



The Budget 2014

ILC-UK Policy Briefing

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About this note

This note analyses today's Budget and OBR forecasts from an ILC-UK perspective. This means that we focus primarily on measures that are likely to impact on, or address the challenges of, an ageing population. This note is not therefore just concerned with how policy will impact older people but also the extent to which policy is equitable across generations and whether the chosen measures are likely to be effective in addressing the economic and social challenges of demographic change.

Overview

The Budget statement

- According to the Chancellor, Budget 2014 was a Budget for “makers” “doers” and “savers”.
- Of particular interest from an ILC-UK perspective were the announcements impacting those at the point of retirement – including abolishing the requirement to annuitise altogether. People with small and large pots will be able to take-up drawdown products, annuitise or take their pension as a lump sum.
- We think that while removing ‘the effective requirement’ to take out an annuity will help some by providing additional flexibility, for many others, annuities help to reduce the risk of living in poverty towards the end of life. It is therefore critical that those at retirement are able to access advice in order to make an informed decision.
- The Budget also included measures to help older savers through a new savings bond for the over 65s, by increasing the limits on ISAs to £15,000 and by abolishing tax on small savings income.
- These measures – and particularly the older peoples’ savings bond were suggestive of the fact that this was a budget for the Grey Vote. We think it would be fairer if the bond was available to all age groups and not just those over 65.
- Nevertheless, many of the reforms to savings are positive steps in the right direction, which should help to increase the number of people putting something away at the end of the month. Yet these measures will only go so far given continuing economic pressures.

The OBR's Economic Forecasts

- Despite economic growth for 2014 and 2015 being revised upwards, the UK's level of economic output will remain far below that implied by the long-term trend rate of growth.
- Future growth is forecast to be primarily driven by increasing private consumption with question marks remaining about prospects for investment-led growth and with net trade (exports-imports) still negative.
- Consumption is likely to be driven by rising household liabilities with the OBR revising upwards the pace at which liabilities will rise over the coming years. But incomes will not rise as fast which is likely to mean an erosion of savings.

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- The OBR has also revised up its forecast for the pace at which house prices will grow to 2016. Part of this growth is the consequence of Help to Buy. Strong house price growth is likely to cause problems with affordability – both for those looking to buy as well as those renting.
 - The combination of consumption led growth fueled by rising household liabilities and continued house price growth putting pressure on affordability will continue to put pressure on the Bank of England to maintain loose monetary policy.

Political and Economic Context

With the General Election a little over a year away, this year’s Budget is an opportunity for the Chancellor to address many of the criticisms labelled at the Government’s economic policy over the last few years. The Chancellor will be pleased that UK GDP is now growing at a relatively healthy rate of 1.9% per annum – which outstrips most of Europe and matches the United States. He will see this as vindication of so-called “Plan A” which has hinged on cutting government expenditure to reduce national debt.

From now until the Election, the Chancellor will argue that the job is far from complete and that a Labour Government would put the recovery at risk through a return to profligate spending. By the end of 2014, the Government will only have undertaken 53% of total planned spending cuts illustrating the depth of continued fiscal consolidation to come if the Conservatives are elected. This will be a hard sell, and the Chancellor will be looking at ways to soften the blow for the electorate without departing from his overarching fiscal policy framework.

The Opposition will focus on the fact that, while the economy is at last growing, it has been the slowest economic recovery for over 100 years – with economic output still below its pre-crisis peak. They will also be keen to frame the debate around a “cost of living crisis” with real (inflation-adjusted) earnings and incomes continuing to fall and a substantive increase in the numbers of people using foodbanks. The challenging aspect of this strategy is to articulate how a Labour Government would be able to solve these problems. This will not be easy, given that policy must be directed at addressing significant structural weaknesses plaguing our economy which could take a number of Parliamentary terms to resolve.

