Fiscal Affairs Scotland Monthly Bulletin

July 2015

Topic covered in this issue:

UK July Budget 2015 and Office for Budget Responsibility (OBR) forecasts

MB/2015/07

UK July Budget 2015 and Office for Budget Responsibility (OBR) forecasts

UK's economic outlook (see Table 1)

Forecasts for the main economic measures have changed little since the previous Budget in March of this year.

- Real terms (i.e. inflation adjusted) growth of **GDP** is now forecast to be 2.2% in the current financial year (2015-16), then forecast to rise a little to 2.4% for most years up to 2020-21.
- **Inflation** (CPI) is forecast to bottom out at 0% this year, then to gradually rise back to its 2% target by 2020.
- Average **earnings** (cash terms) are forecast to recover to around 4% by 2017-18 and to be over 2% above inflation for each year up to 2020-21.
- **Interest rate** (i.e., LIBOR 3-month interbank rate) is expected to slowly but steadily rise from 0.6% this financial year to 2.4% by 2020-21.

Table 1: Key UK economic measures, growth rates

Measure	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
GDP (real)	2.2%	2.5%	2.4%	2.4%	2.4%	2.4%
CPI (September)	0.0%	1.2%	1.7%	1.8%	1.9%	2.0%
Average Earnings (cash)	2.3%	3.6%	3.9%	4.0%	4.2%	4.4%
Interest Rate (level)	0.6%	1.2%	1.7%	2.0%	2.2%	2.4%

Source: Office for Budget Responsibility Economic and Fiscal Outlook, July 2015, Table 4.1

UK's fiscal outlook (see Table 2)

The UK's fiscal outlook has changed dramatically in comparison to that shown in the March budget.

This change has not been caused by changes to the economic outlook, which has, as explained above, changed little. In fact, excluding the impact of policy measures, the fiscal outlook has worsened a little, with the impact of higher than expected tax revenues being more than offset by higher expenditures, including higher debt interest payments.

Policy changes have radically altered the fiscal position, with both net tax increases and benefits related spending cuts and the timing of the shift into a fiscal surplus being moved back a year. Overall, this has resulted in an increase in net borrowing.

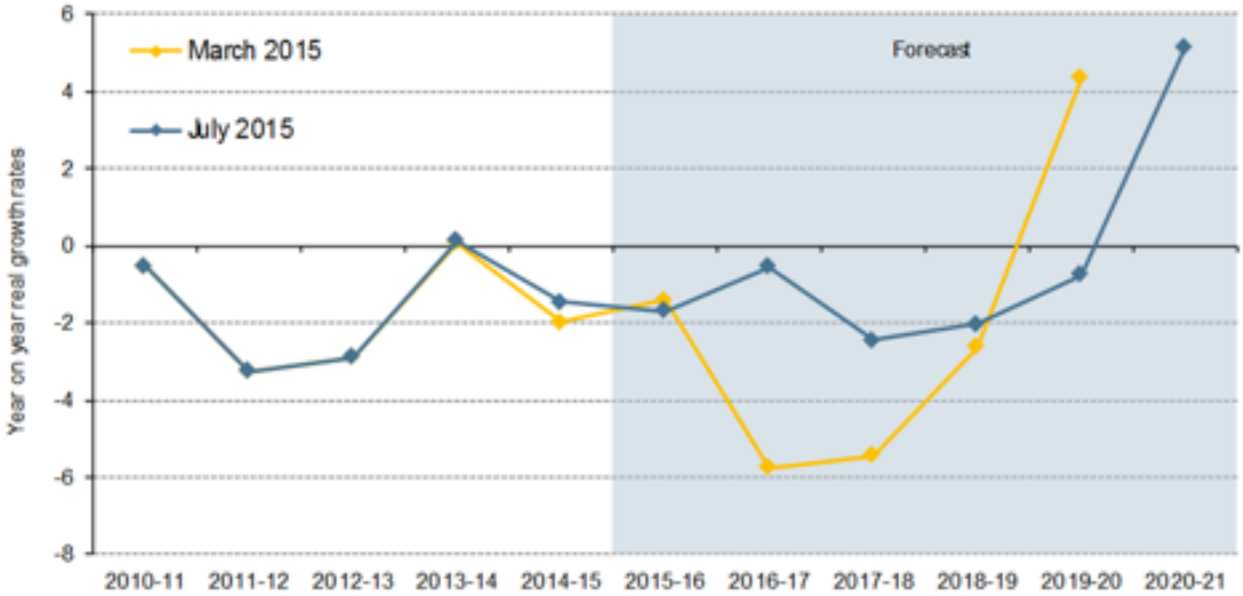
The principal beneficiary of all this has been the public services day-to-day (RDEL) spending budget. Over the period of the current Parliament (2015-16 to 2019-20) the RDEL budget has been revised up by £83 billion. This has been in part due to the UK government having finally identified its £12 billion of welfare cuts (which the OBR had previously assumed to come from DEL), but also due to extra funds stemming from higher taxes now being collected.

