

A Budget for recovery?

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No one expected the Chancellor of the Exchequer, in the present very difficult economic conditions, to do more than present doom-laden economic projections for the next few years, squeeze public spending, substantially increase government borrowing and increase taxation wherever it was really possible to do so, and all the while remaining as upbeat as conceivably possible. We were not disappointed. The Treasury predicts that while the UK economy will contract by 3.5% this year, the economy will start growing "towards the end of the year" towards 1.25% growth in 2010 and 3.5% from 2011. Such optimism looks rather misplaced as the International Monetary Fund expects the economy to contract by a further 0.4% next year, which is strongly at variance with the Chancellor's projections. As so often happens, we find that in the cool light of day this was a disappointing Budget for the hospitality and tourism industries with very little direct support or encouragement given. Given the parlous state of the economy we expected very little to be given away and confidently expect that all of us, individuals and businesses, will be paying more taxes in the years to come.

Budget highlights

- ◆ New 50% top income tax rate from April 2010 for those earning more than £150,000 a year and their pension tax relief cut from April 2011
- ◆ Alcohol and tobacco taxes up, with 1p on a pint of beer, 4p on a bottle of wine and 7p on a packet of cigarettes
- ◆ Fuel duty up 2p a litre from September then a 1p a litre increase each April for four years
- ◆ State pensions to increase by 2.5% with winter fuel allowances maintained at current levels
- ◆ ISA (individual savings account) tax free limit rises from £7,200 to £10,200 for the over-50s from October and for everyone from April 2010
- ◆ VAT will return to 17.5% by December
- ◆ The VAT threshold is increased from £67,000 to £68,000 on 1 May this year
- ◆ From May those scrapping cars over 10 years old will be able to claim £2,000 when purchasing a new car, until March 2010
- ◆ Under 25s will after a year of unemployment get a subsidised job or training place
- ◆ Air passenger duty increases to go ahead
- ◆ The stamp duty holiday for homes up to £175,000 extended to the end of the year
- ◆ Statutory redundancy pay increased from £350 a week to £380 from October
- ◆ Increases in income tax personal allowances announced in the Pre-Budget Report go ahead as planned as does the rise in national insurance contributions scheduled for April 2011
- ◆ Grandparents of working age, who provide free childcare so their children can go to work, will receive a tax break
- ◆ Unspecified "efficiency savings" of £9 billion a year by 2013-2014
- ◆ UK economy to shrink by 3.5% this year, expand by 1.25% next year and from 2011 grow annually by 3.5%
- ◆ Public borrowing will this year reach £175 billion (12.4% of GDP) and in the years after, will be £173 billion, £140 billion, £118 billion and £97 billion

The economy

The Chancellor's 51 minute Budget speech comes at a time when the economy is in a precarious state. The Chancellor began by saying that the Budget was designed to help people through the global recession and "prepare Britain for the opportunities for the future". To this end he wanted to help people get back into work quickly, support businesses and homeowners facing problems, support investment in green industries and as recovery takes hold ensure that public finances are sustainable. Britain's public debt is forecasted to be £1.4 trillion by 2013-2014, which is 79% of GDP. Government borrowing over the next two years will reach a total of £348 billion and £703 billion over five years, which is the biggest increase in borrowing since the Second World War. Given that the UK banking system was close to collapse only a few months ago we can be forgiven for thinking that things could hardly get any worse. Indeed the

Chancellor, while predicting that the UK economy would contract by 3.5% this year, has indicated that the economy would start growing again “towards the end of the year”, reaching 1.25% growth in 2010 and 3.5% from 2011. Unfortunately the Chancellor, or more specifically The Treasury, does not have a good track record in economic forecasting and appears to be chronically over-optimistic. Indeed the latest data from the Office for National Statistics shows that GDP fell by 1.9% in the first three months of 2009, the sharpest quarterly decline since 1979. Output in the first quarter of 2009 fell by 4.1% compared with a year ago – the worst decline since the end of 1980. Manufacturing fell by 6.2%, the worst since records began in 1948 while the service sector declined by 1.92%, the sharpest decline since 1979. The financial sector is especially weak.

Should the Chancellor’s projections be wrong and consumer confidence (which means improving consumer spending) does not return this year then government debt will be even higher. The International Monetary Fund (IMF) believes this year will probably be the worst year since the 1930s as countries across the world go into a “synchronised slowdown”. More worryingly, the IMF recently pointed out that recessions provoked by financial crises tend to be more protracted and difficult, and it is this type of recession which the UK is now experiencing.