While impending demographic change is unlikely to take centre stage in the debates running up to the election, both parties will need to consider how they will respond to an ageing population sooner rather than later. The number of people age 16-64 – often termed the working age population – is set to grow by just 4% over the next 20 years while the number of people over 65 is expected to grow by 64%. Unless measures are taken to incentivize longer working lives and to support the health and social care needs of an ageing population there could be significant economic, political and social consequences. Politicians from all sides will therefore need to carefully consider the options and agree on a set of solutions before it is too late.

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Commentary

Retirement income

This year's Budget is likely to have significant implications for the ways in which people draw on their savings in retirement.

Removing the effective requirement to buy an annuity: While people will still be able to take out an annuity, individuals will also be able to extract all their pension savings in a lump sum. Those who do not want to purchase an annuity or withdraw their money in one go will be able to keep their pension invested and access it over time. Therefore under the new system anyone, regardless of the size of their pension pot will be able to choose between drawdown/other product, annuitisation or full withdrawal.

Free and impartial face to face guidance: The Government will guarantee that all those at the point of retirement will get access to free and impartial guidance. To deliver this, the government will introduce a new duty on pension providers and trust based pension schemes to offer this guidance guarantee. The government will make available up to £20m over the next 2 years to develop this initiative.

Under current plans, both reforms will be implemented in **April 2015**.

ILC-UK view

While removing 'the effective requirement' to take out an annuity will help some by providing additional flexibility, for many others, annuities help to reduce the risk of living in poverty towards the end of life. It is therefore critical that those at retirement are able to access advice in order to make an informed decision. Otherwise the proposed reforms could leave consumers exposed to longevity risk as well as the wrong sorts of products to meet their needs. For many, this will be the first time that they take such an important financial decision – and we know that there are behavioral biases which may result in individuals making the wrong choices, including the fact that people generally underestimate their life expectancy. Guidance may not therefore be sufficient – access to proper independent financial advice is required to deliver these proposals in an effective way.

There are a number of related policy changes outlined in the Budget which will impact the retirement income landscape. These will come into force from **27 March 2014**:

- The amount of guaranteed income people need in retirement to access their savings flexibly will fall from £20,000 to 12,000.
- The amount of total pension savings that can be taken as a lump sum will increase from £18,000 to £30,000.
- Increasing the capped drawdown withdrawal limit from 120% to 150% of an equivalent annuity.
- The maximum size of a small pension pot which can be taken as a lump sum (regardless of total pension wealth) will increase from £2,000 to £10,000 and increasing the number of personal pots that can be taken under these rules from two to three.

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ILC-UK view

While the headlines are likely to focus on abolishing the requirement to annuitise come April 2015, these other measures are also highly significant particularly because they are coming into force straight away. They will increase the number of people who can use their pension wealth flexibly at the point of retirement. As noted above, increased flexibility is likely to benefit some, particularly where an annuity will pay out a very small income in retirement. But there are risks attached to these measures, including a rise in the numbers of people using their pension wealth to invest in inappropriate products – especially before the new access to free, impartial guidance is up and running.

Pensioner bonds: For people aged 65 or over, National Savings and Investments will launch a choice of two fixed-rate, market-leading savings bonds, available **from January 2015**. Under current assumptions, NS&I will offer products which would pay rates of 2.8% gross/annual equivalent rate (AER) on a one year bond and 4.0% gross/AER on a three year bond under current market conditions, with an investment limit of £10,000 per product.

ILC-UK view

It is clearly a positive move to provide people with a safe and stable financial product which provides a return above the rate of inflation (OBR expect inflation to remain at 2% for the duration of their forecast). But it does seem somewhat unfair that these products are only open to the older age groups – people under the age of 65 are also struggling to save in light of the current economic climate and they could benefit from such a product. Offering the bond to all may also help to induce healthier savings rates offered by banks and building societies if the bond causes savers to switch from investing in a bank account to investing in the NS&I bond.