As a result, the profile of cuts in day-to-day spending in public spending is very different to that seen in March (see Chart 1). In particular, the cut in spending due in 2016-17 has been eased very significantly and the medium term profile of adjustment is now much smoother than before.

Nevertheless most of the upcoming cuts to public services continue to involve day-to-day spending rather than capital projects.

The OBR's view of these fiscal changes is that "*On the basis of these provisional plans, the forthcoming Spending Review would be a lot less challenging than it appeared in March*".

Chart 1: Year-on-year real growth in resource DEL



Note: RDEL series excludes major historical switches with AME. Details are in the supplementary fiscal tables on our website.
Source: OBR

Table 2: UK public finances key measures

Measure	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Debt (% of GDP)	80%	79%	77%	75%	72%	69%
Borrowing (% of GDP)	3.7%	2.2%	1.2%	0.3%	-0.4%	-0.5%
DEL resource (% change)	-1.7%	-0.5%	-2.4%	-2.0%	-0.8%	5.2%
DEL capital (% change)	-4.7%	-1.3%	0.2%	12.0%	3.3%	2.1%

Sources: Office for Budget Responsibility Economic and Fiscal Outlook, July 2015, Tables 1.2 and Supplementary Table 2.15

Welfare changes

The UK government has now identified **the source of its long announced £12 billion of savings in UK benefits** (note: this is a cash terms reduction on what had been proposed to the rising profile of benefits spend, NOT a reduction in the overall level of Benefits).

By 2020-21, almost £13 billion less will be spent on various welfare benefits. Sources for this include:

- Just under half of the savings will come from the capping or cutting of various Universal and Tax Credit related payments; saving £5.8 billion in total, over 40% of the total cut
- Freezing the uprating to working-age benefits, tax credits and the Local Housing Allowances for the next 4 years will deliver £4 billion of these savings, 30% of the total cut
- Benefits related to housing support (both in the public as well as private sectors), are

set to fall by almost £2 billion, 15% of the total cut
- Capping total benefits paid to any one household (£23,000 in London and £20,000 elsewhere) will save £495 million, 4% of the total

The BBC is also expected to contribute towards the benefit of a free TV licence for those aged 75+ to the tune of £745 million by 2020-21.

Net impact of welfare and tax changes on households and businesses

Overall, there has been an extensive ‘give and take’ across households and businesses in terms of changes to taxes and benefits.

For households, the introduction of a Nation Living Wage (NLW), starting in April 2016 at £7.20 per hour and rising to £9 per hour by 2020, will, for some, be offset by changes to tax credits (both work and child). Clearly, the net impact of this will differ across individuals and households. Each household’s net position will also be affected by: the rise in the Income Tax personal allowance limit; the increased childcare entitlement (for those with children); the freeze in the uprating of working-age benefits and the reduction in the benefits cap (for those on benefits); continued public sector pay restraint (for those working in the public sector); and the changes to housing costs for those in social housing (ie, capped housing benefit) or those deemed to be earning too much to pay only a social rent rather than a market rent.

