Rt Hon Jeremy Hunt MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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By email to: action.chancellors@hmtreasury.gov.uk

18 September 2023

Dear Chancellor

As your team starts work on the Autumn Statement, 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.

As you know, 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'. To this end, our top five recommendations are:

1. **Tax credits for companies that train staff to meet national skill shortages.**
2. **Stronger incentives for SME net zero transition - such as a differential corporation tax rate.**
3. **Permanent 100% capital expensing.**
4. **An export target based on volumes (not values) and the proportion of companies that export.**
5. **Greater reputational pressure on slow invoice payers.**

Towards the end of this letter, we also make some observations relating to the draft 2023-24 Finance Bill clauses that have already been published.

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Broader economic leadership
There is also, however, an important overarching point. There has long been a debate around the need to raise productivity in the 'long tail of British industry'. There is therefore much to be gained by thinking of interventions that shape the broader economy rather than focusing exclusively on segments that are already market-leading, important though those are.

We understand the desire on the part of government to work with strategically important 'priority' sectors, but to do so exclusively misses a broad swathe of economic activity. Over half (56%) of our members do not identify as being in one of the government's five current 'priority' sectors, yet their activities are no less significant to our national prosperity.

Regardless of size or sector, 88% of our members agreed in a survey conducted in May 2023 that they wanted to see 'an industrial strategy that defines long-term objective for business in terms of priorities and policies'. Less than 10% of members felt that UK economic development should be left entirely to market forces. In terms of the substance, our members' priority is for an industrial strategy which focuses on reinforcing the UK's capabilities as a centre of excellence for innovation and R&D (73%) and green investment (41%). They also believe that should be a strong emphasis on the development of skills (58%) and infrastructure (57%). Further information is available here.

In a similar vein, business leaders recognise that there are significant opportunities from the development of artificial intelligence (AI) but would also welcome the development of a viable regulatory framework to mitigate the accompanying risks so that the UK is able fully to take advantage of the opportunities offered. Further information around our members' views is available here.

In the sections that follow we set out our key recommendations that would have the greatest impact on prospects for Britain's future prosperity.

Tax credits for companies that train staff to meet national skills shortages
The Prime Minister, in his February 2022 Mais lecture as Chancellor, committed to examine as part of a future tax strategy "whether the current system… is doing enough to incentivise businesses to invest in the right kinds of training". We support that ambition and encourage this work to continue. Skills shortages are consistently identified as one of the main pain points our members face.

Since then, the government has committed substantial resources to an expansion of childcare which is welcome, as is the current workstream on using the tax system to improve access to occupational health services in the workplace, on which we are engaging with your officials. However, there remains a broader market failure that prevents many small and medium sized businesses from training staff to meet skills gaps that are also present in the

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wider economy: they fear that newly-trained staff will leave when they realise their value in the marketplace. This could be the explanation for why investment in workplace training in the UK is significantly lower than in comparable economies.

To address this problem our recommendations are:

- An independent body set up to produce a list of Britain's national current and future skills needs, working with industry and building on the work of the Migration Advisory Committee and the existing list maintained by the Department for Education for the Level 3 Guarantee.
- Incentives for business to provide training to employees to meet the demand identified through this list, thereby overcoming the market failure. We propose a tax credit – or super-deduction – for the provision of training to meet the specific skills gaps identified in the list. This targeted solution overcomes concerns around deadweight loss.

In the same vein, we also advocate:

- Allowing sole traders to deduct for tax purposes the costs of reskilling into areas that are entirely new for their business, if these are on the list of Britain's national current and future skills needs.
- Where there is already free training provided to overcome skills shortages under the Level 3 guarantee, these should be available to anyone, regardless of their previous qualification levels.
- VAT exemption for private sector training designed to address Britain's national current and future skills needs, as identified in the list outlined above.
- Reimbursement of payroll costs for firms who allow existing employees away from their normal duties to undertake Level 3 guarantee or the shorter 'bootcamp' courses in skills shortage areas, subject to an upper limit. This will increase uptake by people who are constrained from retraining due to caring responsibilities.
- Allowing greater flexibility in how Apprenticeship Levy training funds can be drawn upon, while retaining 95% funding of SME apprenticeship training costs.
- Widening access to work coach support to individuals' labour market needs rather than eligibility for benefits.
- Regular, rather than ad-hoc, reviews of the Shortage Occupation List for work-related visas at set intervals.