Savings

Reforms to ISAs: From **1 July 2014** ISAs will be reformed into a simpler product, the ‘New ISA’ (NISA), with an overall limit of £15,000 per year. The government is also abolishing the rule that only half can be saved in cash. The government will also raise the limits for Junior ISAs and Child Trust Funds from £3,720 to £4,000.

ILC-UK view

The increase in the ISA limit is certainly a significant change allowing individuals to put a greater proportion of their savings away tax free every year which may help to incentivize more savings across all age ranges. With ISAs now likely to become even more prominent as a savings vehicle of choice of individuals, there debate about the role of ISAs versus pensions and whether it is possible to combine the two in some way may gather more steam. This will require careful consideration and consultation, as there are specific benefits attached to both products.

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Abolishing the 10% rate of tax on savings income: For low income savers the government is also announcing that it will abolish the 10% rate of tax on savings income, and replace it with a new 0% rate.

The government will also increase the amount of savings income that can benefit from the new rate, from £2,880 to £5,000 in April 2015. This will ensure that lower earners don't pay tax on their savings income.

Premium bonds: The cap on investments in Premium Bonds will be lifted from £30,000 to £40,000. This will come into effect in **June 2014**.

NS&I will also offer two £1 million prizes per month, rather than one, from **August 2014**. In the financial year 2015 to 2016 the investment limit on Premium Bonds will be increased to £50,000.

ILC-UK view

Many of the reforms to savings are positive steps in the right direction, which should help to increase the number of people putting something away at the end of the month. Yet these measures will only go so far given continuing economic pressures. As we set out below, economic growth continues to rely on consumption which in the absence of real income growth is dependent on rising household liabilities. Unless incomes rise, the UK's savings ratio will continue to be eroded.

Benefits

Working age benefits: The spending on welfare will be capped at £119.5bn for 2015-2016. But the basic state pension and some unemployment benefits will be excluded from the cap.

ILC-UK view

Exempting the state pension and some employment benefits from the welfare cap seems fair from an intergenerational perspective. Given the continuation of the "triple lock" which commits the Government to keeping state pensions rising every year by the higher of inflation, average earnings or a minimum of 2.5% - our ageing society would have meant an increasingly disproportionate amount of the total welfare budget going towards older people. But the cuts ahead will be very tough indeed. Carers UK noted that the £119bn cap was similar to the amount of unpaid care given by carers who are seeing their benefits cut.

Health and Social care

The Chancellor mentioned health in the context of continuing the tobacco price escalator (2%). However he confirmed the scrapping of the escalator for all alcohol duties and a freezing of duty on Scotch Whisky and cider, and a 1p cut in beer. The Government argued that their work on the enforcement of minimum pricing was more effective from a health perspective than the escalator.

ILC-UK view

Neither alcohol nor tobacco is good for our health but Government is clearly worried about accusations of "nanny state". We must have a decent public debate on the balance between education, "nudge" and compulsion in relation to these social bads.

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It is disappointing that there was no recognition of the huge challenges being faced by local authorities delivering social care under increasing pressure. Health and care spending is likely to need a significant boost in a future spending review.

Employment

Childcare

Ahead of the Budget, the Chancellor of the Exchequer confirmed an extension of the childcare tax break scheme. 1.9 million families become eligible for the benefit and the total cost of childcare that working parents can claim tax-free will rise (£2,000 per eligible child).

ILC-UK view

Getting care right is vital if we are to support extended working lives. Too many people are forced out of work too young as a result of caring responsibilities for both grandchildren and children, and parents and grandparents. There is a strong case for a significant growth in spending on care to ensure as many people as possible can remain in the workforce. Government should extend the NI voucher scheme for childcare to older people.

Skills and training

The chancellor announced plans to double the number of apprenticeships and extend the grants for smaller businesses to support over 100,000 more.

