Chartered Institute of Management Accountants (CIMA)

Back to Black - Restoring the Public Finances and boosting resilience Post Pandemic

Comprehensive Spending Review Response

30/09/2021

About CIMA

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Proposals

Increase Resilience in the Public Finances:

1. Outline tax plans for at least the next two years to provide greater clarity.
2. Merge the national insurance, income tax and new health and social care levy tax rates to simplify the tax system.
3. Phase in the equalisation of national insurance tax rates so those of retirement age pay the same rate as younger workers to ensure that the balance of taxation is fair between the generations and to simplify the system.
4. Ask the Office for Budget Responsibility (OBR) to compile a National Register of State Assets and Liabilities and identify public assets where the value could be realised through a sale or used more efficiently.

Increase resilience among the UK citizenry:

5. Ensure any changes to higher rate pension relief and pensions in general do not introduce double taxation or reduce the incentives to save
6. Increase Lifetime ISA limits to produce more flexible retirement options for the UK population.

Increase Resilience among SMEs:

7. Pause planned changes that increase business regulations until the UK economy has recovered fully from the pandemic.
8. Create an SME Investment ISA and expand the range of investible opportunities in UK SMEs to ensure sustainable funding for SME growth.
9. Introduce a Growth Accelerator Scheme for SMEs.

Increase Resilience in the Wider Economy:

10. Support for businesses to diversify their supply chains.
11. HM Treasury to consider introducing legislation to create a strategic national stockpile in partnership with businesses to continue delivery of key goods and services.
12. Invest in skills development and re-training to plug the UK skills gap.

Overview

The Chartered Institute of Management Accountants (CIMA) urges the UK Government to use the budget and the comprehensive spending review to set out a policy platform to encourage private investment and business growth and put the public finances back on a sustainable footing. We believe the policy platform should build up national resilience to:

- Deliver greater certainty for businesses planning investment after the range of tax changes announced in the last year.
- Identify efficiencies in public spending and manage public assets more effectively.
- Encourage personal saving to produce a more resilient population that places fewer demands on the public purse.
- Help small businesses grow and achieve their full potential through investing in skills and training.

We note that the pandemic has clearly taken its toll on the public finances. Interest rates could increase, and this poses significant potential problems in servicing the national debt. There is a need to reassure public markets that there is a plan to reduce the UK's national debt as a proportion of GDP over time.

However, we believe that this pandemic debt should be treated differently to the debt incurred to support everyday spending. In short, the pandemic debt is related to an exceptional and hopefully time limited event like a major war and could be paid down over a 30-50 year period.

In contrast, the challenges of increasing demographic related expenses in healthcare and pensions call for a different response because these spending commitments are ongoing. There is no equivalent to a peace treaty or vaccine to alleviate the costs of an ageing society.

The response to the demographic changes must be less about short-term cuts and more about long-term savings. It involves fundamental questions about the role of the state and taxation policy. We believe that resilience in company supply chains, the public finances and personal finances is vital.

One key message we keep hearing is that businesses need as much certainty as possible as this allows them to have a more stable footing on which to make investment, employment and growth decisions. This is why a long-term plan is needed.

To help policymakers shape good policy on tax we have produced the attached 'Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals.[1]' Below our submission outlines policies drawn from our research to boost economic growth and encourage saving and investment to build resilience in the UK.

[1] tax-policy-concept-statement-no-1-global.pdf (aicpa.org)

How to Build Resilience in the Public Finances, citizenry, SMEs and the wider economy:

1. **Increase Resilience in the Public Finances:**

The UK tax system is very complex and is in need of simplification. The balance of taxation and benefits between the generations is becoming more skewed and arguably in need of some rebalancing. At the same time the percentage of the population that is old will grow as a percentage of the population and place a higher level of demand on pension and health services. Added to this there has been a huge increase in the national debt in recent years.

Simplifying the tax system by merging National Insurance and Income Tax and phasing in people over state pension age in work paying the new combined tax rate will provide a more transparent and fair tax system. It will reduce the cost of administering the system and raise more revenue. It will finance some of the cost pressures that an ageing society imposes and make the tax system broader based and resilient in the years to come.

Lastly, there has been a great focus on levels of tax and spending. However, the state also owns substantial assets. Given the scale of the debt and the concerns around national productivity, it is time to consider whether the state's assets are being efficiently used and whether some of the value can be released to finance public investment or a reduction in the national debt.

