Policy briefing

March 2014

Budget 2014

Summary

The Chancellor's central Budget theme was maintaining the progress being made towards the creation of a more resilient economy. This requires a more balanced economy, achieved through a long term move away from consumer-led recovery to one driven by exports and manufacturing. The Budget address focused on a series of announcements on to promote saving: principally the simplification of ISAs, introduction of a pensioner bond, reform proposals for defined contributions pensions and the abolishing of the 10p rate for savers.

Other headline announcements included:

- Biggest changes to the pensions system in a generation, including the removal of the need to annuitise.
- Changes to income tax thresholds – personal allowance to rise to £10,500 in 2015. 40% to rise 1%.
- Right to advice of people retiring with Defined Contribution pensions.

The main budget documents can be accessed via: https://www.gov.uk/government/publications/budget-2014-documents

General overview

Twelve months ago the Chancellor faced a grim set of choices for his Budget for 2013. This Budget, his penultimate before the 2015 General Election, gives him more room for manoeuvre. There have been the usual calls by some groups for relief or support for different aspects of the economy as well as a lot of noise from within his own party for greater relief for the expanding number of people being caught by the 40% income tax band (with those caught rising from 6% in 1990 to 16% today). The Chancellor's challenge is to welcome the improvement in growth of the economy over the past 12 months - more than most expected - and yet keep everyone focused on the central objective of deficit reduction. This Chancellor will continue to try to 'frame' the choices for the impending election, so many of the high profile announcements are focused on electoral considerations as economic ones. Key themes are therefore savings, housing, childcare, the cost of living, retirement and youth unemployment.

The Budget red book provides a clear summary of the Government's long-term economic plan for "*a stronger, more competitive economy, a fairer society, and secures a better future for Britain by*:

- Reducing the deficit to deal with the UK's debts, safeguard the UK economy for the long term and keep mortgage rates low
- Cutting income taxes and freezing fuel duty to help hardworking people be more financially secure

- Creating more jobs by backing small business and enterprise with better infrastructure and lower job taxes
- Capping welfare and controlling immigration so the UK economy delivers for people who want to work hard and play by the rules
- Delivering the best schools, skills and apprenticeships for young people so the next generation can succeed in the global race".
- Improving the income of people at retirement.

"*In order to safeguard the economy for the long term, the government is continuing to take decisive action through: monetary activism and credit easing, deficit reduction, reform of the financial system, and a comprehensive package of structural reforms*".

