Autumn Budget 2021 and Spending Review 2021 submission

The Institute of Directors welcomes the opportunity to input into the Spending Review 2021 and Autumn 2021 Budget and supports the government's commitment that an aim of this spending review should be to 'continue to support businesses and jobs'.[1]

The Institute of Directors was founded in 1903 and granted a Royal Charter in 1906. That Charter sets out our objectives *to represent the interests of members and of the business community to government …. and to encourage and foster a climate favourable to entrepreneurial activity and wealth creation.*[2]

Our organisation is unique in that our members are individual board directors rather than companies. We currently have around 20,000 members running businesses across the length and breadth of the country. The majority of members, some 70%, comprise directors of small and medium-sized enterprises (SMEs), ranging from long-established businesses to start-up companies. We have a strong geographic branch structure in the regions and nations of the UK and 85% of our members are based outside London.

We survey our members each month and the recommendations in this submission are driven by the insight that is obtained from that research.

The macroeconomic context

Our starting point is the macroeconomic environment in Q3 2021. It seems likely that the UK economy will return to its pre-pandemic size sooner than was expected at the time of the March 2021 Budget; we expect the Office of Budget Responsibility to revise its GDP growth forecasts for 2021 upwards. As a result, tax receipts are stronger than were expected at the time of the last Budget, and the stock of government debt is lower.[3] Consequently, the government will have more room for manoeuvre than previously expected, without jeopardising the essential need for overall levels of government debt as a proportion of GDP to be on a downward trajectory in the medium term.

In the March 2021 Budget, the projected stabilisation of government debt levels was primarily achieved through a decision to raise corporation tax from 2023, described at the time by the Institute of Fiscal Studies as "the biggest tax raising budget since 1993".[4] Since then, the announcement of a new Health and Social Care Levy further raises taxation on business through an increase in employer's national insurance contributions.

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[1] Spending Review 2021 launch letter - GOV.UK (www.gov.uk)
[2] https://www.iod.com/Portals/0/Badges/PDF's/About%20us/Our%20royal%20charter.pdf?ver=2016-05-12-141548-020
[3] Commentary on the Public Sector Finances July 2021 release (obr.uk)
[4] Budget 2021 - Institute For Fiscal Studies - IFS

Our central contention is that, with rates of economic growth now coming in higher than expected when either of these decisions were made, the justification for raising business taxation to this extent no longer holds.

Recommendation 1: The government should reduce the planned level of business tax rises now that the economic outlook is more positive than was expected at the time of the last Budget.

As the economic environment has improved over the course of 2021, our members have expressed a level of optimism about future prospects both for their businesses and for the economy in general.

In our most recent survey of members, conducted before the announcement of the rise in national insurance, 58% said that they were optimistic about their organisation over the next 12 months (27% pessimistic) and 48% were optimistic about the UK economy over the next 12 months (12% pessimistic).[5]

However, these positive levels of confidence were not sufficient to trigger large-scale private sector investment that the economy will need to continue growth as government support measures are phased out.

While 62% of our members said they expected their revenues to be higher in the next 12 months than in the last 12 months, a much higher proportion – 80% – said they expected their costs to be higher. Overall, only 40% intended to raise business investment at all (33% said business investment would be 'a little higher', 7% 'a lot higher'). This is not only a concern for levels of demand in the macroeconomy, but also for our ability to raise the rate of productivity growth in the future.[6]

In particular, the recent announcement of the 1.25% increase in employer's national insurance contributions, outside of a Budget and implemented without a Finance Bill, adds to the sense of insecurity and political risk felt by the private sector; the very fact that decisions can be made in this way of itself creates an uncertain operating environment for businesses in Britain, that of itself reduces the incentive to invest. Initial indications are that the vast majority of our members oppose the move.[7]

The concurrent rise in dividend taxation further undermines sole traders working through their own limited companies, already disheartened by being the only group to receive no support during the pandemic.

It seems indisputable that the economic effect of the rise in employer's national insurance contributions will be negative: for the macroeconomy, for employment and for the ability of individual businesses to operate at a time when staff shortages are already problematic. In fact, the impact assessment by HMRC states that the measure is anticipated to have:

[5] Policy Voice, July 2021 (updated 12 August 2021). Participants were asked 'How optimistic are you about both the wider UK economy and your organisation over the next 12 months'? n=739
[6] Policy Voice, July 2021 (updated 12 August 2021). Participants were asked 'Comparing the next 12 months with the last 12 months what do you believe the outlook will be in terms of: revenue/costs/business investment?' n=739
[7] Policy Voice, September 2021 (forthcoming)

significant macroeconomic impact, with consequences including but not limited to for earnings, inflation and company profits. Behavioural effects are likely to be large, and these will include decisions around whether to incorporate or not, and business decisions around wage bills and recruitment…This measure is expected to have a significant impact on over 1.6 million employers who will be required to introduce this change.[8]

We agree with this analysis. When we asked our SME members earlier this year what measures government could put in place to *support* their growth, around half our members cited support for employment costs such as NICs relief. It follows that undertaking the opposite will hamper business growth.[9]

We were surprised that there does not appear to be either a quantification of these effects, or an exchequer costing in the government's own impact assessment.