Merge the national insurance, income tax and new health and social care levy tax rates to simplify the tax system.

The UK tax system is very long and complex numbering over 17,000 pages compared to the Hong Kong code which is around 300 pages.[2] Former Chancellor George Osborne suggested that National Insurance and Income tax could be merged to simplify the tax system and launched a consultation on this in 2012.[3] The difficulties in coordinating the merger have put previous Governments off but the benefits in terms of a transparent and easier to administer tax system are clear.

There is little reason for National Insurance (NI) to exist as a separate tax. The Office for Tax Simplification backs the merger of NI and Income Tax. It is not hypothecated to fund pensions or the NHS. There is no fund from which state benefits and services are paid despite a popular misconception that there is. The IEA describe a range of broader issues with NI that make the case for reform:

- "National insurance is complicated, with rates and cut-off points which don't match up with income tax rates and bands. It creates discontinuities in effective marginal tax rates which can have a disincentive effect.
- It's costly to administer. In the early days national insurance payers were a distinct group from income taxpayers: prior to WWI there was no overlap. So different

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[2] Our tax system is too complex, and it just punishes honest people | London Evening Standard | Evening Standard

[3] Budget 2011: Income tax and National Insurance could merge - BBC News

systems made sense. Today most workers pay both imposts: net pay and the government's total take is what counts. A unified system would be cheaper to run.
- The system involves employer as well as employee contributions, again a bit of a fiction which confuses employees into thinking that somebody else is paying for their benefits.... In reality its effect is that of any payroll tax: the incidence falls on employees in terms of lower net wages and/or less employment.
- On grounds of transparency, then, merger is sensible. It would create cost savings for employers and [the] government."

As part of the merger process compromises could be made to ease the process for groups that are more impacted. A special relief could be applied to the self-employed who pay lower rates of National Insurance to prevent them being subject to a tax increase. Special arrangements for those who live off savings, those who take seasonal work or work for a limited time and those who have more than one job simultaneously could also be considered.

Contribution based benefits could be fixed to the number of years a specified level of tax contribution is made. This would match the current system where the number of years of National Insurance credits is linked to the right to receive a full state pension. A more general move towards a more contributory based system of welfare would help ensure that the link between contributions and benefits is preserved and enhanced.

Phase in the equalisation of national insurance tax rates so those of retirement age pay the same rate as younger workers to ensure that the balance of taxation is fair between the generations and to simplify the system.

Ending the age limit on paying National Insurance will help with the merger of National Insurance and Income Tax as most people stop paying NI when they reach state pension age. It will help provide greater generational fairness sharing the burden of increased public spending across the generations. The working population have faced tax increases, job losses and declines in their real wages now face the bulk of the burden to pay for the cost of the pandemic. This has particularly impacted those in the 16-24 age group.[4] At the same time pensioners have been more protected from cuts. This is perhaps why organisations such as the Resolution Foundation have recommended that those over 65 pay national insurance.

The UK Government has begun to make changes in this area with the new Health and Social Care Levy to be paid by both pensioners and those below state retirement age. As the UK population ages changes like these will ensure that the millions working past retirement age in future help finance the increasing level of health and pension benefits that will need to be paid. The Office for National Statistics predict that there will be an additional 7.5 million people aged 65 years and over in the UK in 50 years' time.[5] The proportion of over 65's in work currently is just over 10 per cent.[6] Dealing with some of the age discrimination that prevents those over 65 working longer, helping them to retrain and reskill

[4] Employment in the UK - Office for National Statistics (ons.gov.uk)
[5] Overview of the UK population - Office for National Statistics (ons.gov.uk)
[6] Employment in the UK - Office for National Statistics (ons.gov.uk)

and promoting the benefits of work among those aged 65 or over should also be part of the strategy.

The Office for Budget Responsibility to compile a national register of state assets and liabilities

At this time having a firm idea of what the state owns and is pledged to fund would be of great value. Compiling a comprehensive national register of state assets and liabilities will help inform public debate and give MPs an idea of the scale of the debt challenge.

This process may also help to moderate calls for higher spending as MPs and the public develop an appreciation of the size of the UK national debt and the need to reduce it. This should include commitments the UK government has made regarding public sector pensions where they are unfunded.

We believe the OBR would be best placed to lead this task.

