LeasePlan Consultancy Services

A readable guide to the Budget

March 2016

LeasePlan

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Foreword

This year's Budget exemplified how George Osborne is stuck between competing forces.

Economically speaking, our nation's strong recovery is looking a little less strong than it was, and this is threatening to scupper the Government's deficit reduction plan. The Chancellor knows that he must implement spending cuts and perhaps even tax increases to keep the public finances on track.

Politically speaking, the impending EU Referendum pits the Chancellor – who is for remaining in the European Union – against the majority of his own party. If he wants to be the next Conservative leader, as many assume that he does, then he might also be reluctant to implement some of those spending cuts and tax increases, for fear of angering his colleagues and their constituents.

Perhaps this explains why the latest Budget contained the surprise of a fuel duty freeze, rather than the expected fuel duty increase. Politics won out in that case – and happily so!

These issues, and more, are considered in this document, the first of our Readable Guides to the Budget. It is split into four sections:

- The economic and fiscal forecasts. Here you'll find the graphs and numbers underpinning the Budget's policies.
- The policies for motorists. Our commentary on everything from the fuel duty freeze to driverless cars, with a lot more in between.
- The other policies. Where we describe four other policy themes that stood out from the Budget.
- Sources and further reading. Links so that you can take your understanding of the Budget even further.

This guide isn't intended to be comprehensive. If you want that, there is always the Budget itself, along with the reams of supplementary material published by the Office for Budget Responsibility and the Institute for Fiscal Studies.

Besides, we will also be publishing our annual financial guide in May. This will clarify the Budget's fleet-related policies with the use of real world scenarios, as well as guide you through a variety of fleet funding decisions.

We do intend this guide to be – as we say in its title – readable. Our hope is that it can be digested with pleasure, and will demystify some of the Budget's more impenetrable parts along the way.

Please let me know what you think.

Matthew Walters,
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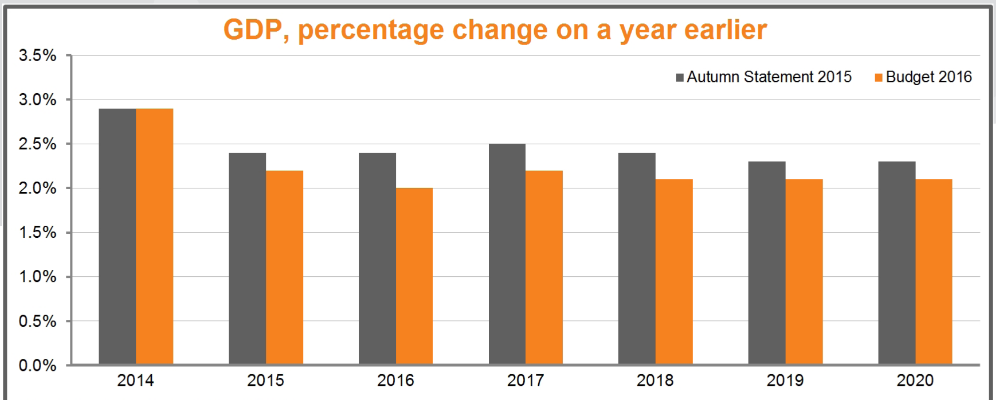
LeasePlan UK

The economic and fiscal forecasts

Whenever there's a Budget there's a new set of economic and fiscal forecasts for us to pore over. These are provided by an independent body, the Office for Budget Responsibility, that George Osborne established for this very purpose. Here's our rundown of what they said on Budget Day 2016.