Instead, the intention appears to have been to rely on the OBR assessment at the Autumn Budget, which is after the legislation is expected to have been passed under the fast-track procedure with no pre- or post- legislative scrutiny.[10]

We conclude that Parliament is being asked to agree legislation with significantly negative economic and business impacts without having the evidence before them of the extent of that impact.

We feel that the way this decision has been made and implemented falls short of good government practice and, specifically, goes against the spirit of the commitment made by the Chancellor in his Spending Review letter to other government departments that "The outcomes and real-world impacts of our spending must be at the heart of decisions, underpinned by the best data and evaluation".[11]

We therefore make the following recommendations:

Recommendation 2: The Treasury should conduct, and publish before the March 2022 budget, its own macroeconomic assessment of the proposed rise in employer's national insurance including but not limited to the effect on GDP, private sector investment and employment, on a national, sectoral, regional and demographic basis.

Recommendation 3: The Chancellor should commit to take account of the results of this assessment before the end of the 2022-23 transition period to the new levy system.

Measures to support business investment

When asked which initiatives would be most helpful in financing their growth initiatives, as mentioned above the most popular answer amongst SME leaders was cutting

8 Health and Social Care Levy - GOV.UK (www.gov.uk)
9 IoD: Government Needs a Plan to Stimulate Enterprise Post-Pandemic | Institute of Directors | IoD
10 Health and Social Care Levy (parliament.uk)
11 Spending Review 2021 launch letter - GOV.UK (www.gov.uk)

employment costs. However, as the table below shows, this was followed by incentives to invest in R&D and digital technologies.

Which of the following initiatives do you think would be most helpful in financing your growth ambitions?	
Cutting employment costs (e.g.reducing employers' NICs)	47%
Greater R&D grants/incentives	35%
Digital/technology investment incentives	34%
Access to low-cost loans	31%
More generous investor incentive schemes (e.g.via EIS, SEIS)	24%
Improved access to angels, business incubators etc.	13%
Government investment schemes in return for equity	9%
Lowering the cost of raising equity via IPO	4%

578 SME respondents. Survey onducted between 2nd-21st June 2021. [12]

To help spur business investment, we therefore ask government to:

- Commit to extend the 130% investment super-deduction beyond March 2023 to give companies the confidence to engage in longer-term investment planning.

- Expand the scope of R&D tax credit system to give greater weight to digital innovation, new applications of cloud computing and innovation of all kinds that will reduce carbon emissions.

- Inject significant capital into the dedicated regional funds managed by the British Business Bank, now that European Commission structural funding is no longer available.

- Double the maximum investment a new company can receive through the Seed Enterprise Investment Scheme from £150,000 to £300,000

- Consult on expanding the definition of qualifying activity on tax relief for investments in venture capital schemes to include professional services, hospitality and low-carbon energy.

- Introduce a more generous company tax incentive for the specific purpose of upskilling on certified professional development courses, including for board directors.

[12] IoD: Government Needs a Plan to Stimulate Enterprise Post-Pandemic | Institute of Directors | IoD

Measures to improve business access to skills

The economic shock of the pandemic combined with Britain's decision to leave the European Union has caused structural changes in the labour market that require a policy response.

In the short term, our members are reporting significant labour shortages. In July-August 44% of all our members said they were experiencing staff shortages.[13] These difficulties are occurring across the board, both in sectors that have historically relied on seasonal and migrant workers and in the higher-wage parts of the economy such as legal and professional services. In our June survey of close to 600 SME business leaders, 40% said difficulties finding the right talent was the biggest challenge their organisation faced in scaling-up.[14]

Importantly, around two-thirds (65%) of directors that are reporting labour shortages in their organisations say that this is because of 'long term skills shortages in required area' as compared to around one in four (38%) who say staff shortages are because 'there is a lack of potential employees from the EU' and around a fifth (21%) saying that it is due to the 'unwillingness of furloughed or inactive workers to return to the workforce'.[15]

This suggests that while the effect of the pandemic and Britain's decision to leave the European Union are important contributory factors, they are only compounding underlying issues that have always been present.

Our view is that while individual schemes designed to address particular sections of the market at this time are important, the highest priority is to design economy-wide systems for lifelong learning that will ensure a better match between demand for, and supply of, the skills that businesses need.

In particular, at this time, we are interested in the potential for businesses to use the new technologies to access new groups of workers who were previously self-excluding themselves for reasons of geography or mobility. The challenge now is to support these and all individuals to retrain or upskill in a way that addresses the very real labour shortages felt by businesses.

To this end, we recommend a **Five-Point plan for Skills:**

1. Increase the resourcing and mandate of Sector Skills Councils to ensure high-quality industry-specific accredited and modularised training and progression paths are available at every level of every type of work, online and in person.