For businesses, the enforcement of an NLW will be offset, to some extent, by a cut in Corporation Tax (down from the current 20% to 18% by 2020). The OBR indicates the impact of this NLW proposal may nonetheless, lead to some level of job loss (around 60,000 by 2020-21), but it offers no insights as to the sectors or businesses most likely to be affected.

Charter for Budget Responsibility

The Chancellor also outlined a proposed new Charter for Budget Responsibility i.e, the fiscal policy framework within which the UK Government will set its long-term tax and spending plans. It is the UK Government’s intention for this to be approved by Parliament and sets the following limits:

- Once a budget surplus has been achieved, such a surplus is to be maintained in each subsequent year; AND
- For the period up to 2019-20, public sector net debt as a % of GDP is to be falling year on year;
- These limits will apply, UNLESS, the OBR assesses UK GDP growth is likely to be less than 1%, described as outside ‘normal times’, in which case a temporary return to a deficit is allowed.

Such rules are aimed at making the UK government more accountable and the fiscal targets more transparent. Adding the backing of Parliament may add to confidence in its tax and spending plans. However, fiscal rules keep changing with each new Government, potentially undermining such credibility.

Finally, whatever the UK Parliament legislates, the Charter and the associated fiscal framework will also have to work within any new arrangements which are set for the revised tax and borrowing powers to be devolved to the Scottish Parliament. The Charter is so far silent on this point.

Scottish Budget

Previous OBR forecasts have implied a reduction in the Scottish Budget of around £3 billion between 2015-16 and 2018-19. Alternatively, recent analysis by the Scottish government, based on IFS analysis that incorporated £12 billion of benefits cuts rather than DEL cuts, suggested a reduction over the same period of almost £2 billion. The current

OBR forecast now implies a reduction in the Scottish Budget of close to £1 billion between 2015-16 and 2019-20

However, the actual Barnett consequentials of the spending plans will not be known until after the Autumn Spending Review. The Budget did confirm that the NHS in England would get extra funding and that Defence and International Aid spending will be protected. While the former will result in positive Barnett consequentials for Scotland, the latter two will not.

Scottish Revenue Forecasts by the OBR

The OBR also provides updates on the Scottish revenues that will arise from the devolved taxes, namely, the Scottish Rate of Income Tax (SRIT), the Land and Building Transactions Tax (LBTT), the Landfill Tax Aggregates Levy (see Table 3). The changes made to the UK forecast and Budget measures result in a small increase in the revenues from the four taxes which are set by the Scottish government.

At just over £100 million in most years this is relatively small compared to the total. However, the revision to commercial LBTT has been substantial, up by around a third. The OBR note that "*Our forecast for Scottish LBTT in 2015-16 of £540 million is higher than the Scottish Government's estimate of £381 million. This difference is concentrated in the commercial LBTT forecast. Such are the uncertainties around estimating the fiscal effect of the introduction of new taxes that the difference between the two estimates should not be regarded as significant. In particular, differences in the number of property transactions in Scotland could result in LBTT receipts in 2015-16 that are higher than our forecast or lower than the Scottish Government's forecast.*"

It is also curious that price changes since March are expected to raise commercial LBTT revenues but lower residential LBTT.

Table 3: Difference between OBR's March & July 2015 forecasts, £million (cash)

	2015-16	2016-17	2017-18	2018-19	2019-20
Income tax (SRIT)	58	76	61	61	33
Land & Buildings Transaction Tax (LBTT)	109	106	91	76	64
Landfill tax	-3	-3	-3	-2	-3
Aggregates levy	-3	0	0	0	0
TOTAL change	161	179	149	135	94
TOTAL new level	5,271	5,616	5,966	6,345	6,800

Source : OBR, Devolved Taxes Forecast, July 2015

Fiscal Affairs Scotland
July 2015

Contact details

John McLaren m: 07429 508 596
e: john.mclaren@btinternet.com

Jo Armstrong m: 07740 440 766
e: jo@jo-armstrong.co.uk

Charity details

Fiscal Affairs Scotland SCIO
SC044827

Website fiscalaffairsscotland.co.uk