For further detail, please see our May 2023 publication Innovating for Talent.

Stronger incentives for SME net zero transition – such as a differential corporation tax rate
The Skidmore review recommended that government "review how HMT incentivises investment in decarbonisation, including via the tax system and capital allowances".

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SMEs generate around half of greenhouse gas emissions from businesses and so will need to play a significant role if the UK is to meet its 2050 net zero target. However, government policy has so far focussed on the large carbon emitters and, as a result, our data shows less than three in ten SMEs (28%) currently have a plan to achieve net zero, insufficient to achieve our national goal. Supply chain pressures also appear weak: around three-quarters of our members have never been asked by a current or future customer or client to demonstrate their carbon footprint.

In an IoD survey conducted in August 2023, we found that across the SME population as a whole around 15% agree with the statement "we have increased overall investment spending mainly in order to implement the organisation's policy on climate change" rising to around one in five companies employing between 50-249 people and one in three larger companies. Getting the incentives right for small companies to reduce their carbon footprint therefore also increases aggregate levels of investment, supporting the wider macroeconomy.

Our members cite the 'lack of a clear business case to invest in net zero measures' as one of the biggest obstacles in reducing their carbon footprint. Two-thirds says financial support or incentives from Government would be most useful in helping them to address climate change.

Our own research shows that the most effective way to spur change would be to have **a lower corporation tax for organisations that have achieved net zero** compared to those that have not: 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 do so if it resulted in a lower corporation tax bill. More information on these results is available here.

Depending on how the tax differential is calculated, this outcome could be achieved **at nil cost to the Exchequer**. The important outcome is that there is a wedge between the two to act as a clear business case for change; the differential could be adjusted over time to calibrate the response and in the light of prevailing fiscal circumstances.

Further detail on this proposal including implications for the company accounting is available in our publication The Green Incentive (2022).

Getting the incentive right for decarbonisation will not only help Britain achieve its carbon targets but it will also lead to higher levels of investment across the board, spurring productivity improvements and overall economic growth.

The following additional measures are also required to support SMEs during the transition to net zero:

- Guidance to businesses around the type of monitoring of greenhouse gas emissions that will be expected in future. This would minimise the compliance costs of starting to measure in one way then having to alter the methodology later.

- Implementation of the Skidmore recommendation to launch a 'Help to Green' campaign, offering information resources and vouchers for SMEs to plan and invest in the transition.
- A requirement on landlords to provide organisations with information about the carbon footprint of the premises they lease, to ensure that businesses can access the data they need to calculate their carbon impact.
- Prioritise the development of the UK's Green Taxonomy to channel capital into viable, sustainable investments.

Permanent 100% capital expensing

We welcomed the decision in Budget 2023 to introduce a 'Temporary Full Expensing' policy which allows all capital expenditure on qualifying plant and machinery to be 100% deductible against revenue for tax purposes in the year in which it is incurred. Previously this had only been possible for the first £1m of capital expenditure covered by the Annual Investment Allowance.

By June 2023, our data showed this policy had already had a measurable impact for those firms affected. Of organisations that have capital budgets above £1m, around a quarter (22%) told us they have altered their investment plans as a direct result of the policy. This impact is particularly pronounced in the two government priority sectors of 'advanced manufacturing' and 'green industries'. We have shared this analysis with your department.

At present the full expensing policy is only costed to last for three years. Since most of the impact on the public finances is a re-phasing of receipts with the reduction in the earlier years, rather than a direct cost, it feels inefficient to unwind it after the benefits have already started to flow.

We therefore call for the **100% capital expensing introduced in the March 2023 budget to be made permanent.**

An export target based on volumes (not values) and the proportion of companies that export

Britain's export performance has lagged that of comparable countries in recent years. Although around half (48%) of our members are currently exporters a further 9% tell us they used to export but do not do so anymore. 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. Free Trade Agreements with new partners, while possibly helpful for firms that have already decided to export to the countries concerned, are not a panacea for the wider problems that our members identify.