2. Increase Citizens Personal Resilience:

The focus on the size of the national debt is important and correct. However, the debt is a product of government spending. The demands placed on public spending are not fixed. In short, a population with a higher savings rate could place fewer demands on the Government as it will require less support. The decline of home ownership among younger generation cohorts means that they will need higher pension and other savings not less as many will continue to have housing costs in the form of rent during retirement. Consequently, they will need to generate a higher income, and this can only be done through their savings.

Pensions, higher rate tax relief and encouraging savings

We recognise that the government supports saving through policies such as pensions auto-enrolment. However, we note with concern the regular media coverage suggesting there are policy proposals to reduce higher rate pension tax relief. We believe it is important to address issues and misconceptions regarding higher rate tax relief:

- Pensions tax relief is not a giveaway — the relief defers taxation; tax is paid when the individual withdraws their pension. Estimates of its 'in year cost' are therefore highly misleading.
- Pension saving helps ensure that individuals do not fall back on the state in retirement, reducing the demands placed on future taxpayers.
- Reducing tax relief now will cut future tax revenues as pension pots will grow less and be smaller in retirement.
- With the decline of defined benefit pensions in the private sector and low employer contribution rates, higher rate tax relief is one of few incentives to invest in a private pension.
- The decline in homeownership means many UK citizens will experience higher housing costs in retirement than previous generations, so higher pension savings are now needed, not lower contributions.

- Cuts to higher-rate pension tax relief would mean that higher rate taxpayers could face double taxation in retirement.
- The proposals will affect millions more UK citizens than the in-year number of higher rate taxpayers suggest because the number of citizens that pay higher rate tax during their lifetime is much higher.
- The proposals would disproportionately affect self-employed workers more than PAYE employees as the former lack access to a company pension.
- A survey by Hargreaves Lansdown has shown that one in four pension savers have stopped or reduced their pension contributions and a further 8% plan to stop paying in or cut their contributions in future — indicating that, looking ahead, around one in three (33%) people may end up stopping or reducing their pension contributions.

If changes to pension tax relief are required to reduce the in-year cost, then a reduction in the annual allowance from its current rate of £40,000 would be less distorting although we do not advocate this policy. This would prevent higher rate taxpayers from facing double taxation with the mooted changes to higher rate tax relief and reduce the in-year cost of the relief.

Increase Lifetime ISA limit

In addition, the government should consider increasing the annual limit for Lifetime ISA contributions substantially from the present £5,000 including government bonus to the present ISA limit of £20,000 including government bonus. This would retain an incentive to save, reduce distortions and allow self-employed workers on basic rate tax greater flexibility to save more for their retirement. The government bonus attached to the scheme would increase from £1,000 to £4,000 matching the percentage bonus offered under the existing scheme for contributions made. LISA savers would be able to save £16,000 and receive a £4,000 Government bonus. Savers would be able to access their LISA savings at age 60+ as currently.

3. Increase SMEs Resilience

SMEs have experienced 18 months of business restrictions and multiple lockdowns, increases in business taxation, changes in consumer behaviour and workplace practices and the need to understand and access complicated Government support schemes. They are in need of a period of greater certainty and stability on tax and regulation and for this reason we would advise that tax policy for the next few years is set out. Changes that add to the regulatory burden on companies should also be paused until a full recovery has taken place. Lastly, the pandemic has left some families with excess savings, and we believe that through creation of an SME Isa they could be directed to fund business growth.

Outline tax plans for the next two years to provide as much certainty as possible from government especially in economically challenging times.

One important way the government could provide this is to outline their tax plans for the next two years for businesses. This would give businesses knowledge of the tax framework they will be operating in for the medium-term and mean they can make better investment decisions.

A 2011 Treasury Select Committee report said: ‘Tax policy is only one of the factors on which businesses and individuals make their decisions, but lack of stability and clarity about the direction of travel in tax policy will, over time, undermine the competitiveness of a tax system and make it impossible for businesses to plan. If tax policy is to support growth, then the direction of travel of tax policy should be clear’.

This shows why tax policy and clarity around it is so important for businesses. In these economically uncertain times, one way the government can create some certainty for business is to be clear on its tax plans for the next few budget cycles.

The government should put on hold plans for changed business regulation until the economic crisis has passed.

The government currently has plans for a whole range of changes to business regulation, from changes to environmental rules to plans to reform how company audits and regulation of business take place.