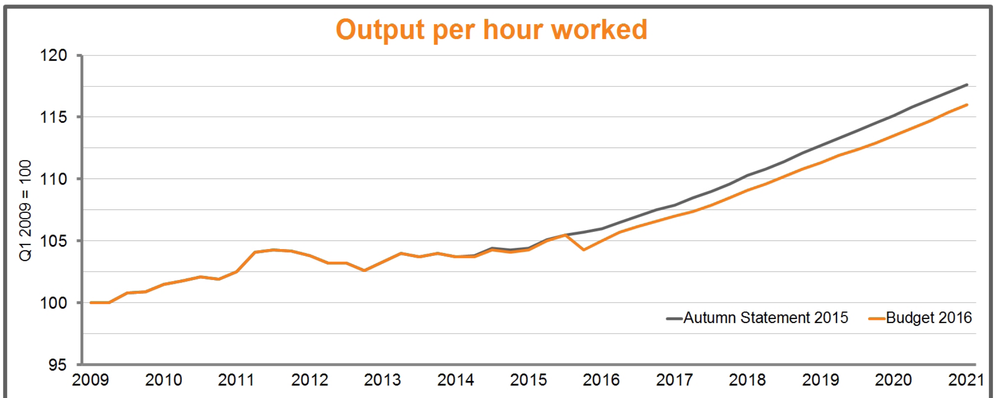


Source: *Office for Budget Responsibility*

Growth

The UK economy is still expected to grow faster than any other G7 economy this year, although it's growing less quickly than previously thought. As the above chart shows, the OBR has downgraded all of the growth forecasts that it made at last November's Autumn Statement.

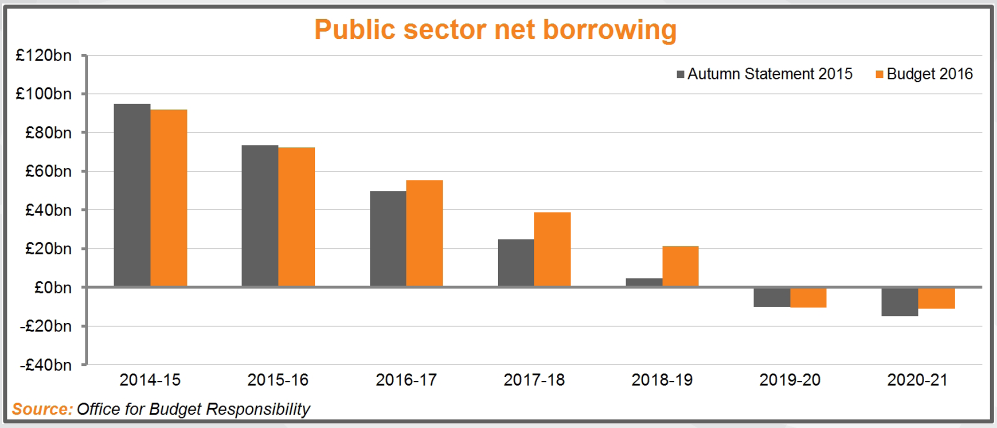
The worst of the downgrades is for this year. It's now expected that the economy will grow by 2 per cent, rather than by 2.4 per cent, in 2016. This has ramifications for almost all of the OBR's other significant forecasts.



