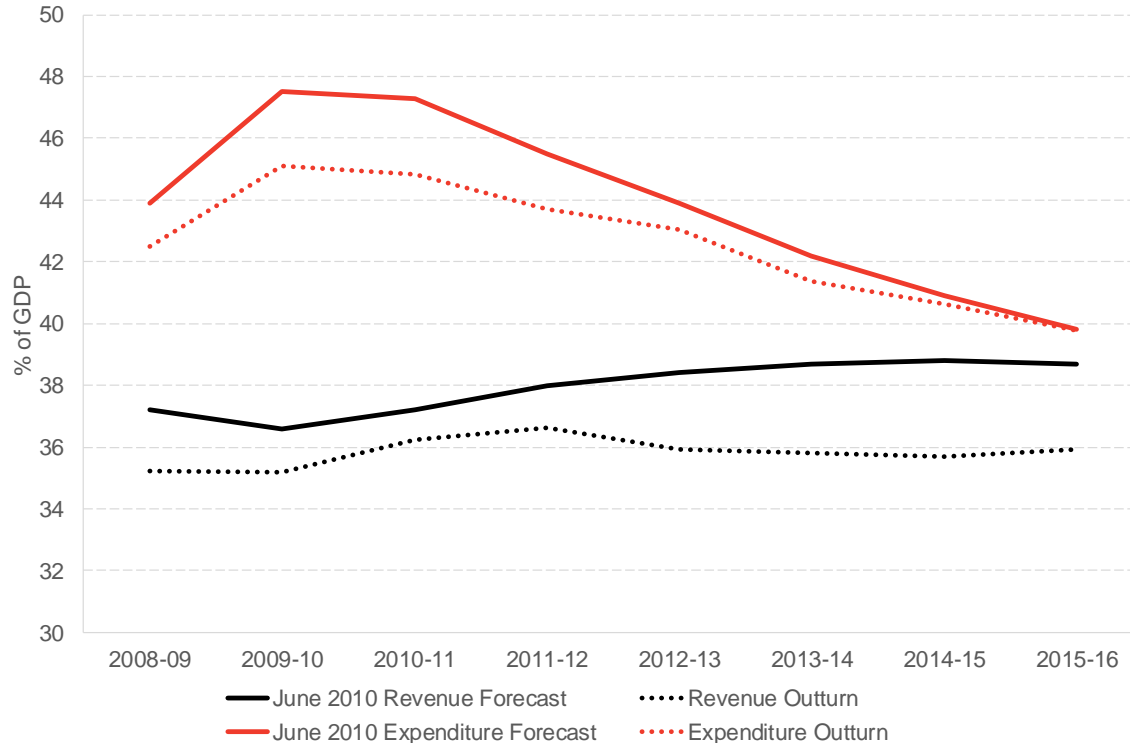


And remember, the original Osborne plan had been for net borrowing to be in balance next financial year and a surplus thereafter.....

.....now further fiscal restraint is likely – if the Conservatives remain committed to their Fiscal Rules – well into the 2020s

This could mark 15 years of a squeeze

...weak revenues being the reason



The reason why both George Osborne and Phillip Hammond are missing their targets is weak revenue growth

Public spending has been falling as a share of GDP since the financial crisis

But weak productivity growth – and tax giveaways – have meant that tax revenues have underperformed

UK Government's response

- › After repeatedly being broken, whether the Fiscal Rules are binding is open to debate
 - › That being said, Chancellor undoubtedly remains nervous about public finances
 - Weak economic outlook
 - Brexit
 - High debt (NB: debt interest bill roughly the same as prior to financial crisis....despite debt doubling. But low interest rates may not always hold)
 - › Limited scope for giveaways
 - Housing – although much scepticism about whether policy will have desired impact
 - Measures to support the economy – national productivity investment fund & industrial strategy
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Summary

- › No escaping the main story of the Budget was the outlook for the economy
 - › OBR now much more pessimistic on productivity – turnaround since March is dramatic
 - › Weak outlook for UK will mean budgets will continue to be squeezed. With the block grant - not to mention welfare (and other) reserved spending in Scotland - still driven by UK fiscal policy, the outlook for public spending looks tough
 - › Of course, what also matters for Scotland is the view of the Scottish Fiscal Commission
 - › Two scenarios likely –
 - They may disagree with OBR outlook on grounds of principle (seems unlikely)
 - If agree that productivity across the UK has been hit, then little evidence to suggest that Scotland is immune (indeed likely that some factors may be more acute)
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Part 2: The view from ICAS



