Edelman Global Advisory

SPRING BUDGET 2023

OVERVIEW

Remember September?

How can you not. Kwasi Kwarteng's mini-budget, was political theatre and economic drama. Millions are still feeling the consequences of it now in their mortgages. In No 10 and the Treasury the battle-scars of the Trussonomics experiment are still raw.

So the over-riding priority of Jeremy Hunt's first Budget Statement (the last two Chancellors didn't last long enough to give a Budget) is to keep the markets calm and reassured. No drama: under-promise and over-deliver.

The work of Rishi Sunak's government to stabilise the economy over the last six months has certainly paid off: the OBR expects inflation to fall to 2.9% by the end of the year; and while they expect the UK economy to shrink by 0.2% over the course of 2023, this is a distinct softening compared to the cataclysmic predictions the Bank of England had made last Autumn.

That fiscal headroom has been used, in the short-term, for some significant cost-of-living measures. Fuel Duty will continue to be frozen and the energy guarantee scheme will be extended for three months.

In the longer term, the Government has made significant interventions at either end of life's journey: free childcare is extended to come in from the moment that people return to work from their parental leave; and, to encourage older, wealthy workers back into employment, the lifetime allowance on pensions contributions has been abolished. Both measures are designed to bring more people back into the workforce and generate economic growth, as is the reform of universal credit support for disabled people.

But these measures are also political choices. The childcare pledge is designed to cook Labour's goose on an area of their strength, but it will not come into full effect until September 2026, after the general election. The pensions allowance may help high-earning doctors stay in the NHS but it is an expensive tax break for the most wealthy and there is concern in Conservative circles that this is going to be seen by the public as yet another example of them favouring the rich.

Elections are decided by the facts on the ground. One fact the Chancellor didn't mention was the OBR's projection that real household incomes will continue to fall this year and next. While taxes introduced since April 2021 will lead to 3.2m people becoming new taxpayers, 2.1m becoming higher rate taxpayers and 350,000 hitting the 45p rate. These are facts that no Chancellor wants to take into an election due at some point in the next 18 months.

So today the Chancellor has shown that he can stabilise the economy. He's shown that the government is still capable of delivering effective retail politics. But noises off from his backbenchers have been quieted rather than silenced. And there is much work still to be done if our economy is going to grow with vigour in the second half of the 2020s.

WHAT DID THE CHANCELLOR SAY?

In his Autumn Statement, Hunt was clear that the country needed to "face into the storm" and find a path through it. This sombre tone was replaced today by an increasingly confident Chancellor who claimed that despite enormous global challenges, the UK economy is proving the doubters and declinists wrong.

Demonstrating that the government has a coherent plan which is working underpins not just today's budget announcements, but the Conservatives' entire political strategy as they attempt to narrow the significant gap between them and the Labour Party ahead of the next General Election.

By highlighting at the beginning of his speech the International Monetary Fund's view that the UK economy is on the right track, the Chancellor will have sought to present himself in stark contrast to his immediate predecessor. This assertion, backed up by the Office for Budgetary Responsibility confirming that the UK is not in a recession, will have provided him with the personal credibility he was looking for ahead of outlining the four pillars to his approach to deliver economic growth: Enterprise, Employment, Education and Everywhere.

Each of these four pillars contains a series of individual policy announcements aimed at the audiences every Chancellor is simultaneously addressing from the Dispatch Box – the markets, the voting public and their Parliamentary colleagues.

As outlined in the recent machinery of government changes, boosting innovation and driving business investment is a key priority for this Prime Minister and Chancellor. As part of his enterprise pillar, the Chancellor announced today increased support for the UK's research and development sector, a transformation in capital allowances worth £27bn to businesses, and the launching of 12 new Investment Zones.

The Chancellor's employment pillar focuses on tackling labour shortages and breaking down barriers that stop people working. To help people move into work, increase their hours and extend their working lives, the Chancellor announced that he will increase the annual pension allowance to £60,000, abolish the Lifetime Allowance, launch a new Universal Support programme to further support disabled people and the long-term sick who want to work, and abolish the Work Capability Assessment.