Source: *Office for Budget Responsibility*

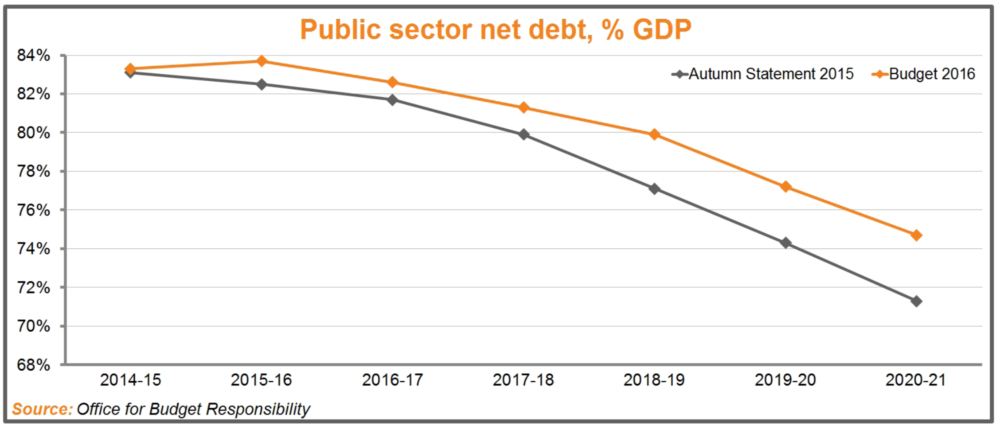
Productivity

Why have the growth forecasts fallen? Part of it is the global economic climate, with China slowing down, instability in the Middle East, and low oil prices. Yet it's not all to do with problems abroad. The OBR makes forecasts for the productivity of the UK labour force – as measured by output per hour worked – which have also been downgraded since November. In fact, they describe these downgrades as 'the most significant forecast change we have made since November'. If the productivity of our economy isn't growing as fast as it might, then neither will the economy itself.



The deficit

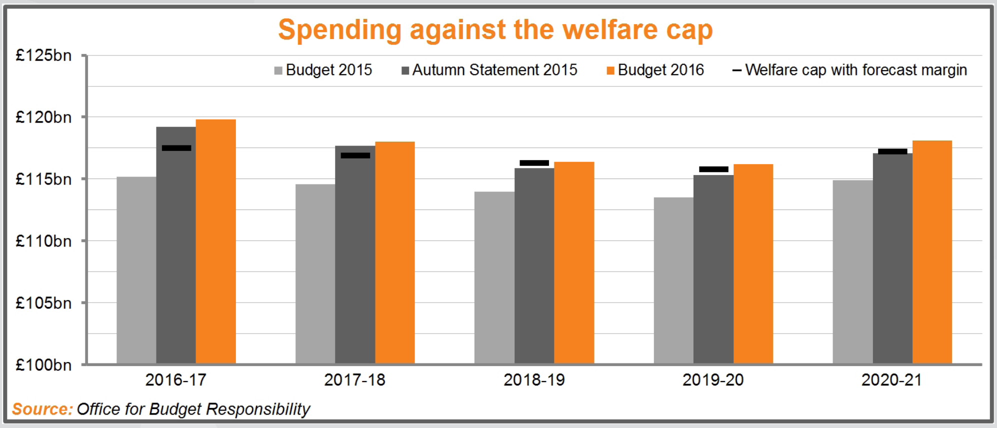
The Chancellor has promised to eradicate the deficit, and bring the public finances into surplus, by 2019-20. This is the first and most important of his fiscal targets. So, how's he doing? Thanks to slower-than-expected economic growth, which depresses the Government's tax revenues, the OBR reckons that Mr Osborne will borrow more than he intended in each of the next three fiscal years – and quite a lot more too. They put the sum for 2018-19 at £21.4 billion, rather than the £4.6 billion they expected back in November. But they still think that he's on course for a surplus of £10.4 billion in the target year of 2019-20, mainly thanks to some tax rises and spending cuts that have been timed for around then. Whether these actually happen, so close to a general election, is another matter entirely.