While we support many of the planned reforms, we think that during the economic crisis it would be best for these to be paused to allow time for businesses to recover. Businesses need to focus on changing their models to cope with the reality of their changed operating environment and on how they can start to recover and build and grow again. By adding regulatory change on top of this during this already difficult time for businesses, the government will be forcing businesses to put resources elsewhere when they should be solely focussed on recovery.

A pause on additional business regulation plans will support businesses to recover, support jobs and mean Britain is on the pathway to economic recovery sooner.

The recent Centre for Policy Studies report titled, After the Virus: A Plan for Restoring Growth, called for ‘A moratorium on all new non-urgent regulation on business, and a cross-government review of which regulatory measures could be delayed or waived’. We would support such a policy.

Introduce a Growth Accelerator Scheme for SMEs.

The previous Growth Accelerator scheme aimed to accelerate the growth of promising start-ups and small businesses in England. The programme aimed to support businesses as they scaled up, offering them access to mentoring, coaching, financial guidance, and expert professional advice. The then Department for Business, Innovation and Skills’ (now BEIS) own research at the time showed that the scheme had a significant return on investment.

The government’s own analysis at the time showed this scheme added an economic benefit of at least £1 billion, with the unquantifiable benefit likely to be substantially higher. The scheme had a return on investment of at least 700%. As mentioned above many SMEs have a real need for professional support to be able to not only survive but also in some cases thrive over the next six months to a year. A scheme such as this proposed would help them

be able to access this support and deliver real value for both them as an SME, but also the wider economy.

Create an SME Investment ISA

Many SMEs require access to finance to continue their operations and make necessary adjustments to their offering to adapt to the new ways of doing business. The UK population saved record amounts during lockdown. Between April and June in 2020 the ONS revealed that the household savings ratio increased to 29.1% compared to under 10% in the prior decade. Since lockdown restrictions were imposed in March average savings rates have declined for each of the five months until August 2020. Increased savings are being invested in cash accounts rather than invested in the economy. Matching the increased savings with productive investment opportunities will help UK savers, UK businesses and the overall economy.
The government should consider policies that will achieve the following:

- Simplifies the existing complex government support schemes to encourage UK SME investment.
- Easy to brand and can generate investor interest and matches familiar existing financial products that people understand.
- The new product will provide a government-financed financial incentive to invest.
- That incentive will be spread over several years so that it encourages long-term patient capital. We believe the answer could be a new SME ISA.

It could work like this:

- The SME ISA would allow people to invest up to £10,000 a year.
- A government-funded bonus would be paid at a rate of 30% of the original investment.
- The bonus could be paid in instalments over a three-year period at 10% per year on the anniversary of the original investment to encourage long-term investment
- The SME ISA could be in addition to the existing £20,000 ISA allowance.

The SME ISA could be invested in:

- UK SMEs directly where they are listed on the AIM market.
- A new employee share ownership scheme to add to the existing schemes.
- Tracker funds that encompass a basket of securities provided they qualify as UK SMEs.

4. Increase resilience in the wider economy:

With recent world shortages impacting energy markets and potentially threatening supply the case for a national strategy to diversify supply chains and provide a strategic national stockpile of key items has been strengthened and is compelling. More needs to be done to fill domestic skills gaps, encouraging skills development among the UK population is more important than ever.

Support for businesses to diversify their supply chains.

The government should review what incentives it can create to support businesses to diversify their supply chains. Businesses' supply chains should include a range of either domestic or foreign suppliers — rather than only one foreign country or company supplying goods — to ensure there is resilience in their supply chain.

The Department for Business, Energy and Industrial Strategy should look at how it can educate and provide information to companies of all sizes on what good supply chain resilience looks like. Studies have shown that supply chains are a business activity that can generate 90% of overall business costs.

A blog by American Express has shown the importance of having multiple suppliers making up part of an organisation's supply chain and how it can help make supply chains more resilient.

Supply chain diversity can add value to businesses. A study by the Hackett Group showed that supply chain diversity can generate a 133% greater return on the cost of procurement and that companies could add $3.6 million to their bottom lines for every $1 million in procurement operations costs with supplier diversity programmes.

Supply chains internationally, regionally, and locally have been interrupted and affected as a result of this crisis with the effects of lockdown disrupting supply chains and countries holding back stock to keep it for domestic use.

This can most acutely be seen with the issue of personal protective equipment where mass orders across the globe were put in for these products and we could see nations in some instances holding back supplies for their own healthcare systems during the early stages of the pandemic.

