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IoD Autumn Budget Submission 2024

Ahead of the Autumn Budget, we are writing to summarise the policy changes that would, according to our evidence, have the greatest positive impact on the rate of sustainable economic growth in the UK.

About the Institute of Directors

The Institute of Directors is an independent, non-party political organisation representing approximately 20,000 company directors, senior business leaders, and entrepreneurs. We represent businesses of all sizes and across all industries, regions and nations of the UK.

The average IoD member's organisation has a turnover of around £15m and employs around 75 people. Over half are based outside London and the South East. Around 44% identify as being in one of the government's five 'priority sectors'; the remainder are most likely to be technical, professional or other parts of the service sector. The IoD has a role under our Royal Charter among other things to 'promote a climate of entrepreneurship'.

Economic and fiscal context

The UK has enjoyed the highest rate of economic growth in the G7 in 2024H1. But this disguises the UK's relatively poor economic performance. There have undoubtedly been common drivers across advanced economies which have led to a relatively universal slowdown in productivity growth, including heightened risk aversion post-financial crisis. But the UK has both suffered from common drivers apparently more severely and has had additional domestically generated shocks as well.

Against a challenging economic backdrop, UK public spending and taxation are respectively at post-war highs as a percentage of GDP. Unfortunately, we have reached a situation in which a lack of transparency regarding the feasibility with which public sector budgets can deliver against policy commitments has built to a worrying degree. There has been understandably much focus on the necessity to balance the books. But there is a risk that short-term budget balancing takes place at the cost of future growth prospects.

The most important priority for the UK and for this Budget is to deliver a clear message and framework for increasing the UK's potential growth. This is the key to delivering a higher standard of living for all. The key components of this are an updated fiscal strategy, a business tax roadmap, and labour market reforms, all of which need to have strong government commitment to deliver meaningful longevity.

Key proposals

Our key recommendations for the Autumn Budget are:

1. **Fiscal rules that protect investment spending**
2. **A business tax roadmap that supports business confidence and planning**
3. **Improving the UK's labour market to address skill and labour shortages**
4. **Addressing the UK's trade performance**
5. **Supporting SMEs in the transition to net zero**

1. Fiscal rules that protect investment spending

Fiscal rules are an important mechanism by which governments commit themselves to responsible management of the public finances.[i] Their intention is to overcome the implicit incentive for elected governments to spend beyond their means in the short-term to secure stronger growth, leaving future generations and administrations to deal with the consequences.

Although the UK has adopted fiscal rules, and created the Office for Budget Responsibility to ensure independence in public finance assessment, further changes are needed to ensure that the UK's fiscal framework delivers discipline, confidence and growth. The frequency with which the rules have changed in recent years has undermined their role in delivering confidence, clarity and stability.

An IfG assessment of their discussions with financial market participants concludes that what matters is "… a credible set of fiscal plans that support the achievement of fiscal sustainability"[ii]. Credible fiscal rules are an important component of that, but need not be framed with the same specificity as equivalent targets for monetary policy in order to demonstrate that they contribute to public finance sustainability. This will enable the government to set out its overall intentions regarding its management of the public finances, setting the context for fiscal rules and other mechanisms by which they can be held to account for delivering public finance sustainability.

In the further design of fiscal rules, it is vital that the role of the public sector in funding major infrastructure investments is recognised and protected. The OBR has recently estimated that increasing public sector investment by 1% of GDP leads to a long-term increase in potential output of 2.5% of GDP.[iii] In the IoD's August Policy Voice survey [publication forthcoming], members indicated that they were largely comfortable with the notion of the government borrowing to fund infrastructure investment (65% of survey respondents were in favour, with 29% opposed). A number of organisations have undertaken analysis which finds in favour of borrowing to fund investment being considered separately in the UK's fiscal rules, including the Institute for Fiscal Studies, Institute for Government and the National Institute for Economic and Social Research. The greatest payoffs from public sector investment will tend to occur outside the five year forecast horizon for which the OBR produces detailed forecasts. It is important that a move to accommodate borrowing to fund investment spending is accompanied by forecasts from the OBR which demonstrate the impact on potential growth.

