ISSUE 13: MARCH 2020

technical news

For professionals working with international clients

Budget 2020 – A coronavirus special

In his first budget, the chancellor Rishi Sunak announced a series of measures to support the economy in the face of coronavirus over the coming months, as well as lay the foundations for a major programme of infrastructure investment.

Just weeks ago, the plan for the new government was to use the Budget as an agenda-setter for post-Brexit Britain, but the landscape has since shifted dramatically. The Budget's focus was firmly on tackling the short-term economic challenges posed by coronavirus, with spending taps turned on to help the NHS, businesses and the population cope with the impact of the virus.

Other changes may have been put on hold for a spending review and second Budget later this year.

Fighting coronavirus

The chancellor unveiled a package of measures worth around £30bn aimed at doing "whatever it takes" to vaccinate the economy from the threat of coronavirus, while stressing that any disruption would be temporary. Sunak said the NHS will get "whatever extra resources" it needs to cope with the impact of the virus, setting aside a £5bn emergency response fund.

Meanwhile, statutory sick pay will be available to employees who are advised to self-isolate to help people affected by the virus, although this will be a substantial income drop for many earners. There will also be a £500m hardship fund for vulnerable people made available. A series of financial support for businesses were announced. These include refunding smaller businesses with less than 250 employees for sick pay for up to 14 days. Also, banks will offer loans of up to £1.2m to small businesses and the government will cover their losses of up to 80%. Smaller firms in retail, leisure and hospitality will have business rates abolished.

As part of a coordinated response to the virus, the Bank of England announced various measures hours before the Budget, such as extra funding schemes for lending, alongside a cut to interest rates, to support businesses and consumer cashflow. The bank's base rate was reduced by 0.5% - from 0.75% to 0.25%.

Efforts to prevent the spread of the coronavirus will have a temporary economic consequence, and without offsetting action, temporary challenges can have lasting effects if they are allowed to start a vicious cycle of job losses, loan defaults or both. Hence, action taken by the Bank of England and government to bridge the economic gap is very welcome.

The economy

The Office for Budget Responsibility (OBR) has revised down its growth forecasts to 1.1% in 2020 from its March prediction of 1.4%. Yet growth is forecast to rise to 1.8% in 2021, up from 1.6%.

However, the spread of coronavirus came too late to be officially included in the forecasts, which could damage the economic outlook.

But Sunak stressed he is committed to improving the UK's productivity over the long-term and the strength of the fundamentals of the UK's economy and prospects. "Our economy is robust and public finances are sound," he stated, with the flexibility to act as needed.

Infrastructure spending

The chancellor used the Budget to pledge a £600bn boost to public spending on infrastructure and innovation – funding roads, railways, broadband, housing and research – over five years, aimed at "levelling up" economic opportunity across the country.

This brings the highest levels of investment in real terms since 1955. However, details of exactly how the extra money pledged by the chancellor will be spent have been delayed. The Autumn Budget is expected to include further plans for the economy and tackle post-Brexit trade arrangements.

Market impact

When the coronavirus first emerged, it was rapidly acknowledged by serious investors as an extremely pervasive virus. Whilst the prospect of illness, hospitalisation and potential bereavement will be occupying many, investors are characteristically single minded in their focus on economic implications.

Whilst the economic impact of the coronavirus will be significant, it is also likely that it will be largely temporary. This is in contrast to the financial crisis in which falling house prices and high levels of consumer debt left many households unable to return to their previous levels of spending for many years.

It's important to note here that it is not the virus itself that concerns markets. Although estimates of the mortality rate differ from expert to expert, they are generally around 1% of cases or lower. Of more consequence to investment markets is the disruption to profits caused by the efforts to contain the contagion.

What markets want is to know how significant the earnings hit from these containment measures will be. Unfortunately, we simply can't know – this is in some respects uncharted territory – which leaves the markets volatile in the face of uncertainty. That volatility will be resolved through the passage of time, but for the time being we need to consider what it is that markets are discounting from their previous valuations.

For example, the UK equity market produces a healthy dividend. Even with the rather tepid growth which the overall index is likely to receive, if you accept the premise that there will be a return to normality once the impact of the coronavirus fades then it looks like markets are pricing based on significant cuts to dividends. In the UK the convention is to maintain dividends unless your long-term ability to meet them has fundamentally changed. Therefore, such cuts seems unlikely.

Underpinning UK dividend yields is a large amount of oil and gas profitability. With a price war having broken out in the oil market on Monday it is tempting to be bearish about this sector. Oil prices are low at the moment because with OPEC no longer functioning properly, oil supply exceeds demand.