Political response

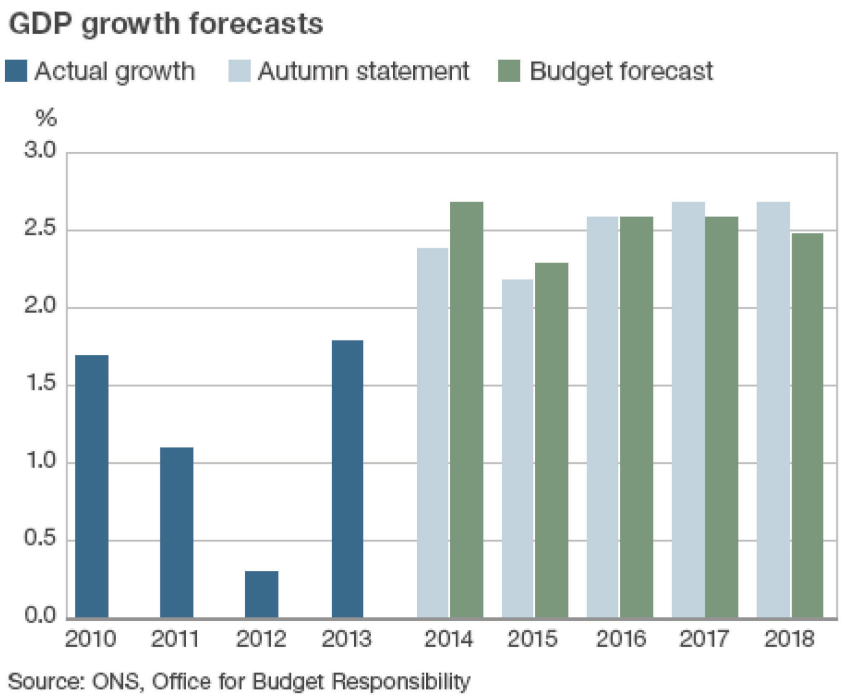
Labour

Ed Miliband, the Leader of the Labour party, responded to the Budget by saying that the Chancellor has failed mention the central issue that the average person was £1,600 worse off under this Government and the key issue for most people was the cost of living. He said this Government had introduced 24 different tax rises.

General economic overview

Economic growth forecast

The independent Office for Budget Responsibility (OBR) has revised upwards its forecast for GDP growth from 2.4% to 2.7% in 2014 and from 2.2% to 2.3% in 2015.



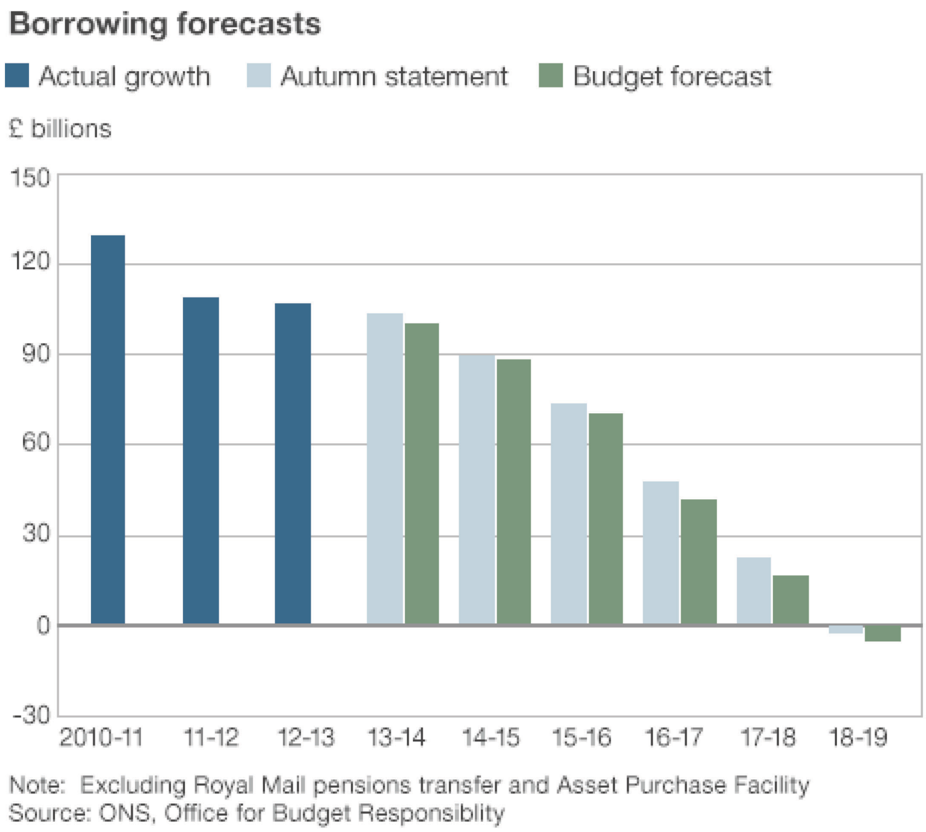
2014: 2.7% *2015*: 2.3% *2016*: 2.6% *2017*: 2.6% *2018*: 2.5%

The OBR also expects GDP to return to its pre-crisis peak in the third quarter of 2014.

The public finances

Borrowing

Government borrowing forecasts have also been revised by the OBR. The Government is expected to borrow £108bn in 2014, £12bn less than previously forecast. As a result of deficit reduction (see below) it is predicted that there will be no borrowing from 2018-19.