The implications for Scotland, the Scottish Government and Scottish businesses

- Measures that affect Scotland
- Measures that don't affect Scotland
- Personal tax rates and allowances 2018/19
- Corporate tax
- Non-residents' gains on property
- VAT
- Tax thoughts for the future

A predominantly English Budget

Measures that do affect Scotland include:

- Corporation tax main rate
 - 19% for 2017/18 to 2019/20 and 17% from April 2020
- Freezing the VAT threshold for next two years
- The rise in the income tax personal allowance to £11,850
- The raising of the higher rate threshold for income tax in the rest of the UK

Measures that don't affect Scotland

- Business rates
- A stamp duty land tax relief for first time buyers of residential properties costing no more than £300,000 (with purchasers benefiting on homes up to £500,000)
- A series of training investment initiatives
- Capital and resource funding for the NHS
- A number of measures targeted at housing

Personal tax rates and allowances 2018/19

UK Personal allowance - £11,850

- Manifesto commitment to increase to £12,500 by 2020/21
- Applies to the whole of the UK

40% higher rate threshold

- rUK - £46,350
- Manifesto commitment to increase to £50,000 by 2020/21

45% additional rate threshold

- rUK - £150,000

‘Scottish’ taxpayers – these rates relevant for savings and dividend income

Corporate Tax

Indexation relief for corporate chargeable gains

- Disposals on and after 1 January 2018
- Indexation relief frozen at the amount due based on December 2017 RPI
- Rate of Research and Development Expenditure credit will be increased from 11% to 12% from 1 January 2018
- Corporate tax and the digital economy
 - Government paper on challenges and proposed approach
 - Withholding tax on certain royalties to be introduced after a consultation

Non-residents' gains on property

- From April 2019 gains made by non-residents on the disposal of all types of UK real estate will be taxed
- Consultation document published setting out the proposed rules
 - Extending the current regime from residential property to include commercial property
 - Extending the regime to cover indirect disposals of property
 - Proposed that rebasing to April 2019 will apply

VAT

VAT Threshold

- Frozen at £85,000 for two years
- Consultation to take place on the design of the threshold

VAT recovery

- Police Scotland and the Scottish Fire and Rescue Service

Online Marketplaces

- Extension of joint and several liability rules on unpaid VAT
- Requirement to display VAT numbers
- Government considering a split payment model
- Call for evidence in 2018 on encouraging compliance by users of digital platforms

Employment status and the gig economy

A number of challenges:

- The Taylor report
 - Employment Status discussion paper to be published as part of the response to Taylor
- IR 35 – public sector and private sector
 - To be a consultation on off-payroll working in the private sector
- Recent decisions – centre on control:
 - Employment Appeal Tribunal – Uber – drivers are workers
 - Central Arbitration Committee - Deliveroo –delivery people are self-employed
- Scottish income tax – another aspect to factor in

Tax thoughts for the future

- Making Tax Digital
- Simplification?
- Employment status and the gig economy – the tax issues will need to be addressed
- Brexit – VAT, Customs Duties, International tax
- Devolution of tax powers



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Part 3: The implications for Scotland