ILC-UK view

It is disappointing that the only mention of skills in the speech focused on younger people exclusively. We need an investment in skills for all ages. Apprenticeship opportunities should be made available for all ages. Our economy needs a skilled older and younger workforce. A greater focus on upskilling and reskilling of older workers would have been very welcome.

Low income:

The Chancellor argued that the “country can afford a real terms increase in the National Minimum Wage”.

ILC-UK view

A growing proportion of people in their 20s and 30s are living on the minimum wage. Many have debt and are struggling to afford day to day essentials. If we are to convince people to save for the long-term we have to ensure that people earn an adequate income. Pushing wage levels up for younger people today is vital for their long term retirement income prospects.

Housing

Help to buy

An extension to Help to Buy “so we get 120,000 new homes built” was announced by the Chancellor.

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Stamp duty

The chancellor announced an expansion of the tax introduced to stop people avoiding stamp duty by owning homes through a company. He announced an expansion of the tax on residential properties worth over £2 million to those worth more than £500,000. Anyone purchasing residential property worth over half a million pounds through a corporate envelope will be required to pay 15pc stamp duty.

ILC-UK view

Before the Budget there had been a call for a stamp duty exemption for older people downsizing. In some ways it seems hard to justify a 65+ exemption on the basis of discouraging under-occupancy when those aged just under State Pension Age are more likely to under-occupy. But it is clear the housing market is still not working for either young or older people. We need to build more and we need to ensure that anyone who wants to downsize gets access to the support and advice they need.

Cost of living – Energy costs

The Chancellor announced a “£7 billion package to cut energy bills”. But there were no specific additional announcements to protect consumers against future increases in consumer energy prices.

ILC-UK view

Over the long run, energy prices are likely to continue to increase, posing significant challenges for people on low and fixed incomes. The announcement at the Labour Party Conference of a post-election freeze in energy prices will mean that the Conservative and Liberal Democrats are likely to need to find a way of reducing the fear amongst consumers of future hikes in energy prices. It is however, extremely unhelpful for environmental and fiscal sustainability to be at odds.

Bingo duty cut from 20% to 10%.