Debt and deficit reduction

The OBR has cut the 2014-15 deficit forecast from 6.8% to 6.6% of GDP. This year's deficit will be 6.6% and will reduce to 5.5% next year. It is then expected to be 4.2%, 2.4% and finally 0.8% in 2017-18. The following year forecast is surplus of 0.2%.

The OBR also forecasts public debt "*to be 74.5% of GDP this year; 77.3% next year; peaking at 78.7% in 2015-16 - lower than the 80% previously forecast - before falling to 78.3% in 2016-17, then falling to 76.5% and then 74.2% in 2018-19*".

Employment levels

The OBR has revised up its forecast for employment across the forecast period and expects employment to reach 31.4 million by 2018. At the start of 2014 the claimant count was 1.2 million, and the OBR now expects it to fall below 1 million in 2017.

Taxation

Income tax thresholds

The Chancellor announced that the personal allowance will be raised to £10,500 from April 2015. This follows the rise to £10,000 in April of this year. The government estimates that as a result of the change in 2015, a basic rate tax payer will be £805 better off and that 3.2 million people will have been taken out of tax altogether.

The threshold for 40p income tax is to rise from £41,450 to £41,865 in April (1%) and by a further 1% to £42,285 in 2015.

Corporation tax

No changes to the already announced changes to corporation tax rates: therefore it will fall to 21% in April 2014 before reaching 20% in April 2015.

Tax avoidance

Tax avoidance will be tackled by requiring users of disclosed avoidance schemes and schemes covered by the General Anti-Abuse rule to pay the tax in dispute upfront.

In addition, further tax charges will be introduced to discourage the use of corporate envelopes to invest in housing, and leaving it empty or under-used while not paying tax. Anyone buying a home over £500,000 through a corporate entity will pay 15% stamp duty.

Retirement

Retirement simplification

The Government is announcing a series of measures to simplify choices for people at retirement, especially for those with defined contribution (DC) pension schemes. With effect from April 2015:

- The Government is easing the tax rules to allow people to access their savings as they wish, whether by annuity, lump sum or draw down.
- Drawdown of pension income under the new, more flexible arrangements will be taxed at marginal income tax rates rather than the current rate of 55% for full withdrawals.

As a first step towards these reforms, it has also introduced a range of immediate measures on to reduce limitations by which people can access their DC pensions:

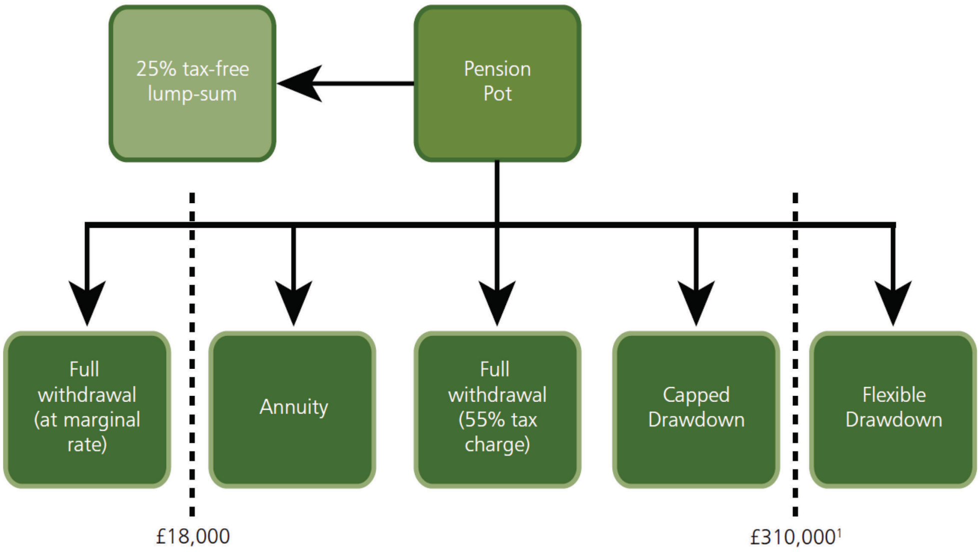
- reduce the amount of guaranteed pension income people need in retirement to access their savings flexibly, from £20,000 to £12,000
- increase the capped drawdown limit from 120% to 150% to allow more flexibility to those who would otherwise buy an annuity
- increase the size of a single pension pot that can be taken as a lump sum, from £2,000 to £10,000
- increase the number of pension pots of below £10,000 that can be taken as a lump sum, from 2 to 3
- increase the overall size of pension savings that can be taken as a lump sum, from £18,000 to £30,000