We welcome the update to the Charter for Budget Responsibility which specifies the definition of "fiscal significance" where it pertains to government announcements of fiscal policy and requires the OBR in such circumstances to notify the Treasury Committee and prepare a report. This is a helpful move to reinforce the transparency of the public finances and to protect the independence of the OBR.

The important priorities for the UK to address in reforms to its fiscal framework are:

- Set out a fiscal strategy which enshrines the principles through which the government will manage the public finances, providing the necessary reassurance to financial markets.
- Update the fiscal rules to include a balanced current budget target and otherwise allow for government borrowing where it is demonstrably to fund public sector infrastructure investment, subject to an overarching public finance sustainability objective.
- Require the OBR to prepare longer term forecasts which enable them to better capture the payoffs from infrastructure investment and consider incorporating other forms of spending which deliver benefits over a longer term horizon.
- Make it more difficult for the fiscal rules to be changed in order to inject greater confidence in their stability.
- Commit to a fixed programme of spending reviews, thus separating their timing from political considerations.

2. <u>A business tax roadmap that supports business confidence and planning</u>

We welcome the Chancellor's commitment to deliver a business tax roadmap in this Budget. This will be an important component of the government's overall fiscal strategy, in combination with fiscal rules and an updated approach to confirming government spending plans.

Against a backdrop of clustered global and domestic shocks, and increasing global unrest, it is more important than ever that the policy environment in which businesses operate is as stable and predictable as possible. In supplementary feedback to the IoD's August Policy Voice survey, IoD members expressed concern regarding media coverage of potential changes to CGT, pensions relief and inheritance tax. It has led some to pause some of their investment and hiring plans, and others to reconsider the UK as a location for their business. A well-designed and clearly communicated business tax roadmap will go some way to enhancing the perceived stability of the UK policy system.

In our July Policy Voice survey[iv], the biggest blocker to growth and investment identified by IoD members was policy uncertainty, cited by 53% of respondents. Steps to improve the stability and predictability of the tax system will be a welcome move in enhancing overall policy predictability.

The complexity of the UK's tax system is considered by many to be a barrier to the efficient collection of tax. The UK has the longest tax code in the world. HMRC estimates that "error and carelessness" account for 45% of the tax gap in 2024-25. And the Chartered Institute of Taxation judges that this is due to the complexity in the system as well as a deterioration in the quality of service provided by HMRC[v], which is reflected in the increase in the amount of time people are being placed on hold when making calls. A simpler and better supported system would help close the tax gap as well as free up business time for more productive endeavours.

As we said in our Manifesto for Business[vi], around two-thirds of SMEs who currently have no plan to achieve net zero say they would either be 'much more likely' (32%) or 'a bit more likely' (32%) to pursue decarbonisation plans if they were incentivised by a lower corporation tax bill[vii]. It is important for the tax system to support the transition to net zero – a point made in the CBI's business tax roadmap[viii].

The business tax roadmap should contain:

- A statement of principles which clarifies the government's approach to taxation over the parliament and beyond. These principles should include a commitment to simplifying the tax system.
- A plan to extend full expensing to leased assets and an expansion of asset classes.
- A plan for the implementation of business rates reform.
- Reference to the important role of HMRC in supporting the delivery of the business tax roadmap and targets for improving its performance.
- A plan for the continued digitalisation of the tax system which is focussed on reducing the administrative burden on business.
- Measures that support the transition to net zero: introduce a lower corporation tax rate for organisations that have achieved net zero.