The debt

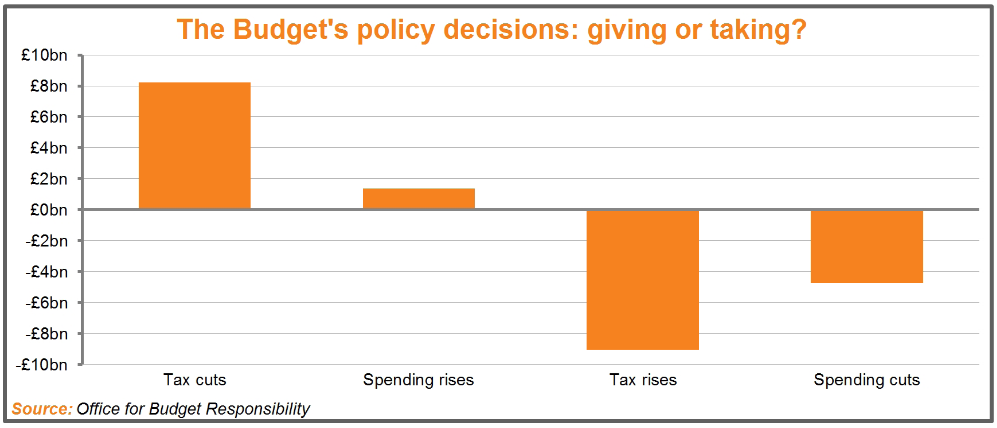
All of that annual borrowing, illustrated above, forms our national debt. This is the subject of the Chancellor's second fiscal target, by which the debt should fall as a percentage of GDP in each year to 2019-20. Except the OBR now expects that it won't. Their latest forecasts have the debt rising from 83.3 per cent of GDP in 2014-15 to 83.7 per cent in 2015-16.

Mr Osborne is set to miss his own fiscal target, which is an embarrassment for him, but not necessarily a political calamity. He also missed some of his fiscal targets during the last Parliament, but it didn't seem to matter at last May's general election.



The welfare cap

The Chancellor had already missed another of his fiscal targets in this Parliament. This is his third and final target to keep certain elements of welfare spending under a particular level each year, also known as the 'welfare cap'. The OBR forecast last November that this would be breached. Their forecasts have now worsened. Mr Osborne is set to miss two of his three targets.



Giving or taking?

Of course, Mr Osborne has ways of making it more or less likely that he will miss his targets. He can raise or cut public spending. Or he can raise or cut taxes. Every Budget is a mixture of these policies, but what was the mixture in this year's? As the above chart shows, the nasty outweighed the nice. It contained £4.7 billion of spending cuts and £9.0 billion of tax rises for the next five years, compared to £1.4 billion of spending rises and £8.2 billion of tax cuts. Which means that the Chancellor is taking £4.2 billion more than he is giving. This was a takeaway Budget overall.

Policies for motorists

This wasn't a Budget like, say, the Autumn Statement of 2014, which – with its £15 billion plan for renovating Britain's roads – lavished a great deal of money and attention on motorists. But there were some standout policies nonetheless, and one very surprising one. We shall start with the surprise:

The fuel duty freeze

Motorists were the beneficiaries of one of the Budget's greatest surprises. There had been a lot of speculation, in the run-up to the day, that Mr Osborne would break the habits of a Chancellorship by increasing the main rate of fuel duty. Instead he froze it at 57.95p a litre for the financial year of 2016-17. This is the sixth successive year that it has been set at that level.

Despite this, it's worth considering why so many people feared a fuel duty hike in the first place. It mostly comes down to oil. The declining cost of oil has reduced unleaded prices by 21 per cent over the past two years, and diesel prices by 25 per cent. It's not expected that they will rise any time soon. With motorists feeling better off because of this, it was thought that the Chancellor might risk asking them for a bit more money.

And the Chancellor could always use some more of our money. The Institute for Fiscal Studies once reckoned that he is forgoing £6 billion in revenue every year by freezing fuel duty, which is the flipside of the Budget's boast that 'the average driver will save around £75 every year in duty compared to pre-2010 fuel duty escalator plans.' The Government loses out from our gain.

So why didn't Mr Osborne take the opportunity to raise fuel duty, and thereby boost his coffers? The answer is, most likely, politics. With the European Referendum approaching, and a Conservative leadership election beyond that, the Chancellor is in a strange position with his party colleagues. He is campaigning for something – remaining in the European Union – that many of them are campaigning against. He may not wish to offend them further by loading their hard-working, hard-motoring constituents with extra taxes.

But politics change, whereas the deficit is persistent. If oil prices remain low, then Mr Osborne might one day be tempted to raise fuel duty – yet, thankfully, that day is not today. We'll be enjoying the freeze just like the rest of you.