However, as time passes oil supply naturally declines and the current low prices will discourage producers from maintaining it. Therefore, the market will come back into balance in due course with every chance of current dividends being maintained.

There can be no question that the coronavirus is very serious. However, it is also true that it will prove to be a temporary phenomenon and as such should only have a modest lasting impact on financial markets.

Tax havens hoarding billions

Tax havens are back in the spotlight since, last year, the UK government cancelled a bill which would have forced the UK's "crown dependencies" of Jersey, Guernsey and the Isle of Man to publish information about the beneficial owners of businesses registered there.

It is not surprising that many have quit the UK for offshore low-tax jurisdictions in recent years. People who become non-UK resident for tax purposes can keep their ownership of companies based in the UK, while avoiding 38.1% income tax on dividends and 20% capital-gains tax on the sale of shares.

There are no HMRC figures on how much tax is lost to the UK's coffers in this way, but estimates put it in the billions.

What exactly is a tax haven?
Most definitions agree that tax havens are jurisdictions offering low or zero taxes, combined with secrecy (or at least strict privacy) about personal information, and in some cases also a lack of transparency in the legal framework governing the tax regime.

James Hines, the most cited academic author in the field, says that "tax havens are typically small, well-governed states that impose low or zero tax rates on foreign investors". Many are islands – the Bahamas, British Virgin Islands, Cayman Islands, Channel Islands and the Isle of Man – also Monaco and Belize. Switzerland tops the Tax Justice Network's 2018 Financial Secrecy Index ranking countries according to 'secrecy and scale of their offshore financial'.

How did tax havens arise?
According to the political economist and historian of tax havens, Ronen Palan, the exploitation of differing tax laws between jurisdictions, for the purpose of paying less tax, is probably as old as taxation itself. In Ancient Greece, for example, sea traders set up schemes to avoid the 2% tariff on imported goods imposed by the city state of Athens by using zero-tariff islands as depositories.

The Channel Islands date their tax independence back to the Norman Conquest. But in its modern usage, the idea of a tax haven dates back to the early 20th century, and in particular the aftermath of World War I, when many European countries ramped up tax rates and neutral Switzerland, followed by Liechtenstein, emerged as low-tax jurisdictions offering cross-border services to wealthy foreigners.

How much wealth do they hold?
Credible estimates in recent years have ranged between $7trn and $32trn. One widely cited academic study from 2017, which is based on data from the Bank for International Settlements, suggests that tax havens hoard wealth equivalent to approximately 10% of global GDP. However, this figure masks big variations.

Russian assets worth 50% of GDP are held offshore, while for countries such as Venezuela, Saudi Arabia and the United Arab Emirates this figure climbs into the 60%-70% range. By contrast, the UK and similar European countries come in at 15%, but Scandinavia at only a few per cent.

Can you outlaw them?
It's hard to outlaw Switzerland. Or, indeed, Delaware. Tax havens are autonomous states and make their own laws, and tax competition is an integral part of the modern globalised economy. It's right that the international community (the EU and International Monetary Fund, for example) has, in recent years, ramped up efforts aimed at encouraging governments to clamp down on (illegal) tax evasion.

But at the same time it's perfectly legitimate (and indeed a mainstay of both UK and Irish policy for decades) for states to seek to attract businesses and wealthy individuals into a country by offering a low-tax environment.

Should tax havens be left alone?
That depends on whether they obey the law. Defenders would argue that plenty of what goes on in tax havens is legitimate, that a globalised economy benefits from offshore centres acting as conduits attracting capital to their larger neighbours (such as the Channel Islands), and that tax havens are typically small countries that would otherwise be poor (such as the Cayman Islands).

In a landmark 2014 study, Global Shell Games, three academics set up anonymous shell companies around the world (or tried to). They found that offshore havens were among the most likely to be fully compliant with international laws requiring people registering new companies to prove their identity.

Jersey, the Isle of Man and the Cayman Islands had compliance rates of 100%, 94% and 100% respectively. The rate in the UK proper, by contrast, was a mere 51%.

If policymakers really want to tackle secrecy and corruption, tax havens might not be the best place to start.

Brexit trade talks begin

The UK and the EU are set for months of tense negotiations, having laid out clashing approaches to their post-Brexit relationship. Talks will cover issues from tariffs to fishing rights and security cooperation. Britain officially left the EU in January, but existing relations will be maintained until the end of the year. Both sides are taking a tough line. The EU insists tariff-free trade is conditional on guarantees that Britain will abide by the bloc's basic regulatory standards.