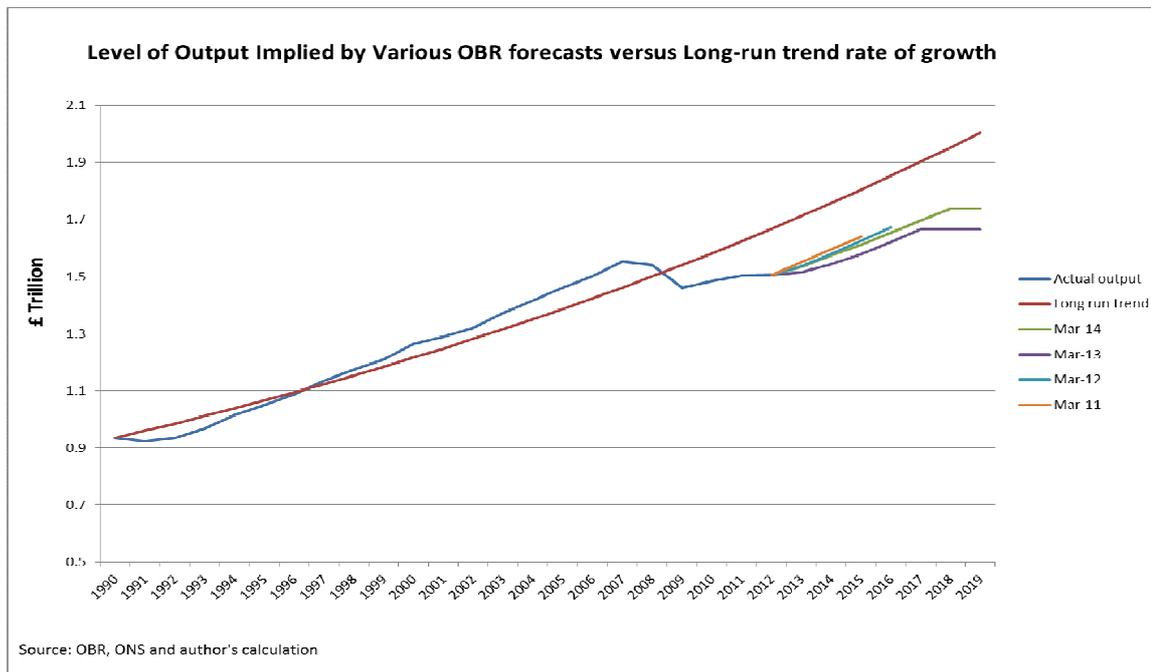
ILC-UK view

Certainly not the most important thing in this year’s budget from an ILC-UK perspective. But it is an interesting announcement. The cost is relatively low yet there are 3 million regular bingo players (many female and older). There has been a longstanding campaign by the bingo industry to reduce the tax levels. Does this announcement (alongside the freeze on Scotch duty!) help emphasise a feeling that this was a Budget for the Grey vote.

ILC-UK Analysis of Economic Forecasts

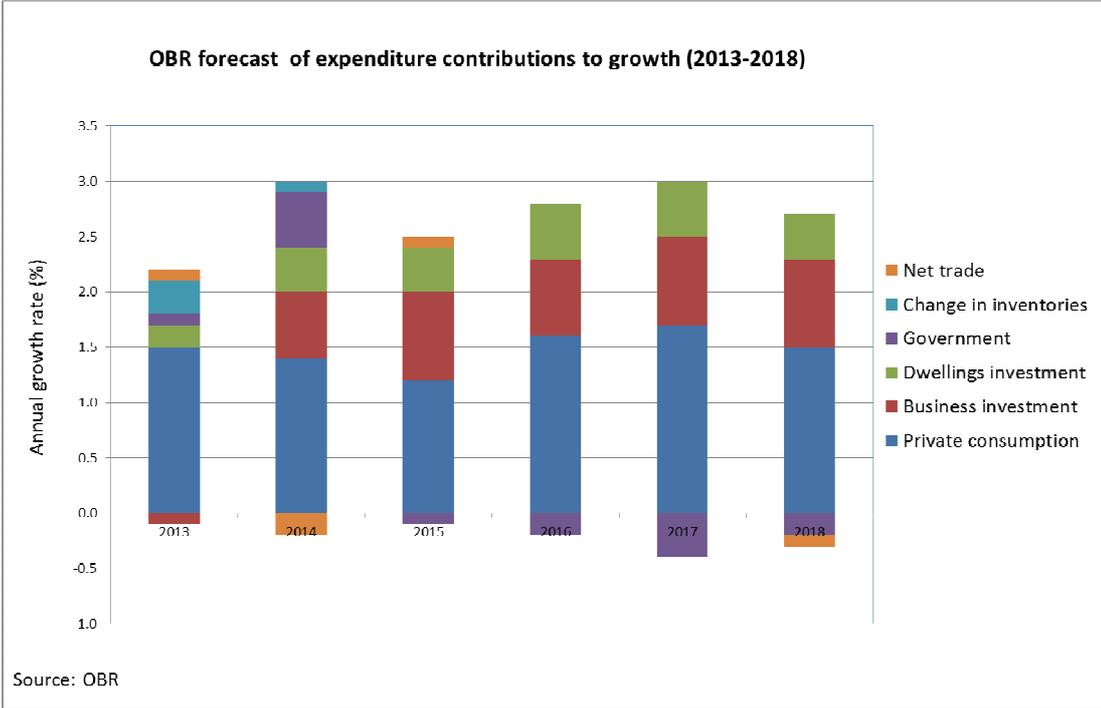
Economic Output

The OBR has revised up its forecast for economic growth for 2014 and 2015 – by 0.3 and 0.1 percentage points respectively – but there are no changes to the forecast for 2016 and beyond. While the Chancellor was keen to highlight the fact that our economy is growing faster than other advanced countries, it's worthwhile putting the recovery in perspective. Assuming that UK output had grown in line with its long-run average since 1948, by the end of the OBR's forecast period, output will still be way below what it should have been (see chart). We are still therefore well in recovery mode. The question is whether we will ever get back to trend or whether we have permanently lost capacity within the economy.