Salary sacrifice

In the latest budget, the Chancellor has followed up on his comments in the Autumn Statement and has confirmed that he is considering tightening the rules around salary sacrifice.

The Budget notes that the Government is 'considering limiting the range of benefits that attract income tax and NICs advantages when they are provided as part of salary sacrifice schemes.' However, this doesn't stretch to 'pension saving, childcare and health-related benefits such as Cycle to Work'.

Cars attained through salary sacrifice aren't on that list, but are also not a current target. It is well recognised that cars are the only salary sacrifice benefit that exchanges a variable treasury income in the form of Income Tax and Class 1 National Insurance for a fixed, predictable and long term income from Class 1A National Insurance. In present value terms the treasury are not getting a bad deal. As the BVRLA recently stated, "The government says it intends to maintain the attractiveness of salary sacrifice schemes...we will have to wait for further announcements about cars provided under salary sacrifice schemes – but any changes would impact on the estimated £4,500 that HMRC receives in tax revenue per year from each salary sacrifice car."

In the meantime, it is worth noting that when politicians have tried to restrict salary sacrifice schemes in the past – as Gordon Brown attempted with childcare vouchers in 2009 – the public outcry and realisation that this was in fact a matter of Employment Law and not Whitehall regulation caused them to back down.

Besides, the current Chancellor has shown a general unwillingness to penalise motorists – not least in this latest Budget, with that surprise freeze to fuel duty.

Policies for motorists, continued

Going green

In some ways, the Government's policy towards company cars is beset by uncertainty. The latest Budget didn't provide any Company Car Tax bands beyond those from last year's Budget, which run up to the year 2019-20. This means that, as of this April, anyone agreeing to at least a four-year lease cannot be sure about their car's tax status at the end of that period.

But there is certainty of a sort: the Government wants drivers to go green. The Chancellor announced that the 100 per cent First Year Allowance would be extended for businesses purchasing low emission vehicles. And, from 2018, the CO_2 thresholds for FYA and for capital allowances for business cars will be reduced, in order to reflect falling vehicle emissions.

Mr Osborne also revealed that he intends to keep on basing Company Car Tax on CO_2 emissions, and, to this end, will consult on reforming the bands that cover ultra-low emission vehicles. Does this mean that he might take the very lowest emitters out of CCT altogether? It would certainly be a good way for him to popularise these green machines.

The Chancellor's dedication to rating cars by their CO_2 emissions does raise another question: what about NOx? This class of pollutants, emitted for the most part by diesel cars, has become a *bête noire* of environmentalists and even of the legal establishment. Last year, the Supreme Court urged Mr Osborne to do more to act against diesel. He hasn't, really – yet.

Infrastructure

There was a lot of talk about infrastructure in and around the Budget, and all of it was welcome. The Chancellor has been an eager builder ever since he decided, half-way through the last Parliament, to reverse some of the cuts to capital spending that he had inherited from his predecessor, Alistair Darling. And now he has added a second Crossrail route, a high-speed rail line between Manchester and Leeds, a trans-Pennine tunnel and even more to his list of *grands projets*.

But, as befits the state of the public finances, not much of the Budget's infrastructure spending was particularly big. An extra £80 million – million, not billion – has been put towards the Crossrail 2 scheme, for the purposes of planning. A similar amount will go towards laying the groundwork for HS3. These sums are better than nothing, and they are a sign of the Chancellor's ambition, but they shouldn't be mistaken for full funding. A lot more will need to be done before any of these projects are complete.

Something similar can be said of the Government's efforts to repair the existing road network. It's pleasing that the Budget allocated another £50 million to the Pothole Action Fund, and provided £130 million for repairing roads and bridges damaged in the recent storms, but many £billions more will be required to completely smooth our country's tarmac.

Driverless cars

Trials of autonomous cars on British motorways by 2017. Similar trials for convoys of driverless lorries. A 'connected corridor' between London and Dover. What else is there to say, but that the future is coming?

