IoD Freebie Growth Plan

SNAPSHOT

- **The Government wants to maximise the opportunities for economic growth but it has little or no money with which to do it.**
- **This article puts forward two dozen policy changes over 10 areas of Government policy which could transform growth prospects and at little or no cost to the taxpayer over the period of the Spending Review.**
- **The 'freebies' are a mix of immediate measures and long-term commitments aimed at creating a positive vision for UK plc.**

The IoD Policy Team identifies key policies to improve the outlook for output, employment and investment.

Given that the fiscal cupboard is bare, what can the Government still do to transform economic prospects? The answer is a lot.

This paper outlines two dozen 'freebies' over 10 areas of policy, which could sharply improve GDP growth prospects in both the short and long term. Most importantly they will cost little or no money over the period of the Spending Review.

Beyond 2015 there are tax reductions which can be funded by proposals for further restraint in the growth of public spending. Clearly there is likely to be a General Election in 2015, with the possibility of a change of government. Despite this constraint, two of the proposals entail the Government committing to less 'tax and spend' if they do retain power. This will help change the current vision of long-term economic prospects by generating light at the end of the tunnel.

The top policy freebies are:

1. **Target employment law reform**

Any growth strategy for small and medium-sized businesses (SMEs) that doesn't deal with employment law isn't worth the paper it's written on. This issue simply cannot be ducked. We need to make it easier and cheaper for companies to employ people. The Government's proposed review of the link between SMEs and government needs to have a clear remit to investigate employment law[1] and to identify those areas which are most damaging to job creation and retention.

But even before such a review gets underway there are some more immediate changes which could be made to boost the confidence of employers that change is around the corner:

- Remove the gold-plating from Agency Workers regulations so that small firms aren't caught.
- Introduce a minimum £500 employee deposit in employment tribunals to deter weak cases.
- Allow firms to escape the risk of tribunals when they dismiss someone within the first two years of service. Unfair dismissal rights and recourse to a tribunal currently apply after one year.
- Abolish the existing rights to request flexible working and training. Currently the Government proposes to extend the flexible right to all parents with children under 18, and looks set to retain the training right introduced by the previous administration. There is no need to formalise rights which exist informally already, because when you formalise a process it creates new cost burdens, on small firms in particular.
- Drop proposals to abolish the default retirement age. Why does the Government want to make it harder for companies to remove staff who are no longer effective? No sensible employer is going to get rid of someone if they are performing. By removing the DRA you are forcing employers, who will have to remove older staff at some point, to manage them out through the normal dismissal procedures. This is immensely time consuming, complex and costly for small businesses and is fraught with the risk of tribunals.

2. Energise deregulation

For civil servants and ministers alike, success is often synonymous with activity. In Whitehall this activity is often translated as a need to regulate. The Government has introduced a 'one in one out' system aimed at minimising new burdens, and sunset clauses to help ensure regulations do not exceed their useful life. However, the record of deregulation by governments of all persuasions is poor.

There needs to be a game changer in order to transform the regulatory culture in the UK. The IoD believes that catalyst could be the introduction of genuine incentives for

[1] We recognise the challenges to reform given that much employment law originates from Europe.

deregulation within civil service pay and promotion structures. Only when the bureaucracy is given the incentive to slim down will it do so.

The Government should establish a review of existing civil service practices regarding salary awards, bonuses, annual assessment criteria and broad career promotion structures in the context of their effect on regulatory behaviour.

A second possibility for energising deregulation could be the introduction of Sector Regulatory Reviews (SRR) aimed at identifying the regulatory burdens in individual sectors which impede competitiveness for companies operating in the UK.

3. Radical public sector reform

Radical reforms are required if the quality of public services is to improve and the perception of them to transform from public sector cost centres to private sector market growth opportunities. Education and health will be key market growth areas in the 21st century; market forces need to be unleashed if the UK is to take full advantage.

Consumer choice and releasing the potential of the market should underpin radical public service reform in health and education. We need a transformation from worrying about the cost of these services in the public sector – as a proportion of GDP – to being excited about the potential of these sectors for fast growth when delivered by the private sector.

The Government's education (free schools) and health reforms (increasing the purchasing power of GPs) are a move in the right direction but they need to shift even further towards genuine consumer power over the coming years – for example education vouchers with top-up capability. Only when parents and patients face a real choice of schools and treatment will competitive forces take most effect. Education and health can remain free at the point of use for the majority, but with private sector delivery.

We recognise that radical reforms will take time to develop but if we want world class public services, with companies which can exploit the market potential of health and education in the 21st century, the sooner we implement reforms the better. The Government needs to prepare now to make the case for reforms over the years ahead. A very big sell-in will be required but the opportunity is to create schools and hospitals competitive with the best in the world.

4. Ring fence privatisation revenues for infrastructure

At some stage over the coming years the Government is likely to divest itself of its shares in the banking sector. As and when this occurs substantial revenues will flow back into the public sector. Whilst the Government is sitting on a loss at present, we believe that any future profit on these asset sales should be ring fenced and earmarked for key infrastructure projects of national importance, which are unlikely to proceed on the basis of private capital alone. The one-off revenue gains should be used for one-off infrastructure projects.

