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The possible implications of UK public sector spending review

Advocate **Raymond Ashton** offers his assessment

UK Chancellor of the Exchequer Rishi Sunak.

THIS is my last article for this year, which has been dominated by the pandemic throughout the world.

Obviously England has suffered much more than Guernsey, which has been subject to a much shorter period of restrictions than the UK. This will imply a smaller proportionate budget deficit.

Recently the chancellor in England conducted a spending review which has put some reality on the situation currently facing that economy in the next five years and for some time after. Similar considerations will apply to the finances in Guernsey.

In paragraphs below I shall identify the challenges facing the chancellor in England which inevitably will have implications for the Crown Dependencies and Guernsey in particular. This short article will also focus on the options open to the Chancellor in terms of reducing the budget deficit, which will have implications for Guernsey. In Parliament the chancellor said that borrowing in 2020/2021 is set to be the highest in peacetime and warned of the largest contraction in the economy for 300 years. What he didn't say is that the potential burden would be much greater if interest rates were not currently so low and the repercussions would be horrific should rates rise to say 5%.

The Independent Office for Budget Responsibility forecasts a £30bn annual deficit by the middle of the decade. Inevitably this means increases in taxes and/or cutbacks in public expenditure, or both, unless there is strong economic growth after the coronavirus. The difficult economic situation might be exacerbated should the prime minister fail to secure a trade deal with the EU before the expiration of the transitional period by the 31 December.

What the media has not focused on is that the OBR produced there scenarios based on the speed and extent of the economic recovery in the coming years. The chancellor focused on the central forecast and the effect of the second wave of Covid. The main effect will be to cause a double dip recession in the final quarter of 2020 with a fall of 11.3% in national output as compared to the previous year.

It estimated that output would be 3% below the level forecasted in March by 2025 and 6% below in a pessimistic scenario. In the first two scenarios, incomes would fall and there would be somewhat higher unemployment (estimated at its peak to be 7.5%).

The problem with a weaker economy is self evident – lower tax revenues and higher public spending. The difference between a normal recession and the pandemic is the impact on borrowing and it is estimated that the government will have to borrow a further £280bn in 2020/2021 to support jobs, companies and the NHS. This extra spending has accounted for three quarters of increased borrowing, which is estimated to be £394bn or some 19% of gross national product in 2020/2021.

Even in 2021/2022 it is expected that another £55bn will be required in Covid measures but the fall as compared to 2020/2021 means that the deficit is estimated to fall by 50% in the central forecast to £164bn.

As stated above, the UK government has not set out how it intends to address how it will reduce the deficit. The figures above would have been higher but for the chancellor cutting £13bn from day-to-day spending plans with public sector pay, including local authorities being hit the hardest, together with overseas aid.

In addition the 'once in a generation' investment in infrastructure is smaller than planned, with reductions of £3.4bn in the four years to 2021/2022. Inevitably in the next few years there will be significant cuts in the public sector and possible tax increases.

Tax increases will inevitably be 'eye catching' but this will be out of necessity. One target, based on the current review, will be the possible aligning of capital gains tax with income tax, an increase in the tax on dividends and yet another reduction in relief for pension contributions. One area

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suggested to this writer and well worthy is that UK dividends paid to foreign residents are not subject to tax at the moment as they are excluded property. Removing this exemption would, it is suggested, increase the tax yield significantly. There have recently even been suggestions of a wealth tax in such august papers as the Financial Times. While a wealth tax would not be popular, it would be a good deal more favourable than the measure introduced by the Labour government in the 1968 Budget whereby unearned income tax for the year 1966/67 was in some cases in excess of 100%. Finally it may be that there might be an increase in VAT, which is a relatively cheap tax to administer, which could be a precursor to its introduction in Guernsey.

Final mention should be made of the impact of a no-trade deal with Europe, the effect of which would be to increase inflation based on increases in tariffs and higher unemployment rising to 8.3% and a further increase in the budget deficit in 2021.

All this is depressing at a time which should be joyous, but it is clear that unless there is a boom in the world economy the prescribed medicine in both the UK and Guernsey (to a lesser extent) will be severe if the fiscal deficit in government debt is to be redressed. This is without taking into account a possible increase in interest rates referred to above.

May I wish readers a very happy Christmas and a prosperous new year.

CI fund prices

THE latest available prices of Channel Islands-based shares and company funds are quoted below. Prices of those in which there is a daily dealing may change by the time of publication.

The following current prices as listed on The International Stock Exchange (TISE):

Bailiwick Investments Ltd: bid £1.15, offer £1.25, yield 4.58%.

Channel Islands property Fund Ltd: bid 98p, offer £1.02, yield 6.6%.

Financial Services Opportunities Investment Fund Ltd: bid £1.13, offer £1.23, yield 0.85%.

Ravenscroft Ltd: bid £6.20, offer £6.30, yield 2.88%.

PraxisIFM Group Ltd: bid £1.25, offer £1.35, yield 2.88%.

Sandpiper: bid 75p, offer 85p, yield 4.61%.