3. Improving the UK's labour market to address skill and labour shortages

The UK labour market has struggled to recover since the pandemic, in contrast with comparable economies. According to the ONS[ix], the level of employment has only recently returned to its pre-pandemic level but, given that the population has continued to grow since the pandemic, this still yields an employment rate which remains 1.7 percentage points lower than pre-pandemic. As has been extensively discussed, this is driven by an increase in the inactivity rate in the UK, itself driven by an increase in the proportion of those of working age out of the labour market due to long-term sickness. The consequence of a lack of available workers has been an elevated number of vacancies, which are still 8% above pre-pandemic levels.

Worker shortages and their impact have been extensively reported by business. In the IoD's August Policy Voice survey, skill and/or labour shortages were cited by 43% of companies as having a negative impact on their organisation – the second highest issue for businesses, after UK economic conditions[x]. According to the ONS's business insights survey[xi], of those businesses that had difficulties recruiting employees, 40% cited a lack of qualified applicants for the role on offer. For those companies experiencing a shortage of workers, the most likely impact was an increase in working hours for existing employees.

The plan to use insights from Skills England to build a list of training programmes on which Skills and Growth Levy funds can be used is a positive move, and a critical step to ensuring that Levy paying organisations can invest in developing the skills they need. However, at present there is a gap in the plans when it comes to SMEs. While the commitment to retaining existing government support for apprenticeship training and assessment costs for non-Levy payers is welcome, the establishment of Skills England represents an opportunity to support SMEs to invest in all types of training which will meet skills shortages.

Forthcoming changes to workers' rights represent a significant intervention in the UK labour market. Research cited by the TUC[xii] notes the potential for these to support productivity and employment in the longer term, but likewise note the existence of negative impacts in the short-term through the imposition of costs on business. In a poll of over 700 business leaders in August 2024[xiii], 57% said that the government's planned employment rights reforms would make them less likely to hire. Of those, 40% said that protections for a six-month probationary period within the current legal framework would partially alleviate any impacts on their recruitment plans, while a further 6% said it would fully alleviate any impacts. The calibration of these reforms, so as to maximise their longer term benefits and minimise negative impacts on business and the economy, is crucial. We look forward to meaningful engagement with the government on the detailed design of these policies to ensure they deliver the desired outcomes.

There are a mix of labour market interventions which will help improve the availability of workers in the UK. The activity rate of women continues to lag that of men: actions to equalise male and female activity rates would add 2 million to the labour market. Alternatively, returning the rate of long-term sickness to pre-Covid levels would likewise add 2 million to the labour market.

To enhance the performance of the UK labour market:

- Transition Skills England to an independent, technocratic body with a clear remit to advise on current and expected future skills shortages in England.
- Insights from Skills England should be used to design interventions – whether direct subsidies or tax incentives – to support SMEs with the cost of investing in training which targets verified areas of skills shortages.
- Strengthen the statutory code on dismissal and re-engagement to ensure that the practice is only used in circumstances where an organisation faces a serious and credible risk to its viability. IoD research in April 2024[xiv] found that 61% of business leaders believe that 'fire and rehire' should be banned.
- Ensure that employers remain able to use zero hours contracts where they cannot guarantee a minimum number of hours of work due to fluctuating demand. IoD research in March 2024[xv] found that 80% of business leaders believe that zero hours contracts play an important role in the economy.
- Support employers and employees to develop bespoke workplace policies on the right to switch off. While our research[xvi] found that 58% of business leaders believe that employers should not be barred from contacting employees outside of working hours, a code of practice which makes it clear that employees should not be disciplined for not routinely responding to contact outside of working hours would be reasonable.
- Commit to retaining probationary periods in their current form to reduce the risk to employers, particularly SMEs, of taking on new staff.
- Reintroduce a rebate scheme, targeted at SMEs, to mitigate the impact of any SSP reform on the businesses least likely to be able to shoulder the additional cost.
- Focus on measures to prevent miscategorisation of employees under the existing employment status framework, rather than on reducing flexibility by merging employee and worker statuses.
- Introduce mandatory disability and ethnicity pay gap reporting for organisations with more than 250 employees. McKinsey research found that organisations in the top quartile for ethnic and cultural diversity were 36% more profitable than those in the bottom quartile[xvii].
- Expand the range of occupational health services that are exempt from being taxed as a Benefit in Kind, to incentivise businesses to increase their overall investment into occupational health. IoD research in August 2023[xviii] found that such an approach was the policy most likely to encourage employers to increase their investment in occupational health. Research by the CBI finds that making Employee Assistance Programmes tax free would generate £10 for the economy for every £1 cost to the Exchequer[xix].

