

Here are the five economic stories which have caught our eye this week:



Let the Race Begin!

Tory Leader Tax Pledges



Boris Johnson

Raise the level at which the highest rate of income tax is paid on from £50,000 to £80,000



Dominic Raab

To cut the basic rate of income tax from 20% to 15% and raise the point at which national insurance is paid



Michael Gove

Scrap the 20% VAT rate and replace it with a new sales tax which is lower and simpler to administer

The highly anticipated race to be the next Conservative Party Leader (and our next PM) got officially under way this week. In total, ten candidates decided to throw their hats into the ring with the promise of lavish spending pledges and radical tax proposals to sway the voting electorate (fellow Tory MPs). Three of the frontrunners of the race each put forward a headline-grabbing tax policy with little accompanying detail of how this would be financed.

Boris Johnson's claim to boost borrowing to help raise the income tax higher threshold from £50,000 to £80,000 appeared to sway the most heads. Income tax is a direct tax paid by individuals on the income that they earn. The system charges a different rate for different levels of income. Currently if someone earns £60,000 they will only pay the higher rate of income tax of 40% on any earnings above £50,000. This move means that someone on this level of income would now only pay the basic rate of 20% for earnings above £12,500. The IFS have estimated that this policy would cost £10bn a year and the funding solution of higher borrowing would need to be replaced with other tax increases.

Dominic Raab suggested an alternative income tax proposal by lowering the basic rate of income tax from 20% to 15%. The basic rate is applied to any earnings between £12,501 and £50,000. He suggested a gradual shift in this tax rate by 1 percentage point for each of the next five years to bring it down to 15%. This will provide a tax boost for 26.3m workers and therefore is expected to be incur an annual cost of £5bn a year.

Finally, Michael Gove has suggested that the current sales tax of VAT would be replaced by a new modern sales tax that is lower than 20% and would only be applied when a good is sold to a consumer. Value Added Tax (VAT) is an indirect tax that is passed on from businesses to the customer. This means businesses would free up the administration time taken to reclaim VAT when dealing with businesses rather than customers. However, under this scheme there would need to be a clear distinction between a business and a customer to avoid any evasion issues.

Explain the difference between an indirect and direct tax.

Using a diagram, show how the PED value for a product can affect the relative effects of the imposition of a new sales tax.

Assess the macroeconomic consequences of a cut in income tax to boost disposable incomes.

F1 Budget Cap

Three Dominant F1 Teams

Mercedes, Ferrari and Red Bull each operate a budget of \$400m a year.

Other Seven F1 Teams

McLaren, Renault, Williams, Toro Rosso, Alfa Romeo, Haas and Racing Point operate budgets between \$120m and \$210m a year.



2021 Budget Cap Proposal

\$175m Budget Cap to be set

Additional funding allowed for team amenities

We are currently a third of the way through the 2019 Formula 1 racing calendar with Lewis Hamilton seemingly cruising to his sixth world championship. On the race track, F1 is marvelled for its slick engineering efficiency and for providing some iconic racing imagery in the most exotic locations in the world. However, off the track, the sport has been undergoing significant change as a result of a change in the sport's ownership structure.

New American owners in the form of Liberty Media are trying to instil as much competition between the sport's ten racing teams and ensure that the commercial setup of the sport is secured. The main goal is to ensure that the sport still maintains its global appeal with loyal fans craving for more wheel-to-wheel action. The main area of focus is the growing financial imbalance between some of the sport's teams and the concern that this is creating a two-tiered championship.

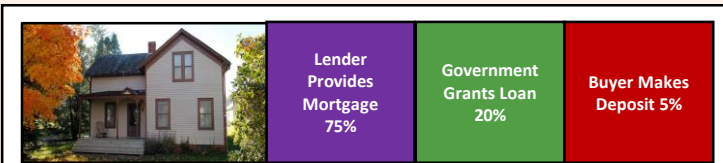
Since 2009, the team of the champion driver has belonged to one of two teams (Mercedes or Red Bull). The more racing success these teams have, the greater their commercial success and the further financial firepower they have for the next season. A rewarding club for the exclusive few that are in the winner's circle, but a demoralising one for the rest. The bodies that oversee the sport have tried to invent some creative ways going forward to bring more competition to the race track.

As you would expect the dominant teams want the status quo to prevail, whilst the emerging constructors want the barriers to entry in the market to deteriorate. The locked-in position for a budget cap, is that from 2021, the team's budgets will be locked in at \$175m. The idea is that once the budget cap has been locked in for all the teams, further technical regulations can be tightened to ensure that the quality of the races improve, whilst maintaining safety standards.

Using a diagram, show the impact that a budget cap is likely to have on the market for motor racing drivers in the sport of F1.

To what extent do you agree with the view that introducing a budget cap into this type of industry will help increase the level of competition between teams involved in the sport?

Help to Buy Scheme



This week a report published by the National Audit Office (NAO) attempted to analyse the impact of the government's Help to Buy Scheme on the UK housing market. The main results of the study were that home ownership in the UK has increased due to a direct increase in first-time buyers getting onto the property ladder. However, the report also looked into the government's exposure to some of the risks embedded within the market.