As suggested by many of the pre-briefings ahead of today's Budget speech, to increase the availability and flexibility of childcare provision, the Chancellor announced 30 hours of free childcare per week for children from nine months to four years. This was followed by the announcement that the Government will pay the childcare cost of parents on Universal Credit upfront rather than in arrears.

Through his fourth pillar, the Chancellor announced that 16 regeneration projects, backed by over £200 million, will be launched to help restore pride in local communities across the country and confirmed the Levelling Up Fund Round 3 process. Levelling up, the key mantra and platform of the 2019 Conservative electoral win under Boris Johnson, has led some Conservative MPs to feel that too much focus is being placed on the 'Red Wall' seats of the North and the Midlands. And that this has been to the detriment and as the cost of the more established Conservative strongholds across the South. So this now becomes "everywhere".

THE LABOUR RESPONSE

In response to today's Budget, Labour reiterated attacks on the Conservative Government, arguing the Budget amounts to "sticking plaster politics" with working people paying for the Government's mistakes.

Responding to the Chancellor's statement, Labour Leader Sir Keir Starmer accused the Government of failing to grip long-term challenges, attacking a "budget for growth that downgrades the growth forecast". Seeking to remind voters that the Conservatives have been in power for 13 years, Starmer attacked the Government's record, saying the economy needed major surgery, but that instead, "like millions across our country, this Budget leaves us stuck in the waiting room with only a sticking plaster to hand".

He accused the Conservative Government of presiding over "a country set on a path of managed decline, falling behind our competitors, the sick man of Europe once again." Referring to recent supermarket shortages, he claimed "after today, we know the Tory cupboard is as bare as the salad aisle in our supermarkets".

Striking a briefly consensual tone, Starmer reiterated Labour's support for the war in Ukraine, and confirmed his Party's support for the military spending announced in the Budget but argued that the conflict cannot be used as "a blanket excuse for failure", arguing that the country's economy already had "weak foundations".

In a demonstration of Labour's attempts to highlight the Government's choices and their failure to support working people, Labour attacked the changes to pension allowances, calling this a handout for the richest 1% and their pension pots.

Starmer's message today was a clear sign of what we will see in Labour's narrative in the months to come as we move ever closer to the next General Election. The Opposition will continue to focus on the Conservative Party's record over 13 years in power, as they seek to persuade voters that the Tories are responsible for the challenges facing the country and that it is their choices which have left working people paying for their mistakes.

KEY MEASURES

- The Energy Price Guarantee will be extended at £2,500 for a further three months until July 2023. This is expected to save the average household £160 over this period.
- As expected, April's planned rise in Corporation Tax to a headline rate of 25% will go ahead. However, a new full capital expensing for the next three years will be introduced, replacing the super-deduction. This will mean every pound that companies invest in IT equipment, plant, or machinery can be deducted in full and immediately in taxable profits.
- 12 new investment zones will be delivered. This includes eight locations in England with four more planned across Scotland, Wales and Northern Ireland.
- All households where both adults work at least 16 hours a week will be entitled to 30 hours of free childcare for children aged nine months to three years for 38 weeks a year. This will be rolled out in phases from April 2024.
- Fuel duty will be frozen for the thirteenth consecutive year, with the Government dropping plans for an 11% increase. The 5p reduction, announced last year, will be maintained for a further 12 months.
- In an effort to incentivise high skilled individuals to remain in the labour market, the Lifetime Allowance charge will be removed from April 2023 before being is abolished entirely from April 2024. Meanwhile, the Annual Allowance will be raised to £60,000.
- Defence spending will be maintained at 2.2% of GDP, with an aspiration for this figure to rise to 2.5% once the economic circumstances allow.

Policy Focus

CLIMATE & ENERGY

With widespread concern around high energy costs, the Chancellor's decision to extend the Energy Price Guarantee for an additional three months will be widely welcomed and is expected to save typical households around £160 over this period. However, critics will rightly point out that this doesn't offer a long-term solution to the issue. Delivering this will instead require a regulatory and investment framework which allows homegrown clean technologies to flourish.