Meanwhile the UK moves closer to deflation. The retail price index (RPI) is projected to fall to minus 3% by September this year, the lowest level of RPI since 1947. If the RPI stays in negative territory the greater is the possibility of deflation. The threat is very real and the consequences profound as the unions and businesses tend to use the RPI in wages negotiations. Wage cuts would be fiercely resisted but pay freezes could become the norm over the next two years. The Chancellor expects RPI inflation to move to zero in 2010 but this view is based on the growth projections mentioned above. In the longer-term (say four to five years time) inflation could be raising its head again.

How it affects you

The introduction of a top income tax rate of 50% on people earning more than £150,000, together with a cut in their personal allowances and reduction in the top rate pension tax relief, will affect around 700,000 high earners, some of whom will be working in the hospitality and tourism industries. Several commentators have focused on this headline change, and point out the possibility that these changes will lead to an exodus of high-earners from the UK, meaning lower tax receipts and less money in the future economy. This may or may not happen but what should be of greater concern is the “here and now” for the majority of hospitality and tourism businesses and organisations and the employees working in them, the majority of whom we can be certain earn far less than £150,000 a year.

HM Revenue & Customs will continue to allow businesses to defer their taxes “for as long as it is needed”. Since this service was set up in November last year, almost £2 billion in tax owed by more than 100,000 companies has been deferred. So small businesses will welcome the extension of the carry back scheme which allows companies to claim back tax paid on the past three years’ profits by “carrying back” losses of up to £50,000. The measure is intended to help the cashflow of loss-making small businesses and was initially announced in the Pre-Budget Report last year; it is now extended to November 2010. The Treasury says that this should help 140,000 businesses which will claim on average £4,000. Anything which helps ease cashflows is to be welcomed in the current economic conditions although it would have been even more helpful if the £50,000 carry-back had been substantially increased. Application can be made through the Government’s Payment Support Service to receive rebates. Besides cashflow, the real problems for small businesses continue to be a reluctance of banks to lend money, the late payments of debtors and the red tape of administration.

The regrettable rise in fuel duty will affect directly or indirectly all businesses and feed through eventually to end-user prices. The increase of 2% in alcohol excise duty has been greeted with understandable dismay by the pub sector. The tax increases the price of a pint of beer by 1p but in reality the price for beer drinkers will rise by up to 4p or 5p. We can expect to pay 5p more for a bottle of sparkling wine and fortified wines while a 70cl bottle of spirits will cost between 13 and 14p more. Over 2,000 pubs closed over the last 12 months and around six are closing each day. It is being suggested that around 75,000 jobs are at risk. Pub groups have said that the Chancellor has reneged on a previous promise to introduce inflation-linked price increases. Back in 2008, following a large increase in alcohol excise duty, the Chancellor said that the excise duty would increase by 2% above inflation in future years. By such a reckoning alcohol excise duty should have been cut in this Budget.

Some hospitality businesses will benefit from the doubling of capital allowances to 40% for one tax year, and this is welcomed although an adviser at the Institute of Chartered Accountants in England and Wales has said the relief will have no impact on smaller businesses, which would use the £50,000 annual investment allowance. Plant and machinery capital allowances particularly benefit large companies while undoubtedly helping smaller companies. We understand

that the capital allowances change is particularly designed to prompt telecoms and utilities companies. For every £1 million of investment, the tax saved in the first year doubles from £56,000 to £112,000. Some commentators believe that the measure does little to boost corporate confidence to invest but it will be remembered that it is only two years since there were reductions in capital allowances, so every little helps.

The finance directors or senior accountants in the UK's biggest businesses will be sleeping a little less easily following the announcement that they are to be held personally responsible for errors in the company accounts and, if accounting systems are found to be faulty, liable to pay fines of thousands of pounds. The finance directors or senior accountants in all companies will be required to certify that their accounting systems are accurate each year. If HM Revenue & Customs find careless or deliberate failures in a company's systems finance directors could face fines of up to £5,000 and the company forced to repay any unpaid tax plus a penalty charge of up to 30% of the unpaid tax sum.

The Young Person Guarantee Scheme for the under-25s is very welcome. Unemployed young people will be offered either a job or a training scheme place if they have been unemployed for more than 12 months. £260 million of new money has been allocated for training and subsidies and every 16 to 17 year old wanting to stay in education or training will be supported. Overall some £3 billion is being spent on jobs and skills enhancement with about half of this being spent on guaranteeing work or training for young people. Apparently some of the money will be used in offering "recruitment subsidies"; some hospitality businesses can expect to be involved in this initiative and hotels, care homes and local authorities will be offered up to £2,500 for each unemployed young person they take on to employment. Employers would receive a 20% up-front payment on hiring a long-term unemployed claimant and receive the remaining amount when the new employee has settled in. It is believed that the Government could announce shortly that some companies could receive the full amount even if claimants were classified as only "job-ready". It is understood (although this needs clarification) that the taxpayer could also pay up to £8,000 a year in wage subsidies. Hospitality businesses would do well to keep a close eye on these developments. The Job Centre Plus network will be receiving an additional £1.7 billion of funding in addition to the £1.3 billion announced last November. In total the Government hopes to create some 250,000 jobs over the next two years. The British Chambers of Commerce doubt whether these changes will have any major impact and there is an expectation that unemployment will still reach 3.2 million in 2010.