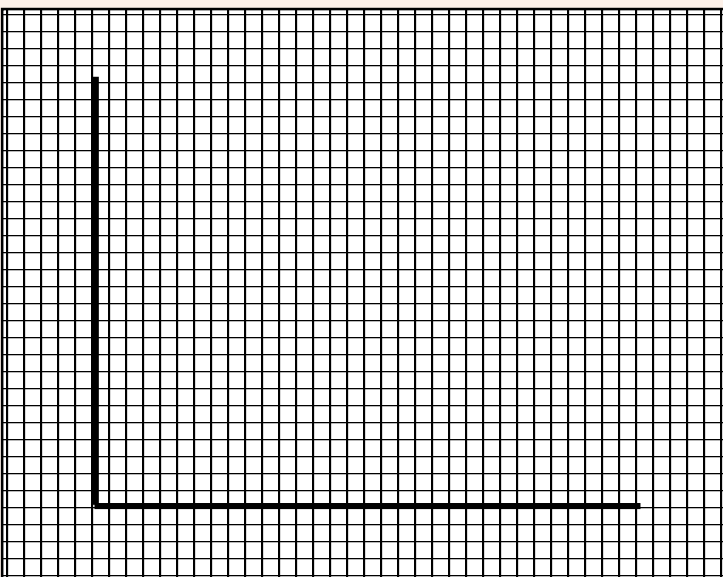
In 2013, the Government launched a scheme called "Help To Buy" which aims to provide financial support to first-time buyers to get on the property ladder in the midst of rising house prices. The government commits to covering up to 20% of the cost of a newly built home via a loan and in return this means that buyers need to fork out 5% of the house value for a cash deposit, with the rest being secured by a mortgage provided by a commercial lender.

How successful has this scheme been? The government claim that almost 500,000 UK homes have been bought under the terms of this scheme and therefore first-time buyers are being fast tracked onto the housing ladder. The scheme has been extended until 2023. The issue for the government will be how it efficiently phases out this scheme without releasing unintended consequences into the UK housing market.

However, despite these positive statistics many believe that this scheme has distorted the housing market. The scheme has essentially subsidised the business models of housebuilding firms such as Persimmon with some warning that it represents the "crack cocaine of the building industry". The argument is that the government scheme has channelled more demand to the homes that Persimmon build and this has pushed up house prices and increased the profit that the firm receives from each house sold.

It is estimated that since the scheme came into fruition in 2013, Persimmon's profit per house sold has tripled. The housebuilding firm has already come under fire with its large pay-outs of £2.2bn to shareholders, as well as the decision to pay the former chief executive a financial package worth £75m.

Using a demand and supply diagram, assess the impact that the Help to Buy Scheme has had on the UK housing market and the affordability of UK homes.



Jobs Boom

UK Labour Market Overview – June 2019



The UK jobs market continues to be the powerful outlier in and amongst a collection of dreary and rather subdued economic data surrounding the UK's macroeconomic performance.

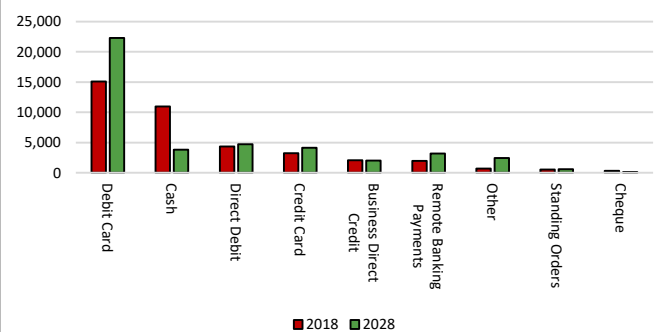
From February to April, the unemployment rate held steady at 3.8% (lowest since 1974), whilst wage growth (average weekly earnings) rose by 3.4% compared to the equivalent measurement period in 2018. This pay growth comes despite the fact that the number of jobs that have been created over the last year came close to 400,000.

A healthy economy is one which continues to create more jobs than it loses as the economy evolves and strategically diversifies. The biggest job increases have been seen across construction and financial services and biggest losses have been in the crumbling retail sector. The ability of an economy to maintain the pace at which jobs are growing is crucial for stability in wages, prices and interest rates.

Using an appropriate diagram, explain why a trade-off exists between price stability and low unemployment.

No More Cash and Carry

Total UK Payment Volumes (millions) – 2018 v 2028 Forecast



This week a report published by the financial body UK Finance, put the recent trends in the payments market under the spotlight. The report showed that rapid technological change has led to significant innovation in UK payment methods.

The surge in the popularity of online and mobile banking has facilitated the uptake in contactless payments for everyday purchases. This enables a rapid, convenient and efficient payments procedure for customers and businesses. This helps explain why debit cards are now a more popular means of payment compared to the old tried and trusted payment method of cash.

The economic relevance of this relates to the future role of cash in society. In 2008, cash was used for 60% of all transactions across the UK and this is expected to fall to just 10% in ten years' time. We might not value cash as much as we used to as a transaction tool but it still plays a valuable role in providing liquidity across society.

Explain the three functions of money in a fiat monetary system.

Discuss the impact that a future economic recession would have on cash use in the UK.