2. Reintroduce lifelong personalised training budgets to be used on such accredited vocational and professional training to ensure nobody is prevented from obtaining high-

[13] Policy Voice, July 2021 (updated 12 August 2021). Participants were asked 'Thinking about your primary organisation, are you currently experiencing staff shortages?' n=739

[14] IoD: Government Needs a Plan to Stimulate Enterprise Post-Pandemic | Institute of Directors | IoD

[15] [15] Policy Voice, July 2021 (updated 12 August 2021). Participants who had indicated they were experiencing staff shortages were asked 'Why do you think you are currently experiencing staff shortages?' n=320

quality industry-specific skills they need to progress, regardless of their age, seniority or employment status.

3. Widen the uses to which firms deploy their apprenticeship levy funding pots to fill skills gaps at all levels within the organisation.

4. Introduce tax allowances for sole traders and the self-employed to incentivise investment in accredited professional and vocational training. Crucially this should include vocational/professional upskilling and reskilling as opposed to the refresher and CPD courses that are already tax deductible.

5. For those out of work, we recommend extending the Kickstart apprenticeship scheme beyond December 2021 and remove the age restrictions, and also reinvigorating the Enterprise Allowance by involving a wider range of organisations in the mentoring aspect of the scheme.

Business rates, digital sales tax and levelling-up

The Institute of Directors has welcomed the government's review of business rates. The existing system is complex, outdated and disincentivises investment in physical buildings, including investment designed to reduce carbon emissions in older properties. Indeed, over 1 in 3 of our members agree that business rates are a disincentive to invest and grow their organisations.[16]

It was also designed for a pre-internet age when the only way for retailers to reach customers was to have a physical presence, and in the context of the levelling-up imperative, it is insufficiently flexible to enable local authorities to work with local retailers to design the types of high streets that their communities want to see.

We would like to see the following three principles apply to **reform of business rates and digital sales tax:**

(1) The tax system should be neutral as to whether an item is sold online or in a physical shop.

(2) The business rate system should reward investment in those geographic areas that have greatest need of regeneration. As part of this it should be sufficiently flexible that local authorities can use it to 'place-make': incentivising the types of retail and commercial environments that communities say they want to see.

(3) Any tax on commercial premises should be designed to incentivise investment in the quality of buildings, including reducing their carbon footprint, improve accessibility and introducing high standards of building quality and ventilation that business leaders and staff find necessary in a post-Covid world.

[16] Policy Voice, February 2019. Participants who said that their primary organisation paid business rates were asked 'To what extent do you agree or disagree with the following statements about the impact of business rates on your (primary) organisation? Business rates are a disincentive to invest in my organisation/Business rates are a disincentive to grow my organisation'. 36% agreed in each case. n=538

(4) Valuations should be more frequent, and in line with the business cycle.

The green opportunity

The Institute of Directors believes that government has a role to help shape markets to deliver on our net zero commitments. New regulatory standards can, if implemented carefully and with sufficient notice, create new vibrant and innovative sectors of the economy that can help Britain as a whole achieve our aims.

Existing businesses want to play their part but are looking to government for guidance on how this should be done. The vast majority (83%) of our members say that it is important for their organisation 'to operate in an environmentally friendly and sustainable way' but only a quarter (24%) report that they 'fully understand' the way in which their organisation can reduce its carbon footprint and meet net zero carbon goals. Moreover, three in ten IoD members (30%) agree with the statement that 'the costs associated with moving towards net-zero goals in my organisation are prohibitive'.[17]

We support a change to the corporate governance framework to make directors' obligations clearer. 70% of IoD members have expressed support for companies moving to a common reporting standard on disclosures relating to climate change and environmental impact. Additionally, 75% of IoD members believe either some changes or significant reform to the UK's corporate governance framework is required to take greater account of climate change.[18]

In addition to the recommendations around investment incentives and business rates above we therefore **ask the government to signal its intention in the Budget** that:

- TCFD requirements around financial disclosures of environmental impact should apply to all UK companies that are currently required to produce a non-financial information statement, and over time to a wider range of companies.

- Section 172 of the 2006 Companies Act should be amended in order to require directors to have regard to, among other things, "the impact of the company's operations on the community and the environment," in line with the Better Business Act campaign.

The economic challenges of the pandemic have been enormous, and have taken their toll on us all, including business leaders.

[17] Policy Voice March 2021. Participants were asked 'To what extent do you agree or disagree with the following statement? "The costs associated with moving towards net-zero goals in my organisation are prohibitive". n=703.

[18] Policy Voice, February 2020. Participants were asked 'In recent months, a number of prominent investors have been vocal in calling for companies to improve their disclosures relating to climate change and environmental impact. Would you support companies moving to a common reporting standard on this issue? E.g. recently proposed by the Task Force on Climate-Related Financial Disclosures (TCFD)?' n=928

We remain committed to working with government to obtain the best possible climate favourable to entrepreneurial activity and wealth creation, in line with our Royal Charter. We hope that the government will use the opportunity of the Autumn Budget Statement and Spending Review 2021 to demonstrate that it too shares these goals.