Boris Johnson says that although he has no desire to reduce standards, he wants Britain to set its own rules and is "prepared to suck up the economic hit of tariffs". He says that Britain will walk away if there isn't a "broad outline" of a deal by June and has embarked on simultaneous trade talks with the US.

The US may be the UK's largest trading partner after the EU, accounting for nearly 19% of all exports and 11% of imports in 2018, but it is dwarfed by the EU, which accounted for 45% of all exports and 53% of imports. According to government figures, a deal with the US would increase UK GDP by a maximum of 0.16% by 2035. The minimum boost would be 0.02%, according to the Department for International Trade.

The figures put things in perspective. And many governments have said they cannot craft a UK trade deal until the nature of London's relationship with the EU is clear.

In terms of a deal with the EU, it is not clear whether the thornier issues can be hashed out in the timescale. Trust is in short supply, in part because Britain has yet to implement the divorce deal which, among other things, requires the UK to carry out checks on goods between the mainland and Northern Ireland. One major potential sticking point aside from fisheries (the EU wants continued access to the UK's richer fishing waters) is financial services, which accounted for 6.9% of GDP in 2018. Brussels says it will only grant continued access to the EU market if the UK stays "in lockstep" on regulations, and knows that this issue of equivalence gives the bloc a useful form of leverage in wider trade talks. Britain is wary of the EU withdrawing access at short notice and Brussels has repeatedly rebuffed requests for assurances on how equivalence will be applied. The bigger picture is that Brussels is well aware that Britain has more to lose from a no-deal exit.

Hard Brexit: Winners and Losers
We don't yet know what Britain's trade deal with the EU will look like once the transitional arrangement runs out at the end of this year. One thing is starting to become clear, however: Boris Johnson's government, with a secure majority in Parliament, will refuse alignment with future EU rules and stick to that position, even if it means that a deal is not possible and we have to

trade under WTO rules instead. Big business groups are not going to be happy about that, but it doesn't make much sense for an economy the size of Britain's to allow its regulations to be set permanently by an organisation it is not a member of. This creates an opportunity for investors.

The losers

The hit will be taken by any major manufacturing business with supply chains that stretch across Europe. The car makers will be in trouble (although a few, such as Nissan, may be able to ramp up sales in the UK to make up for it). Rules of origin, tariffs and quotas will mean that logistics freeze up, just-in-time production systems have to be scrapped and tariffs of up to 10% may be faced in some markets. That is going to hurt. Car manufacturers are going to suffer, both in the UK and in Europe, and so will the parts suppliers and dealers who depend on car sales.

Chemicals and drugs makers might get hit and so might clothes, shoes and textiles manufacturers.

And there may be losers in financial services if passporting rights for the City are lost as a result of failing to reach a deal: it won't make a lot of difference to the banks, but fund managers and insurers may find themselves frozen out of lucrative European markets or forced to open units in Paris or Frankfurt.

The winners

First, and most obviously, technology. Over the last decade the EU has pushed through ever-stricter controls on tech companies. It is still hitting them with a constant round of fines and restrictions – a potential ban on facial recognition, a hugely exciting new technology, is just the latest example. That may protect privacy, to some degree, but it also makes it harder for companies and entrepreneurs to innovate. The UK already has the leading tech hub in Europe. With lighter regulations, UK tech firms can flourish, as can all the venture-capital houses that put money into them.

Next, finance. Whilst some of the big traditional asset managers and insurers may lose out, the EU has also been imposing round after round of rules and regulations on finance. The City has always thrived as a global centre of innovation and excellence. From fintech, to cryptocurrencies, to crowd-funding, to financing emerging markets and new technologies, the smaller, nimbler finance firms will find business a lot easier if we set our own distinct rules from the EU.

Thirdly, retailers. Whilst there may be problems with supply chains, shops will benefit hugely from being able to source the cheapest goods from around the world. We have been so used to EU quotas and tariffs – 16% on oranges, for example, or 8% on coffee, even though both are remarkably hard to grow in the UK - that it will probably come as a surprise to see how much cheaper products can be bought elsewhere. A round of price cuts may tempt people back into the shops again.

Finally, food production and agriculture. The industry has grown used to EU controls, but they never worked for the UK. The food industry has become hooked on subsidies and dominated by controls.

And yet from lab-grown and substitute meats to vertical farms, agriculture is about to go through a technological revolution. The giant agri-businesses of France and Spain will oppose that fiercely, but freed from their lobbying the UK can pioneer those industries – which makes sense for a country that gave up on self-sufficiency decades ago. Farming will look very different with rules set in the UK, but it could also be a lot more profitable.

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