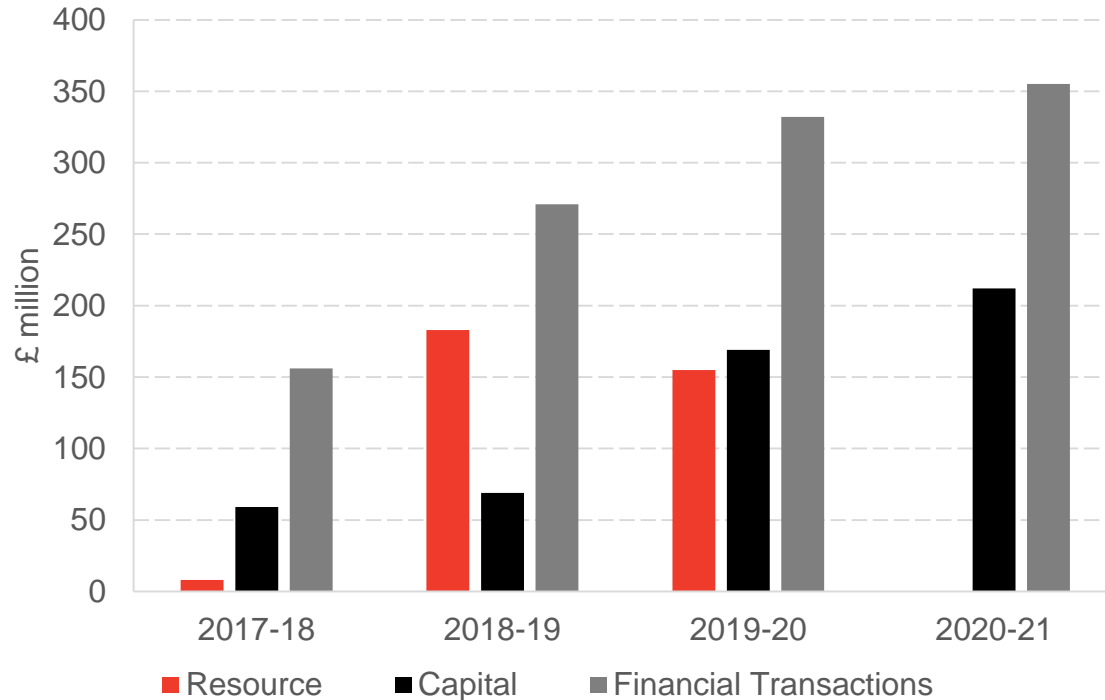
Pre-budget context

- › Outlook for SG resource block grant to fall by 1.9% (£500 million) real terms between 16/17 – 19/20...
 - ...To what extent would increased spending announced in Budget generate additional consequentials?

 - › Outlook for capital up 18% (£500 million) from 16/17 – 19/20... how would this change?

 - › What effect would changes in tax policy have on taxes devolved to Scotland?
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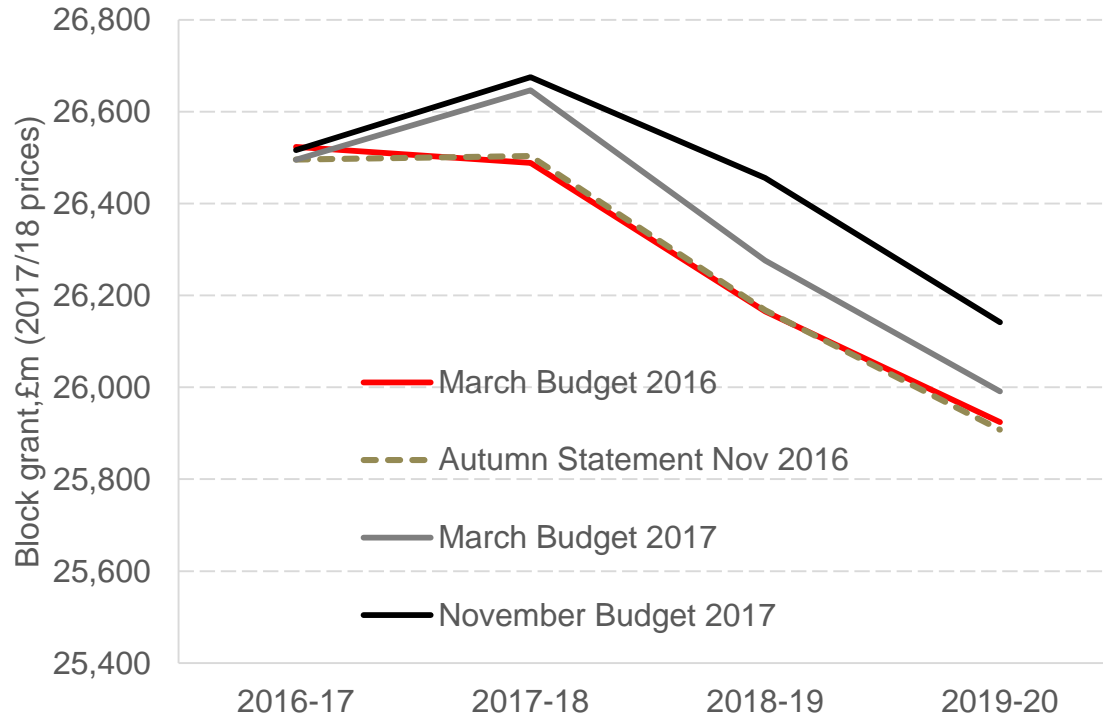
Barnett consequentials (£m)