The Treasury has published consultation paper on the back of this Budget statement that goes into more detail on how these reforms will be implemented.[1]

These changes have attracted much interest amongst industry stakeholders, especially coming so soon after the FCA's thematic review of annuities.

Figure 1.3: Current system for accessing defined contribution pensions at retirement

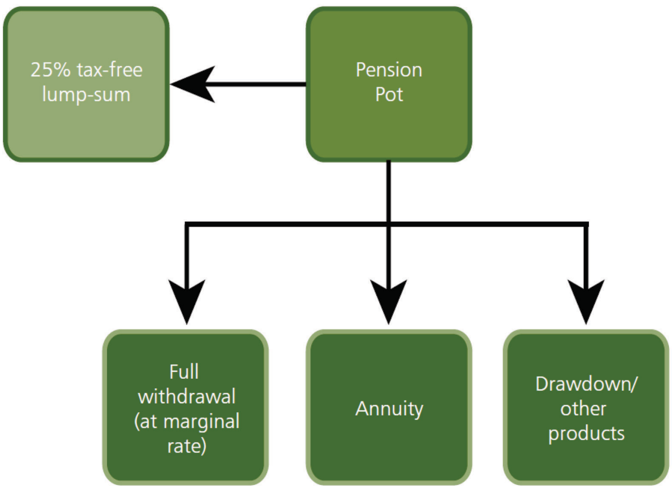
Under the current system, people's choices are constrained by the size of their defined contribution pension pot. There is some flexibility for those with small and very large pension pots, but around three-quarters of those retiring each year purchase an annuity.



[1] This is a stylised assumption based on an individual with a full basic state pension of £5,744 per year, who takes the maximum tax free lump sum (25%) from their defined contribution pension pot and purchases a single life, level, no guarantee annuity worth £14,256 per year (an annuity rate of 6.1%) at age 65. This will enable them to meet the minimum income requirement of £20,000 per year for entering flexible drawdown.

Figure 1.4: Future system for accessing defined contribution pensions at retirement

Under the new system, regardless of the size of their defined contribution pension pot, everyone will be able to choose any of the options in the below diagram. This will mean that everyone has access to full withdrawal, an annuity or drawdown, and potentially other products created by providers.



[1] HM Treasury, Freedom of Choice in Pensions, 19 March 2014. https://www.gov.uk/government/consultations/freedom-and-choice-in-pensions

Right to Advice

To assist consumers in making the best use of these expanded choices at the point of retirement, the Government has also announced that it wishes to create a new "Right to Advice" for people retiring with Defined Contribution pensions. The Treasury calls for this service to be available by April 2015, and it must:

- be impartial and of consistently good quality
- cover the individual's range of options to help them make sound decisions and equip them to take action, whether that is seeking further advice or purchasing a products free to the consumer; and
- be offered face to face

The service would be funded by "a new duty on pension providers and trust-based pension schemes", and the Government will make available up to £20m over the next two years to develop this initiative.

The Treasury consultation goes into more detail on how this would work, and takes views on how best to implement the duty. For example, whether differing approaches should be taken for pension providers operating contract-based schemes and trust-based pension schemes. The consultation will run until 11 June 2014.