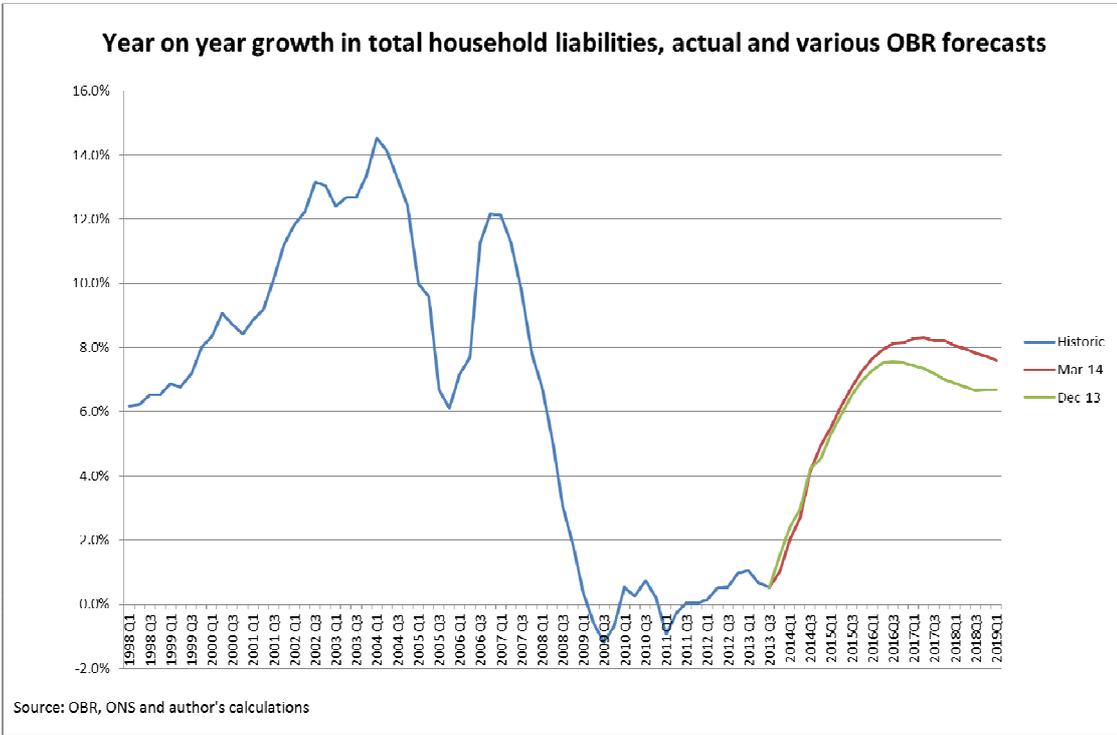
What are the forecasted drivers of growth?

At this year's Budget, the Chancellor spoke about the need to create more broad-based economic growth in the UK and move away from consumption-based growth fuelled by increasing household indebtedness. The OBR's forecast demonstrates just how stark this challenge is likely to be given that, over the forecast period, consumption remains the key driver of growth (see chart). It should be added that business investment is forecast to pick up – though this has prediction has been a common feature of OBR forecasts over the years despite the fact that investment has remained broadly flat. Net exports (i.e. Exports minus imports) are expected to have a zero or negative impact on output over up to 2018.