Very small hospitality businesses will be saved some administrative chores from 1 May 2009 as the VAT threshold is marginally increased from £67,000 to £68,000; this keeps around 6,000 small businesses out of the VAT system. The Budget did not mention at all a widely expected change to small business rate relief in England. The rate relief is automatic in Wales. Neither did the Chancellor accede to calls for mediators to be used in resolving lending disputes between businesses and their banks.

Taxes on air fares are set to double as was pre-announced in the Pre-Budget Report last year. Air passenger duty on all flights will rise sharply for the second time in two years but hit particularly long-haul flights and premium tickets. As an example the tax on an economy flight to Australia increases from £40 to £85 by the end of 2010; this is a quadrupling since 2007 when the duty on such a flight was £20. Rates of duty are determined by the distance travelled and class of ticket purchased. If you travel premium economy, business or first class on the longest haul flights you will pay £170 in tax compared with £40 only two years ago. Air passenger duty raises around £2 billion a year and we can expect further increases in the future as the Government attempts to meet lower carbon dioxide emissions targets. These tax increases come at a difficult time for airlines and suppliers to the aviation industry, as passenger numbers are seriously declining. Rising aviation costs will make it more difficult for airlines and airports to continue operating some routes and companies seeking to expand foreign businesses may suffer, as may some tourism businesses.

Other measures

The announcement of a Strategic Investment Fund where £750 million of Government investment is targeted at the UK's high-tech industries will have no direct impacts on the hospitality and tourism industries. The Fund will support advanced strategic industrial projects in emerging technologies and projects in advanced manufacturing, biotechnology and digital media. One-third of the Fund is ear-marked for low carbon projects.

About 3.8 million homes will get faster internet access following a proposed injection of £250 million of public money which is taken from the £600 million BBC licence fee fund that is to be used to pay for homes to be switched to digital television when the analogue signal is progressively switched off. Around £250 million is felt to be surplus because apparently rather more people have already upgraded to digital equipment than was thought. The Government has pledged to connect every home to broadband as part of its Digital Britain review.

Grandparents of working age who provide free childcare so their children can go to work will receive a tax break. Grandparents in such a situation will be able to earn state pension credits for each year they take out of the job market to look after their grandchildren.

The Treasury confirmed that rescue of the banks has cost about £50 billion so far, or about 3.5% of GDP which is around £1,450 billion. This works out at roughly £1,700 for each taxpayer. Rather than making profits on taking stakes in the banks, the losses are currently estimated at between £20 and £50 billion but the Treasury admits that the final amount "could be either larger or smaller" which is far from reassuring particularly as the IMF is forecasting a £140 billion loss arising from rescuing banks and possibly the nationalising of some other financial institutions. The final figure will inevitably reflect the likely costs of insuring £585 billion of bad debts at the Royal Bank of Scotland and Lloyds Banking Group, and potential losses on the government's £37 billion investment in these two banks last autumn.

Conclusions

The reality of this Budget is that the Chancellor had very little room for manoeuvre – he could afford to tinker at the edges but there was little scope for large give-aways and plenty of reasons for tax increases but tax increases at a time of recession runs a terrible risk of driving business and consumer confidence and spending even lower, and thus prolonging what is turning out to be a very nasty recession. The essential dilemma of this Budget is unfortunately compounded by frankly unrealistic economic forecasts, especially on economic growth, which will regrettably mean that in order to achieve any kind of semi-realistic budgetary balance in the next 10 to 15 years government spending will have to be cut, and cut rather savagely, and taxes raised by more than the Government is currently admitting. With a general election required by law within the next 13 months, unfortunately politics also comes into play. Few will shed any tears for the very rich earning over £150,000 a year and few will be taken in by vague threats to migrate to other countries but there is in truth very little in this Budget for hospitality and tourism businesses, which is regrettable.

For the hospitality and tourism industries economic conditions are generally getting worse but so far the Government wants consumers to carry on spending, and if they have the confidence to spend then some of that expenditure will be on meals and drinks away from the home and holidays. The only things that can be done is to keep costs under constant control and a focus on giving value for money products and services - and hope for the best.