Savings

In an effort to boost savings and support savers, the Chancellor announced a number of major changes including a simplification of Individual Savings Accounts (ISAs).

New ISAs

Cash and stocks and shares ISAs are to be combined into a simpler product, the New ISA (NISA). The overall annual subscription limit will be increased to £15,000 from 1 July 2014, and this full amount will be permitted to be held in either cash, stocks and shares, or any combination of the two. Individuals will be permitted to transfer any funds previously invested in stocks and shares into cash outside of annual subscription limits.

The Government will remove all restrictions on the maturity dates of securities permitted to be brought into an ISA from 1 July 2014.

The list of qualifying investments for ISAs will be extended to include peer-to-peer loans. The government will continue to explore further extending the list to include debt securities offered via crowdfunding platforms. The list of qualifying investments for ISAs will be extended to include core capital deferred shares from 1 July 2014.

Child Trust Fund and a Junior ISA

The annual subscription limits for Child Trust Funds and Junior ISAs will be increased to £4,000 from 1 July 2014.

Savings income tax

The starting rate for savings income tax will be set to 0% (from 10%) and the band to which it applies will be extended from £2,880 in 2014-15 to £5,000 as of 6 April 2015.

National Savings and Investments (NS&I) measures to support savers

The government will support savers through NS&I, by increasing the Premium Bond investment limit from £30,000 to £40,000. It will also offering two £1 million monthly prizes instead of one from 1 August 2014, and then further increasing the limit to £50,000 in 2015-16.

In January 2015 a range of fixed-rate, market-leading savings bonds for people aged 65 and over will be launched. They will be taxable in line with all other savings income. Interest rates and individual investment limits will be confirmed at Autumn Statement 2014 to take account of prevailing market conditions but the central assumption made at Budget 2014 is that NS&I will launch a 1-year bond paying 2.8% gross/AER and a 3-year bond paying 4.0% gross/AER, with an investment limit of £10,000 per bond.

Simple Products

The government has reviewed the progress the industry has made on the development of simple financial products and welcomes the trade bodies' commitment to having an accreditation framework in place by the end of 2014.

Welfare

Welfare spending cap

The Chancellor has set a cap on welfare spending (excluding the state pension). This has been set at £119bn in 2015-16, rising in line with forecast inflation to £127bn in 2018-19.

Supporting economic growth

The Budget contains measures aimed at supporting economic growth including:

- Doubling the annual investment allowance to £500,000 until the end of 2015. This will particularly benefit small and medium sized firms.

- Direct lending from government to UK businesses to promote exports doubled to £3bn and interest rates on that lending cut by a third.

- Business rate discounts and enhanced capital allowances in enterprise zones extended for three years.

Apprenticeships

The Apprenticeship Grants for Employers (AGE) scheme has been extended by providing an extra £85 million in both 2014-15 and 2015-16 for over 100,000 grants to employers. AGE 16 to 24 targets employers with less than 1000 employees, who are new to Apprenticeships or have not enrolled a new recruit or existing employee onto an Apprenticeship programme in the previous twelve months. In addition to the AGE funding, £20m has been committed for degree level apprenticeships.

Flood defences

The Chancellor announced £140 million of funding to repair flood defences that have suffered damage in the recent severe flooding.

Housing and property

Help to Buy scheme

The Help to Buy equity loan scheme is expected to help at least 74,000 households buy a new-build home by March 2016. To help a further 120,000 households purchase a home and to continue to support house building as the market improves, the government will extend the equity loan scheme to March 2020. The Help to Buy: mortgage guarantee scheme will continue to support access to high loan to value mortgages until the scheme ends on 31 December 2016.

Builders Finance Fund

To support SME access to finance, the government will create a £500 million Builders Finance Fund, which will provide loans to developers to unlock 15,000 housing units stalled due to difficulty in accessing finance.

Right to build

For people who want to build their own home, the government will consult on creating a new 'Right to Build', giving custom builders a right to a plot from councils, £150 million repayable fund to help provide up to 10,000 serviced plots for custom build. The government will also look to make the Help to Buy equity loan scheme available for custom build.