- Ensure that the ongoing rollout of expanded free childcare provision is properly funded to support effective delivery against commitments.

4. Addressing the UK's trade performance

Trade with the rest of the world represents a massive business opportunity for the UK, but Britain's export performance has lagged that of comparable countries in recent years. Confidence in exporting has fallen due to a combination of new customs barriers, loss of markets linked to Brexit, the uncertain global economic environment and heightened geopolitical risk. In our June Policy Voice survey[xx], the UK's trade relationship with the EU was identified as the top priority for the new government in its first 100 days by IoD members.

The following would support an improvement in the UK's export performance:

- Prioritise improving the quality and depth of the UK's trading relationship with the EU.
- Establish a revamped exporting strategy, within the context of an overarching Industrial Strategy, which provides a viable roadmap towards an improved UK export performance. This should define meaningful export targets for the UK, along with associated policies underpinning the achievement of those targets. The current target of £1 trillion exports in current prices by 2030 is not sufficiently ambitious, especially when inflation is taken into account. In addition, a target should be established for the proportion of UK businesses that are exporters. A reasonable objective is for 15% of all UK businesses to be exporting either goods or services by 2030. The export strategy should also develop a more ambitious roadmap to enhance the exporting of services, not just goods.
- Reopen an equivalent to the Internationalisation Fund to provide grants to SMEs and first-time exporters. These could be used for travelling to new markets, attending trade shows, using translation services and employing consulting services. Funding options for exporters are limited, especially as a first-time exporter. The Internationalisation Fund, which offered finance for SMEs looking to expand into new markets, was discontinued in January 2023. Meanwhile UK Export Finance, which provides government backed insurance and guarantees for UK exports, is primarily aimed at more experienced exporters. Therefore, a fund targeted at SMEs and first-time exporters could act as a springboard for those constricted by lack of resource and experience to overcome some of the initial market access barriers.
- Implement the recommendations of the Social Market Foundation from its report "Small business, big world"[xxi].

5. Supporting SMEs in the transition to net zero

There is an urgent need for the UK to have a stable, credible, long-term strategy for enabling the transition to net zero. The Climate Change Committee (CCC) assesses that only a third of the emissions reductions required to achieve the 2030 Nationally Determined Contribution (NDC) to the Paris Agreement are currently covered by credible plans[xxii]. As well as there being a disconnect between climate targets and delivery strategy, there is an absence of clarity and support for firms in transitioning to net zero.

- There is an increasing risk of SMEs, though outside the scope of carbon emissions disclosure policy, being overwhelmed by differing reporting requirements being passed down supply chains. IoD research in October 2023[xxiii] found that 28% of businesses have been asked about their carbon footprint data by a customer, up from 22% in December 2022. Government should therefore develop a clear policy roadmap for emissions disclosure policy which includes SMEs and ensures that they are equipped and supported to meet the demands placed on them.

- Launch a 'Help to Green' campaign, as proposed by the Independent Review of Net Zero (the Skidmore Review). This should include information resources and vouchers for SMEs to plan and invest in the net zero transition. IoD research in November 2021 found that 37% of businesses cited upfront or ongoing costs as a barrier to achieving net zero, while 25% cited lack of knowledge about how to make progress.

We hope that this is helpful.

Your sincerely,

Jonathan Geldart
Director General

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