› £2bn additional consequentials

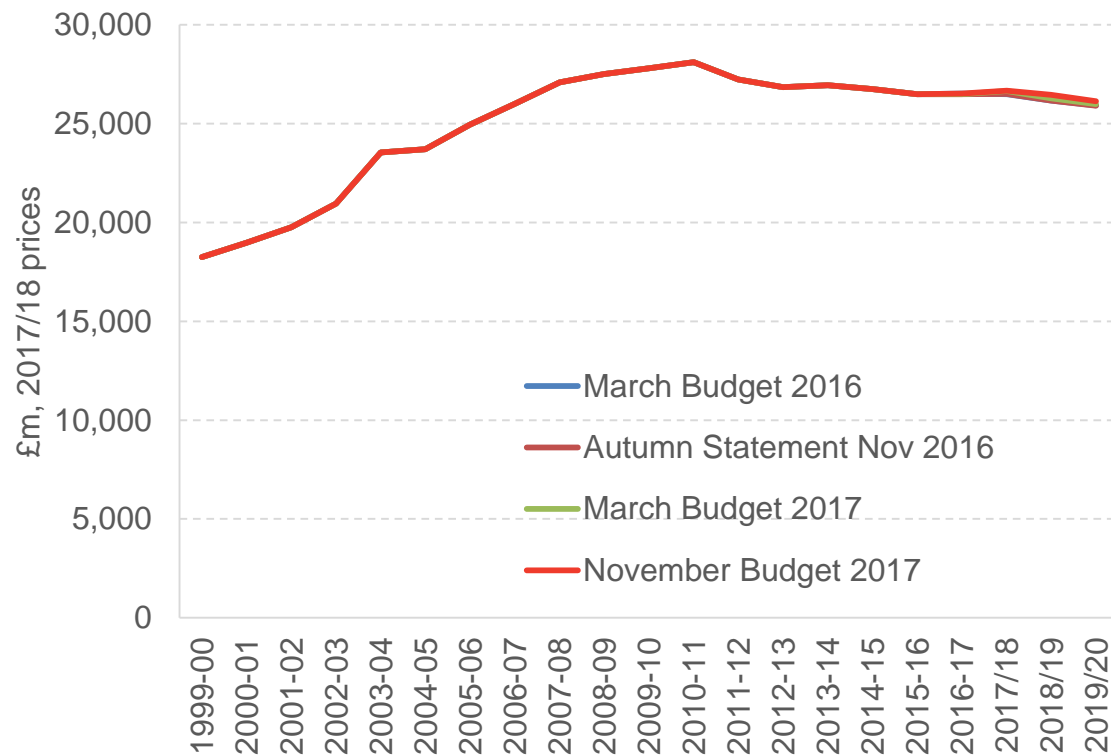
› Over half in form of 'financial transactions'

Outlook for resource block grant



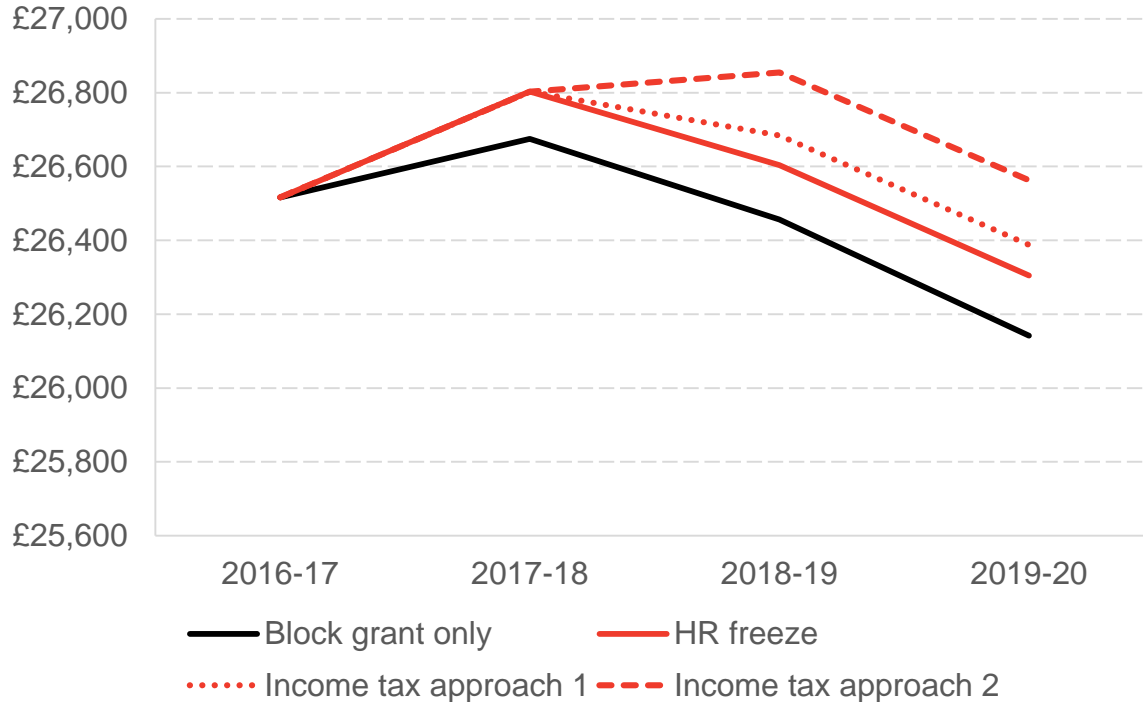
- › Resource block grant down 1.4% (£375m) 16/17-19/20.
- › Outlook improved by £200m per year compared to March 2016 Budget