Childcare

The Budget confirmed that the Tax-Free Childcare costs cap, against which parents can claim 20% support, will be increased to £10,000 per year for each child. This had been announced prior to the Chancellor's speech. This will mean that eligible parents can now benefit from greater support, worth up to £2,000 per child each year.

What others say

Robert Peston BBC Business editor: "*The scrapping of the requirement to take a pension annuity will be very popular with those it directly affects. But also, more broadly, and this is quite astonishing, it will actually raise money for the Treasury. It's predicted to raise more than a billion pounds a year by 2018-19. That's because if you take a large chunk of money out of your pension, you're going to have to pay tax on it".*

British Chambers of Commerce Director General John Longworth: *"Business wanted a Budget that was disciplined, focused, and geared toward the creation of wealth and jobs - and that's what the Chancellor has delivered. With a huge confidence gap still separating employers from young job-seekers, we are very pleased to see the Chancellor heed our call to help firms take on and train tomorrow's workforce.".*

Ros Altmann, pensions expert Tweeted: "*Ppl will flock to take money out of pensions now. Will bring in lots of tax revenue too. Clever."*

Citizens Advice Chief Executive, Gillian Guy, said: "*The proposals to free up pensions are welcome, particularly the new 'right to advice', which recognises the significant value of impartial, trusted advice. I hope Government departments across Whitehall will follow suit and formally recognise the value of advice in helping people cope with other policy areas...The range of decisions people have to make whilst they save and when they retire means many don't always know how to use their pension pot to their best advantage. Giving people choice and access to trusted, independent advice will help them to make informed decisions about their pension."*

Richard Lloyd of Which?: *"The Budget brings a welcome shake up for struggling savers who too often get a raw deal. Hiking the ISA limit will encourage more consumers to save, although we also now need to see more competitive interest rates from banks that have slashed these repeatedly in recent years. The overwhelming majority of people who buy an annuity from their existing provider could get a better deal on the open market, so today's announcement should help stop millions of people from losing out on thousands of pounds of retirement income. The key to making this work will be a requirement on providers to give consumers high quality, impartial advice on their options across the whole of the market, with maximum protection at this critical time in their financial lives'"*

Chris Jones, Chief Executive, City & Guilds Group: "*This Government's investment in apprenticeships is encouraging...But after months of changes, we desperately need stability. We know businesses can benefit from taking on apprentices, particularly as they fight to grow in tough markets and struggle to fill skills gaps, but our concern is that some of the changes, such as the ability to recover subsidies through PAYE, will add too much of a burden to any business delivering apprenticeships, regardless of size*."

Friends of the Earth Economics Campaigner, David Powell said: "*Merely weeks after promising action on flooding and global warming, the best the Chancellor can manage is a U-turn on his own reckless flood defence cuts, and caving in to big business lobbying on pollution tax. Mr Osborne says he wants to make our economy 'resilient', but Britons face paying a hefty price for his failure to confront the reality of climate change."*

Links

Treasury sites

Key Budget announcements: https://www.gov.uk/government/news/budget-2014-key-announcements

Budget "Red Book":
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293759/37630_Budget_2014_Web_Accessible.pdf

Budget Documents: https://www.gov.uk/government/publications/budget-2014-documents

Full Budget Speech: https://www.gov.uk/government/speeches/chancellor-george-osbornes-budget-2014-speech

HMT Budget Website: https://www.gov.uk/government/topical-events/budget-2014

Press

BBC's Budget Website: http://www.bbc.co.uk/news/business-26517496

Financial Times' Budget Website: http://www.ft.com/in-depth/uk-budget

Guardian Budget Website: http://www.theguardian.com/uk-news/budget-2014

Daily Telegraph Budget Website: http://www.telegraph.co.uk/finance/budget/

CII Group Policy & Public Affairs
19 March 2014

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