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Against this backdrop we support the principle of government having an overall export target. However, the current target of £1trn exports by 2030 has limited traction. Our analysis shows that a simple uprating by the average of independent medium-term CPI forecasts would cause the target to be reached without necessarily any change to the underlying volume of goods sold from the UK. It also fails to take account of the longer-term trend of exports correlating with the underlying rate of GDP growth.

We therefore ask government to set a more ambitious export target that removes the effect of inflation by being set in real (chained volume) terms, and seeks to raise the real-terms underlying rate of growth of exports. Additionally, the government should have a second target to raise the proportion of UK businesses that export, so as to focus policy attention on supporting firms that have recently decided to withdraw from exporting and those that have an exportable product but have not yet considered doing so. We will be setting out further detail on these ideas shortly and would welcome a discussion.

To support UK exporters, we also urge government to:

- Make the consultation process for FTAs easier for all sizes and types of business to contribute to.
- Produce more export guidance from a sectoral and cultural perspective.
- Create a central easily searchable database of international trade advisors by region and sector, with their expertise listed.
- Offer clear and concise advice to smaller businesses on how to engage with the SME chapters in FTAs to realise the benefits they offer and build connections with local contacts.
- Establish an SME special committee to monitor the implementation of SME chapters following ratification of FTAs.
- Monitor and publish the impact of government assistance for exporters - both the teams at overseas missions and those UK-based trade advisors.
- Extend the eligibility of funding for trade shows to firms with up to 400 employees.

For further detail please see our April 2023 report Exporting in a post-Brexit world: an agenda for the UK government.

Greater reputational pressure on slow invoice payers

The time taken to pay an invoice matters, particularly for smaller firms. Companies that are paid swiftly can raise their productivity by spending more time on projects of economic value and less time chasing invoices. Yet less than one in ten of our members are aware they can check on the payment practices of large employers; far fewer feel able to take enforcement action themselves against slow-paying customers. As a result, the average payment time has not changed since the requirement to publish information on payment practices was introduced.

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In response to recent government consultations, the IoD has set out a comprehensive plan to speed up payments by putting greater public and reputational pressure on firms that take longer to pay.

The main elements of this plan are:

- Government should publish twice-yearly rankings, by organisation, of the average time taken to pay invoices, as well as of the other payments statistics specified in the regulations.
- These ranking lists should be actively released to the media by the government, to raise awareness of the service and spur change by slower payers.
- The government should also publish an aggregate headline indicator of the average invoice payment time across all qualifying businesses, enabling policy makers to track progress and allowing the performance of individual firms to be compared to this average.
- Public sector entities employing over 250 people should be required to report their payment practices through the same system as private entities.

For further detail please see our response to the government consultations on the prompt payment practice regulations here.

Specific matters relating to draft Finance Bill clauses 2023-24
Finally, this letter turns to some specific measures included in the draft clauses your department has already published for the Finance Bill 2023-24.

Additional tax relief for research-intensive SMEs and a potential merged R&D scheme
As we explained in our letter to you in March 2023, we are concerned that reducing the generosity for all but the most research-intensive SMEs has the perverse policy effect of disincentivising R&D in those organisations that are currently under-investing in innovation and research, thereby doing little to raise productivity in under-performing firms and sectors. We do not think it is possible or desirable to judge the additionality impact of the policy on the basis of the size of the budget or the nature of the company concerned. It also seems odd to be pursuing simplification through a merged scheme on the one hand, and a major exception to that for some types of SMEs on the other hand.

Change to the data HMRC collects from customers
The draft proposals are a significant improvement on the suggestions outlined in the original consultation, about which we had strong reservations. However, we continue to oppose the proposal contained in the draft legislation that employers should be required to provide real time data on the number of hours worked. This is disproportionate, particularly in relation to hours worked by employees who are not paid with reference to fixed time-limited shifts. HMRC has not made a sufficient case to require this information to be provided. Our view is

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that for policy purposes the information can be obtained through the AHSE and LFS surveys undertaken by the ONS.

We hope these reflections are useful as you work on measures to be introduced in the Autumn Statement 2023. We would be happy to discuss them further with you and/or your officials.

Yours sincerely,

Jonathan Geldart
Director General

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