Resource block grant context



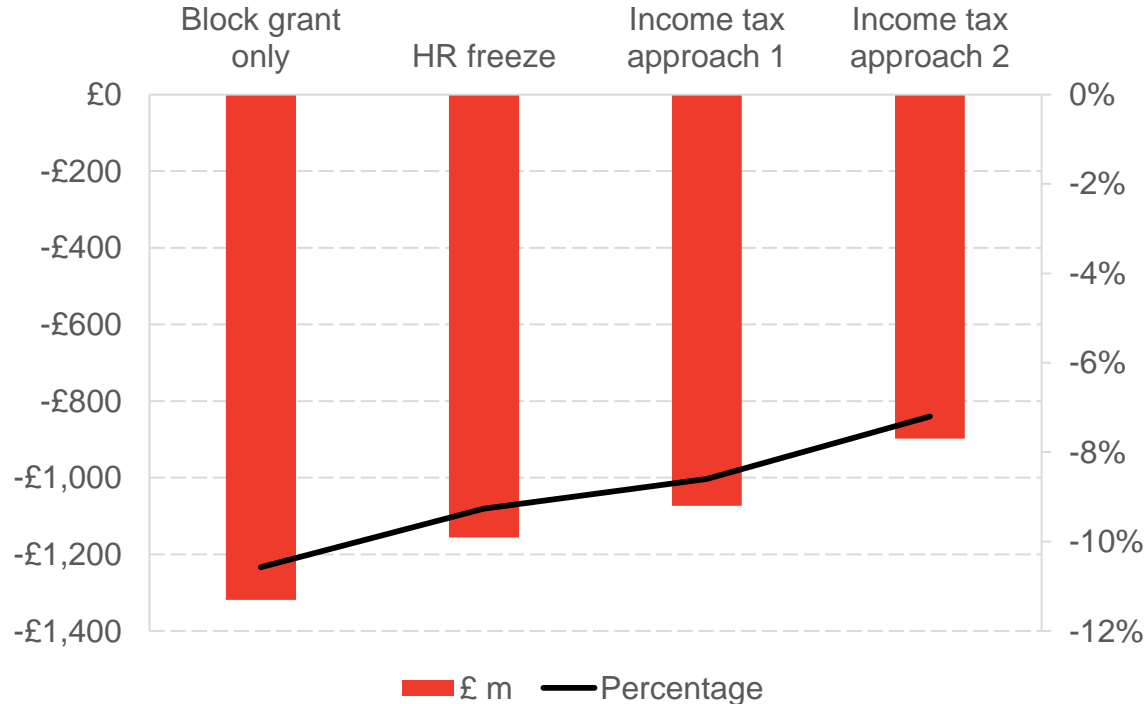
- Recent changes in outlook modest in longer-term context
- Roughly back to where it was in 2006-07 (give or take a couple of hundred million)
- Resource block grant 1.5% lower in 17/18 than decade earlier
- But population 250k higher over the decade to 2017/18

Boosting budget through tax choices?