Significant commitments to nuclear and Carbon Capture and Storage are a step in the right direction, though some will wonder why it has taken so long for progress to be made in areas that many have always seen as critical. Meanwhile, in what appears to be the UK's first significant response to recent US and EU green energy subsidy schemes, the Government will hope that the replacement of the super deduction with a full capital expensing policy – effectively serving as a significant tax break for green supply chain companies – will provide enough economic certainty to drive growth in green industries. However, the lack of specific movement on things like renewables, energy efficiency and electric vehicles will alarm many.

Attention now turns to later this month, with the Government set to use a 'green moment' to outline further action on energy security and net zero via a series of further announcements.

DEFENCE & FOREIGN AFFAIRS

The Ministry of Defence has been one of the few departments to receive an outright budget uplift in the Spring Budget with Hunt confirming it will receive £5bn in additional funding over the next two years, further to the £560m of new investment made at the Autumn Statement in 2022. This will extend to an extra £11bn over the next five years, which Defence Secretary Ben Wallace had been pushing for (although over a shorter time period). This is significant because some Conservative backbenchers have been disgruntled by the Treasury's perceived lack of investment in defence, with calls for a significant uplift only intensifying since the Russian invasion of Ukraine last year.

The additional spending made available will be directed towards a range of initiatives, including the modernisation of the UK's nuclear enterprise, replenishing and increasing stockpiles of ammunition and supplies, investing in the resilience of the UK's munitions infrastructure, including investment in infrastructure, skills, and support to in-service submarines.

The initial announcement of the MoD's future spending limits came on Monday with the publication of the Integrated Review Refresh (IR23) setting out the UK's defence, national security and foreign policy requirements going forward. IR23 states that the UK ranked second in the G7 and OECD in terms of defence spending, having spent over £50bn in 2021 (2.2% of GDP). Treasury officials are keen to point out that this will rise to 2.5% once economic circumstances allow. The announcement was also timed to coincide with signing of the landmark AUKUS pact, highlighting an active post-Brexit Britain on the world stage, keen to build new strategic relationships.

WHAT DOES THE SPRING BUDGET MEAN FOR BUSINESS?

Following relentless briefing that this would be a "Budget for growth", the Chancellor will hope that the measures announced today will provide the stability and certainty needed to drive business investment and generate growth.

Against a challenging backdrop of record inflation, sluggish growth and widespread strikes, the Chancellor argued that his plan would "deliver long term, sustainable and healthy growth" by "removing obstacles that stop businesses investing, tackling labour shortages that stop them recruiting, breaking down the barriers that stop people working and harnessing British ingenuity to make us a science and tech superpower".

While recognising the "importance of a competitive tax regime" to attract business investment, Hunt said he wanted the UK to have the "most pro-business, pro-enterprise tax regime anywhere". Notwithstanding the fact that the planned corporation tax increase will go ahead, he will hope that a landmark "full capital expensing" regime – meaning that every single pound a company invests in IT equipment, plant or machinery can be deducted in full and immediately from taxable profits – will go a long way to delivering this goal.

In an attempt to address the UK's workforce crisis, the Chancellor also announced a set of reforms to remove the barriers that stop those on benefits, older workers, and those with health conditions who want to work from working; an increase in the pensions Annual Allowance from £40,000 to £60,000 and the abolition of the Lifetime Allowance will remove the disincentives to working for longer; and a new 'Returnerships' skills offer for older workers and more stringent Universal Credit job search requirements also feature in the plan that will boost the UK's workforce, fill vacancies and support economic growth.

As widely pre-briefed ahead the Statement, the Chancellor also announced reforms to childcare to remove barriers to work for parents with a child under 3 in England. This could significantly reduce costs for parents and have a real benefit on child development and education as well. However, there have been concerns raised that the free hours are only available if both parents working. This means that people in training or studying, for example, will still not get access to childcare.

Overall, the Government will hope that the measures announced today can deliver a business investment boom over the next three years, particularly ahead of the next General Election. However, businesses may be wondering what happens if the "full capital expensing" policy is not made permanent, and this leaves room for uncertainty which could impact business investment in the long term.

