SPENDING REVIEW
NOVEMBER 2020

wellway
Growing businesses

THE ECONOMIC DAMAGE OF COVID–19

Chancellor declares “economic emergency”.

Had everything gone to plan this year, the Chancellor would have been delivering his Autumn Budget speech. Instead, Rishi Sunak declared an “economic emergency” alongside a slimmed down spending plan to see him through until spring.

Nobody in government would privately claim there is any way to avoid tax rises at some point, but the Chancellor stopped short of announcing any of that in his speech to a handful of MPs in a socially-distanced House of Commons.

Any tax changes to fill the £280 billion hole in public finances left by COVID-19 in 2020 won’t come until Spring Budget 2021 at the earliest, and perhaps not until after that.

Some political sources believe the inevitable tax hikes might even form the basis of the next scheduled general election, due to take place sometime in 2024.

But for now, Sunak’s Spending Review painted a serious picture of the country’s finances and challenges on the horizon – although the Brexit transition on 1 January 2021 went conspicuously unmentioned.

The latest Spending Review was intended to set out the Government’s plans for the next three years. This was reduced to just one year, however, due to the economic turmoil caused by the coronavirus.

As a result, the difficult financial climate dominated this year’s review with the economy projected to be 11.3% smaller than it was pre-virus, back in February 2020. This represents the largest annual fall in output since that triggered by the Great Frost of 1709.

That gloomy economic forecast came from the Office for Budget Responsibility (OBR), which supplied the second of its two annual predictions, the first having been delivered in March 2020.

ECONOMIC FORECASTS

The OBR based its economic outlook on three scenarios – an upside, a downside, and a central forecast.

Its central forecast assumes that medium-to-high public health restrictions will remain in place over the winter, but warmer weather in spring next year will allow for those restrictions to be eased. Following this, it assumes an effective vaccine will be made widely available in the second half of 2021.

Based on this scenario, the OBR predicted that the economy would recover steadily over the next couple of years, with UK GDP growing by 5.5% in 2021, 6.6% in 2022, then by 2.3%, 1.7% and 1.8% over the next three years.

However, as the Chancellor warned in his Spending Review speech, economic damage is “likely to be lasting”.

Despite a gradual recovery, economic output is not set to return to pre-crisis levels until Q4 2022. As a result of “long-term scarring” effects, such as sustained unemployment and deferred or cancelled business investment, the UK economy will be 3% smaller in 2025 than the OBR expected in March 2020.

SPENDING PLANS

More than £280bn has been spent this year to "protect people's lives and livelihoods" from the fallout from COVID-19, with another £55bn expected to be spent in 2021/22.

The furlough scheme had cost £43bn as of 25 November 2020, and those costs will increase further with the possibility of eligible staff being furloughed until 30 April 2021.

And there may be more spending needed yet. Adam Marshall, director-general at the British Chamber of Commerce, said: "With an uncertain winter ahead, the Government will need to maintain an open mind on providing further support to businesses struggling to survive.

"As we look to rebuild and renew local and national economies, businesses will also need further significant incentives for investment in people, productivity and the planet."

One detail hidden in supporting documents is a freeze on the business rates multiplier for 2021-22. The Government says this will save businesses in England £575m up to 2025.

WAGE INCREASES

Before the furlough scheme ends next spring, employers will also have to account for another increase to the minimum wage – which has been rebranded as the national living wage. It will increase to £8.91 an hour, with the rate extended to over-23s for the first time.

Increasing these rates in the current climate was a formidable task for the Low-Pay Commission, which had to balance the very real solvency risks to smaller employers with the needs of workers on lower pay.

Workers aged between 21 and 22 will see their minimum hourly rate increase to £8.36, while the rate for 18 to 20-year-olds is set to rise to £6.56 an hour. Under-18s and apprentices will see their respective rates hit £4.62 and £4.30 an hour.

"Many lower-paid workers have been the heroes of the COVID-19 crisis," said Rain Newton-Smith, chief economist at the Confederation of British Industry. "But unemployment is rising in lower-paying sectors and these increases will be tough for some firms to afford."

Employers might soon have a wider pool of talent to choose from due to a new £2.9m restart programme, which aims to help more than a million unemployed people find work over the next three years.

Unemployment as a result of the coronavirus is expected to hit 7.5% by spring 2021, equivalent to around 2.6m people.

BALANCING THE BOOKS

The OBR said support for public services, households and businesses is expected to cost £280bn in 2020, pushing the deficit to £394bn – the highest since the height of the Second World War in 1944 and representing 19% of UK GDP. It also takes debt above 100% of GDP for the first time since 1960.

"Given what's happened to the size of the economy, that can only mean one thing for taxes," said Paul Johnson, director at the Institute for Fiscal Studies. "They, too, could be set on an inevitable, if delayed, upward trajectory."

The OBR's central forecast shows the Treasury needs to raise between £20-30bn through spending cuts or raising taxes to balance revenues and day-to-day spending and stop debt from rising by the end of this parliament.

Sunak has already received recommendations for a capital gains tax overhaul from the Office of Tax Simplification (OTS) and, while he's under no obligation to accept those, the temptation of raising an extra £14bn a year from harmonising capital gains tax rates with income tax rates is bound to play on his mind.

Inheritance tax could be another option for reform. Ahead of the March Budget, there was some speculation that this tax could be overhauled, as it faced criticism for complexity.

In January 2020, a group of MPs recommended cutting the rate of inheritance tax, but removing almost all of the reliefs associated with it would help to prevent tax avoidance.

Any changes to inheritance tax might overlap with reforms to capital gains tax, as the OTS report highlighted some crossover between the two taxes.

Reports earlier this year also suggested that Sunak was considering increasing national insurance contributions for the self-employed, to bring them in line with the rate for employees.

Steven Cameron, pensions director at Aegon, said it's "vital" that any cost-saving measures don't discourage people from saving for retirement or emergencies, and that investment in the economy should be encouraged instead.

"For those lucky enough to have any extra funds, now may be the time to make as much use as they can of incentives they may lose by topping up pension contributions or making full use of ISA allowances," he added.

If you're concerned about the effects future tax changes could have on your finances, it makes sense to review your position now, use up any available allowances, and take advantage of any reliefs before the end of the tax year.

Get in touch to review your taxes