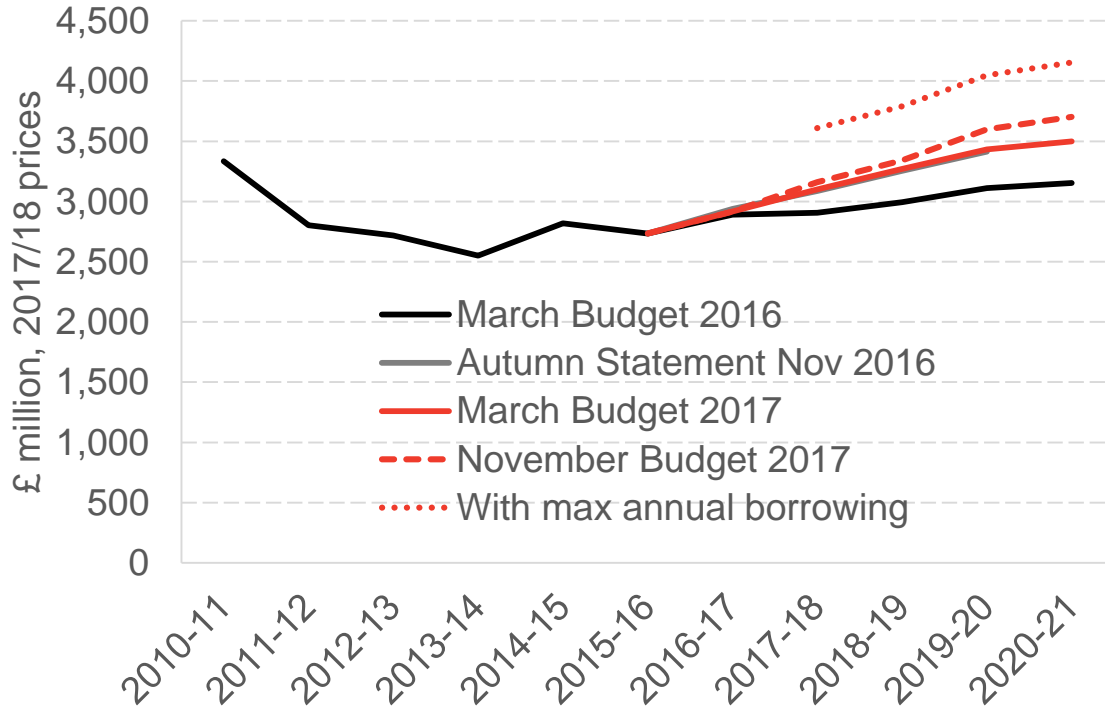
- › Budget also depends on tax policy choices and strength of growth of tax base
- › In 'principle' possible to offset grant declines via tax policy
- › But need to consider economy.....
- ›budget loses £120m for each year that income tax revenues grow 1% slower than rUK

Unprotected portfolios 16/17 – 19/20?



- › Commitments made to protect or increase spending on health, police, childcare, elements of education
- › Implies remaining 40% of budget faces substantial consolidation

Outlook for capital spending



- › Capital budget on course to surpass 2010 peak by 2018
- › Borrowing can support further investment
- › Combined – capital and resource DEL – on track to increase by around 1% between 16/17 and 19-20
- › Of course, cannot switch between the two, so day-to-day spending still squeezed

SDLT and implications for LBTT

- › Chancellor announced sig cut in Stamp Duty for first time buyers in England (& NI), costing around £600m/yr
 - › OBR sceptical on benefits: makes a small difference to capital outlay required to buy, and is strongly likely to push up prices
 - › Reduced rUK revenues will reduce block grant adjustment by about £25-30 million/yr
 - › SG may face pressure to match policy but should resist – better ways to address housing affordability
-

Using Financial Transactions

- › Can only be used to make loans or equity investments into the private sector
 - › Recently FTs largely used to support ‘Help to Buy’ (where SG takes up to 15% equity stake in property, repayable at any time with no interest)
 - › Other uses for FTs?
 - Access to finance to SMEs or business facing barrier to finance? Supporting infrastructure investment? Supporting innovative R&D? Underpinning Scottish National Investment Bank?
 - › Issues: demand, impact, risk
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Summary: UK outlook

- › Huge downgrades to growth forecasts, with implications for fiscal position and living standards
 - › Chancellor hemmed in by this outlook and target to achieve deficit of 2% GDP by 20/21...
 - › ...and little room for fiscal loosening given parties commitments not to increase any of main taxes
 - › Despite this, managed to fund some additional spending...
 - › ...but only went part way to meet demands for increases to NHS budgets, and no funding to support relaxation of pay cap
-

Summary: Scottish budget impacts



- › An improvement to the outlook for resource spending compared to March...
 - › ...but still a relatively tight settlement over the next two years
 - › Resource budget depends too on devolved tax policy and the performance of the Scottish economy...
 - › ...not implausible to offset cuts to resource block grant, but tax decisions should be taken in context of spending decisions
 - › Mr McKay will face pressure to address housing affordability issues in Scotland, but there are likely to be more effective ways than cutting LBTT
 - › Opportunities for Scottish Budget: scope for ramp up in public investment, and to explore use of FTs to stimulate economy
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