Yet it can also be seen with less obvious items such as flour where there has been a huge increase in demand from household customers during the lockdowns. This is due to customers being indoors with limited activities to undertake, and the food retail shops did not have enough flour in smaller bags for the demand. This is in part due to the fact a lot of flour in the supply system was in bigger bags for commercial bakeries and restaurants which were unable to use them as they were closed.

Disruptive events can come in all shapes and sizes. In recent years there have been global pandemics, cyber-attacks, floods, and ash clouds to name a few. Every disruption is a test of risk management processes and resilience in supply chains not only for countries but also for businesses big and small.

An increase in spending on SMEs in government supply chains was recognised as important by the Coalition government when it set a 25% target for central government spending on procurement to be with SMEs. The government should look to have a new target for spending on SMEs by government procurement to help diversify government supply chains and investment in the UK SME community.

If the government were to support businesses to diversify their supply chains, not only could it add value to the bottom line of UK companies, but also help the UK business community manage future economic shocks in whatever guise they come.

One quick action the government could do in this space is to ask the Financial Reporting Council to require better corporate reporting of supply chain risks and diversification in UK companies.

HM Treasury to consider introducing legislation to create a strategic national stockpile in partnership with businesses to continue delivery of key goods and services.

In the US there are considerations underway to introduce Strategic National Stockpile legislation. This legislation would incentivise commercial enterprises, both public and private companies, to produce products and goods in quantities that exceed the company's normal annual level of sales. The production in excess of the level of sales results in excess inventory designated by the legislation. Governmental agencies could then draw upon the excess inventory held by the companies at any time of need at prices agreed in advance by contract.

The UK government should consider introducing similar legislation to help secure its supply chain for products and goods of strategic importance in future. This policy would only need to be linked to the most strategically important products and goods, such as oil, PPE, medical equipment, defence equipment and products from similar sectors. It does not need to be for every single product or goods — we are not advocating a planned economy

Invest in skills development and re-training to plug the UK skills gap.

As Nobel Prize winner Paul Krugman has stated, 'Productivity isn't everything, but in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker'. An article by the Institute for Fiscal Studies in 2017 highlighted the importance of productivity to wage growth and wider public finances by saying, 'Slower productivity growth means, on average, slower wage growth, which in turn depresses government revenues'. This shows how important tackling the UK's sluggish productivity growth is not only to the individual companies, but also to increase real wage growth, support economic growth and public finances.

Reasons suggested for the UK's recent poor performance include low levels of investment and R&D spending and a long tail of companies and workers with low skill levels. A 2018 report by McKinsey Global Institute on the UK's productivity puzzle showed that the UK's productivity growth slowdown post the 2008 financial crash was more comprehensive than that of France, Germany, and Spain and occurred across all regions and 83% of sectors in the UK economy. This report also highlighted how an investment in skills for current and future workforces, adoption of digital practices and investment in areas such as R&D can help boost productivity.

The virus will have had a negative effect on the productivity of some workers as their skills become obsolete or decline while they are on limited hours and for those that experience

unemployment. This will also have an effect on companies' productivity and therefore the UK's national productivity. The decline in the availability of some low skill roles in the retail and restaurant sector saw businesses collapse and companies shed jobs which may have reduced the long tail of less productive firms.

As weaker firms fold, it provides an opportunity for capital and labour to transfer to the more productive firms. The challenge is to ensure that low skill workers do not become unemployed or underemployed. If this occurs, they will not be developing their skills and increasing their productivity. The President of the Confederation of British Industry (CBI) has highlighted the need to improve productivity saying that 'now was the ideal time to invest in infrastructure, R&D and skills to boost productivity'. As furlough ends today (30th September 2021) the economic impact of the end of the scheme is uncertain, it is possible that the level of unemployment will increase.

There is an opportunity as the UK comes out of this crisis and rebuilds for the government to put a renewed emphasis on tackling structural problems in the UK economy in order to support growth-enhancing productivity in support of providing real wage growth and the levelling up agenda should be a number one priority. Skills development and investment in both apprenticeships and lifelong learning are key and we would suggest the UK Government explore the following to support the uptake of skills training:

- Maintain spending on higher-level apprenticeships and simplify the apprenticeships system to improve access to the accountancy profession and other such services.
- Create a rebuttable right to retrain so employers are empowered to discuss skills and training with their employer to boost the numbers improving their skills.
- Create and invest in skills clusters across the UK to build up industries and areas of competitive advantage to spread growth around the country.

<u>Contact</u>

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