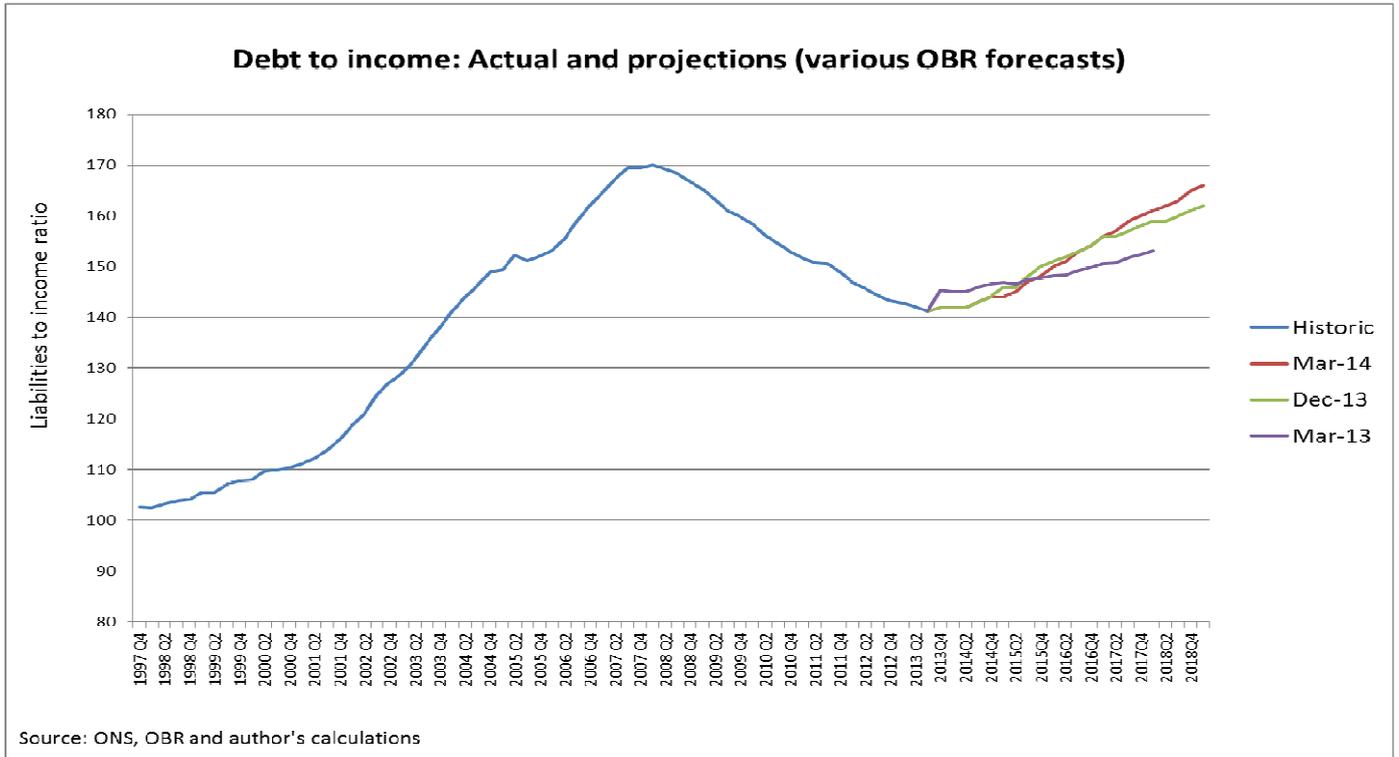


Increased consumption based on debt

The OBR forecasts a substantial rise in household liabilities up to 2019 with rates of growth in liabilities comparable with the pre-crisis period. The chart below also demonstrates that the latest OBR forecast projects household liabilities to rise faster than was set out in the December forecast (see chart).