The other policies

Apart from the policies directed at motorists, five other themes stood out from Budget 2016. Conveniently, they all begin with the letter 'S'. Here are our five 'S's.

Small businesses

Small businesses will benefit from various tax breaks, including cuts to business rates. And even the smallest businesses – 'micro-entrepreneurs' who might sell a few things online, or share out their car – will gain from the new allowances.

Hailed as a "permanent long term saving for all businesses in Britain", Osborne told Parliament that the reduction means that from April 2017 60,000 SMEs will pay no business rates at all and 250,000 businesses will see their rates cut.

He also promised to "radically simplify" administration of business rates and from 2020 they will follow the Consumer Price Index (CPI) instead of the Retail Price Index (RPI).

In fact, the Chancellor pulled off quite a feat: despite all of the advance chatter about extra austerity, he wrote a Budget that appears, at first glance, to be rather friendly. Yet there are losers in the fine print, among them Mr Osborne's own colleagues in Government. They will be expected to find £3.5 billion of extra efficiency savings later in this Parliament.

Savers

Mr Osborne has always tried to appeal to those who do things by and for themselves, and this Budget was no different. There were several policies designed to encourage and reward saving, such as new 'Lifetime ISAs' that will be topped up with money from the state. The tax-free personal allowance was raised once again, and other tax thresholds were made more favourable for middle-income earners.

Sugar

Jamie Oliver will be pleased. One of the more headline-grabbing policies in the Budget was a 'soft drinks industry levy' that will be imposed on companies according to how much sugar they put in their drinks. The sweeter the pop, the higher the tax.

It is hoped that this levy will help to tackle childhood obesity in more ways than one. Not only does the Government expect it to incentivise companies to reduce the sugar content in their drinks, but they also intend to put the some of proceeds towards funding more sports in schools.

Schools

Schools appeared elsewhere in the Budget too, to a remarkable extent. The Chancellor decreed that every state school in England should either be an academy – independent of any local authority – by 2020, or well on the way to gaining academy status. He also revealed plans for a new National Funding Formula for schools from 2017-18, as well as a review of how maths is taught and studied.

All of these policies, like most policies, involve government spending in some way, so it's natural that the Chancellor should have an interest in them. But you might normally expect to hear them announced by the Education Secretary. It's probably another sign of how Mr Osborne was constrained in this Budget, and had to take what he could get.

Storms abrewing

For someone who is regarded as one of the architects of the Conservatives' election victory last year, the Chancellor has not had an easy time from his own party in this Parliament. In the aftermath of his July Budget, there was so much internal opposition to his tax credit cuts – as well as opposition from elsewhere – that he was forced to abandon them in November's Autumn Statement.

If there is going to be a similar struggle after this latest Budget, then it will probably be about Mr Osborne's cuts to the Personal Independent Payments made to disabled people. Already, there are reports of 'huge unease' among Conservative backbenchers. The Chancellor may have to think again about this measure, even if it if is expected to save him £4.4 billion over the next five years.

Sources

- *Budget 2016*, HM Treasury
- *Economic and Fiscal Outlook*, March 2016, The Office for Budget Responsibility
- *Weekly road fuel prices*, Department for Energy and Climate Change
- Paul Johnson's introductory remarks to the Institute for Fiscal Studies' briefing on Autumn Statement 2013, 6th December 2013
- 'Webb: Treasury could scrap "salary sacrifice"', CityWire, 11th June 2015
- 'Disability benefit cut: Tory backbenchers call for rethink', The Guardian, 16th March 2016

Further reading

- *Green Budget 2016*, Institute for Fiscal Studies
- *Fuel for Thought*, RAC Foundation and the Institute for Fiscal Studies
- LeasePlan UK's online coverage of Budget 2016, which can be found at: www.easiertoleaseplan.co.uk/budget-2016

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