THE POLITICAL ROAD AHEAD

Sunak came into off the back of a political and economic implosion with a promise of restoring stability, and at around the five-month mark of his premiership, it can be said that he has succeeded. Improvements in the global economy, specifically the fall in energy prices, meant he and Hunt had more fiscal leeway than he may have previously expected. As a result, while still committing to keeping the ship steady and not spooking the markets, particularly given the recent volatility in the banking sector, they were able to throw a few crowd-pleasers into the mix in a bid to improve the government's standing with Tory backbenchers and the wider electorate.

In addition to the more positive economic outlook, Sunak and his government have been working hard to address legacy challenges and build a platform for future success. Over the past couple of months Sunak has had a strong run – from achieving a breakthrough on Northern Ireland in the form of the Windsor Framework, unveiling a Whitehall restructuring aimed at boosting the UK's science and innovation performance and also setting out a plan to stop small boats crossings which while highly controversial, plays well with the voters the party needs to retain. Consequently, the mood music around the government and wider Tory party is better than it has been for a long time, with fewer calls for a Boris Johnson restoration.

Nonetheless, everything is relative, and there is a risk that things being less bad than expected are mistaken for things being good. Even with the upgrade, the economy is expected to contract by 0.2% this year and then grow at under 2% next year. Meanwhile, the OBR expects real household disposable income to fall this fiscal year and next – a cumulative contraction of 5.7%, the largest two-year fall since records began in 1956-57, compounding the weak growth following the 2008 financial crash. This was well illustrated by today's strikes by teachers, doctors and transport workers, the latest in what risks becoming the new normal.

If borne out, this would hardly be an optimal backdrop ahead of a general election which many people have pencilled in for Autumn 2024 (the latest it can be held is January 2025). This is especially true given that many of the giveaways announced by Sunak are not set to come into effect until next year, or they will not have had time to bear fruit by then. And even where they do make a difference, voters might still feel less well-off overall.

In any event, the general election is still some way off – the immediate political test coming up is the May local elections. Expectations are already low and local elections are not always an accurate gauge for what subsequently happens at Westminster but a truly bad night for the conservatives could yet upset the fragile intra-Tory party truce and embolden dissenting voices within the party.
This includes those who want a much more radical economic approach comprising tax cuts and deregulation. Now that the dust has settled slightly on the Truss premiership supporters of her approach may begin to argue that the underlying ideas were sound, the problem was the timing and execution.

REACTION ROUND UP

Giles Wilkes, Senior Fellow, Institute for Government:
"…in terms of improvements since November, it comes down to one thing: real growth is higher, because inflation is lower, because gas and oil prices are lower. That is it, really".

Sebastian Payne, Director, Onward UK:
"This is a Budget to bring back trust – reassuring and optimistic, providing support now and fostering growth in the future. It balanced fiscal security and creating better conditions for prosperity. A solid start, but there's still an electoral and delivery mountain to climb".

Gemma Tetlow, Chief Economist, Institute for Government:
"Today's Budget contained a genuinely important package of measures to boost labour supply – particularly generous childcare support – but that got rather lost in the speech among a multitude of micro announcements".

Robert Colvile, Director, Centre for Policy Studies:
"Overall: a very Hunt/Sunak Budget. Tackling the problems in front of them, no drama (but also little flash). Calm competence. Policy over politics".

George Dibb, Head of the Centre for Economic Justice, IPPR:
"There were welcome announcements today…but the UK investment is back below the G7 average and on the biggest economic and environmental issues this budget has come up short".

Rachel Wolf, Founding Partner, Public First:
"This was a much bigger budget than most people assumed…major announcements and funding (childcare; full expensing; disability; energy)".

Steven Swinford, Political Editor, The Times:
"This is politically very difficult for the Tories with backbench MPs. Stealth taxes will drag nearly six million people into higher bands over the next four years".

Paul Johnson, Director, IFS:
"I think the changes to pensions rules will make very little difference at all to the number of people in work".

Rachelle Earwaker, Senior Economist, Joseph Rowntree Foundation:
"The Chancellor has made some steps towards tackling some of the issues which have affected families on low incomes over recent years, but we have to be clear – the difficult years are far from over".

Edelman Global Advisory

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