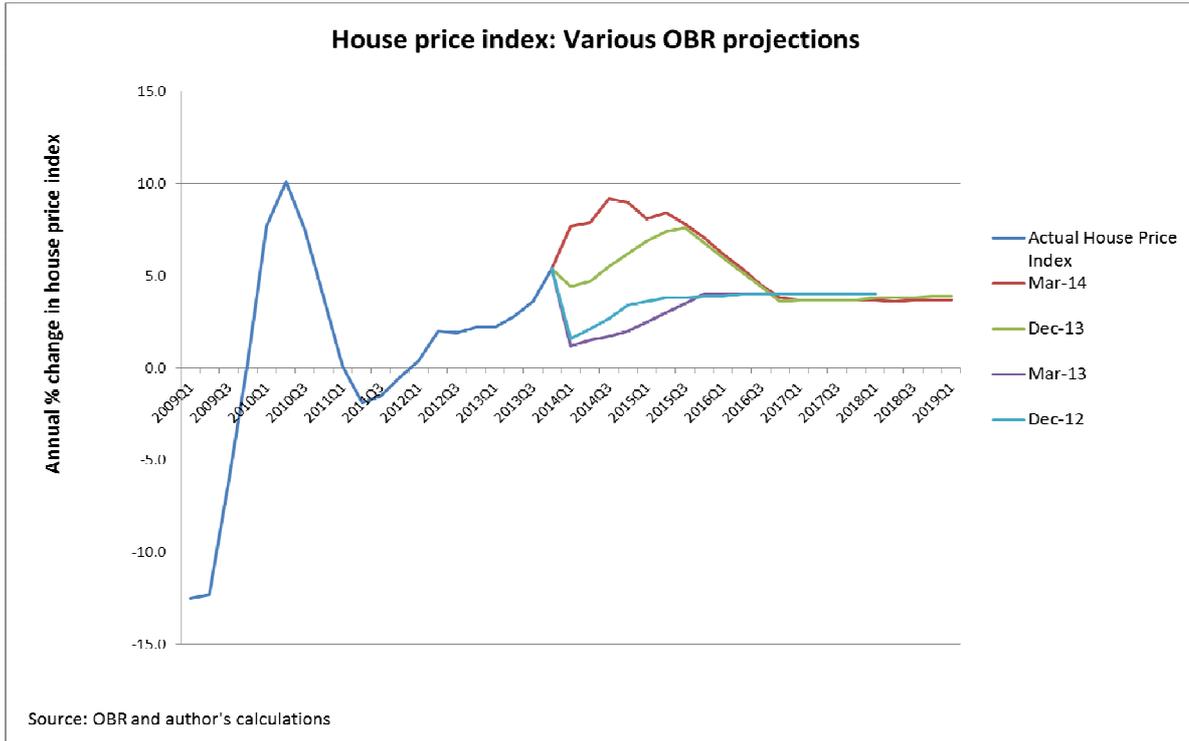


Worryingly, the OBR do not expect incomes to rise as fast as household liabilities. As a result, debt to income is set to rise rapidly – back to pre-crisis levels by the end of the forecast period (see chart). A rise in debt to incomes of this magnitude could put additional pressure on the Bank of England to keep interest rates low so as to provide relief to those in debt and to ensure that the recovery is not derailed. Rising household indebtedness will also make saving harder – so we should expect the savings rate to continue falling over the coming years, despite the latest announcements from the Chancellor.



House prices

The OBR forecasts a substantial increase in house price over the next few years boosted by Help to buy. You can see the impact of the initiative on the OBR's forecasts by looking at the difference between the March 2013 forecast and the March 2014 forecast (see chart).



While growth in house prices slows from 2016, house price growth remains above inflation. While the Government has announced the building of new homes and some extra funding for small house building companies, more needs to be done to ease the price of housing in the UK – not just for those seeking to buy but also for the growing numbers of renter across the country. This is an issue that is relevant for all generations and not just, as has been widely reported, young first time buyers.

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The International Longevity Centre - UK (ILC-UK) is an independent, non-partisan think-tank dedicated to addressing issues of longevity, ageing and population change. It develops ideas, undertakes research and creates a forum for debate.

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