5. Planning revolution

The planning revolution has two components – residential and key national infrastructure.

Approximately 90 per cent of the population live on 9 per cent of the land in the UK. Expected population growth means ever increasing pressure for higher urban densities, especially in the South East of England. Surely there is an opportunity here to release a substantial portion of green belt land for development. This could help boost the construction sector and economic recovery in the short term, whilst improving urban congestion in the long term. Greater land release could also lead to lower land and house prices and greater affordability.

The second element to the planning revolution relates to key national infrastructure projects. With the demise of the Infrastructure Planning Commission (before it became fully operational) there is great uncertainty with regard to key national infrastructure projects and the sheer length of the planning process. The Government has published the National Infrastructure Plan and proposes to create a Major Infrastructure Planning Unit.[2] As part of this process the IoD urges the Government to create a genuine and effective fast track system. An effective fast track system would also help reduce construction costs given that the UK is one of the most expensive countries in Europe in which to build infrastructure.[3]

6. Regional radicalism

One of the keys to greater reform and higher productivity in the public sector is decentralisation. The Government needs to grasp the nettle of radical reform in the public sector labour market. Wherever it is practicable (hospitals and schools, not the army and navy) there should be an end to national collective pay bargaining. In other words headmasters should decide what a teacher earns, paying reference to existing pay scales, but not bound by them. The IoD has argued[4] for a number of years that decentralisation of pay bargaining could help establish a far stronger link between pay and performance and help drive up public sector productivity.

Other potential radical shifts could include focusing regional policy on ‘winners’ not ‘losers’. In other words, on those areas likely to yield the greatest return on the investment. In a fiscally constrained environment this raises two interesting possibilities – focusing on cities and clusters with scale. Research by the McKinsey Global Institute[5] suggests that cities have

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[2] *The path to strong, sustainable and balanced growth*, HM Treasury and BIS, November 2010.
[3] The Government has established the Cost Review, led by Terry Hill, into the sources of the UK’s high costs of construction.
[4] In Budget and Pre-Budget Report submissions to HM Treasury.
[5] *From austerity to prosperity: Seven priorities for the long term*, McKinsey & Company, London, McKinsey

been responsible for almost 80 per cent of UK growth over the past decade. McKinsey also argue that the UK needs to 'innovate at scale' if clusters are to become strong growth centres. This will require a concentration of investment into large and connected centres.

7. Tax incentives

The most significant and affordable change the Chancellor could make to the tax system would be to announce an end to the 50 per cent top rate of Income Tax by the end of this Parliament. We do not want to see the UK marked out as a high tax country. The 50 per cent rate will raise little or no extra revenue and reduces the incentive to work, save and invest for the most entrepreneurial in our society. It also reduces the incentive for high income globally mobile individuals (and companies) to locate in the UK. Whilst the politics of the 50 per cent rate are clear – 'we're all in this together' – there is also a very strong economic counter argument.

Other low cost tax changes which could aid economic recovery include:

- **CGT on shares** – If a new company starts in business between now and 5th April 2012 then the people who subscribe for shares in it within that period would be exempt from Capital Gains Tax when they sold those shares, whenever they sold them. This would encourage the injection of fresh equity capital into businesses (only shares subscribed for would qualify, not shares bought from existing shareholders). The tax benefit would be available to owner managers, including sole owners of companies, as well as to outside investors. It would therefore be much more widely available than the Enterprise Investment Scheme. There would be no immediate tax cost because the benefit would only come on the sale of shares after they had increased in value. The long term cost would be modest and spread over many years. There might be a cash limit on the qualifying amount of shares but this could be set generously.

- **Annual investment allowances** – The annual investment allowance allows businesses to write off the full cost of some fixed assets against tax in the year of purchase, up to £25,000 a year. It should be extended to all tangible fixed assets (it is currently limited to plant and machinery, excluding cars). This would create an incentive to invest in a wider range of assets. Business premises, for example, would come to qualify. Small firms would find that investment decisions become simpler because all expenditure on tangible fixed items would qualify. The £25,000 a year cash limit should be retained in order to keep the cost of the change relatively small.

Global Institute, November 2010.

- **Carrying back investment** – If a business invests in fixed assets in its second year, before making its return for the first year (and it makes its return on time), then it should be able to treat the investment as made in the first year. This would allow a profitable business to defer payment of tax on the profits of its first year by investing in fixed assets. The overall effect should be to make some business plans more feasible. A plan for expansion after the first year would not be hampered by the need to find within the second year, so much money to pay tax on the first year's profits. The cost would be very modest and essentially only a cash flow cost to the Exchequer, because the tax would be payable eventually. The amount of the investment that could be carried back could sensibly be limited to £25,000, the amount of the annual investment allowance.

8. Energy policy certainty and competitiveness

If the UK economy is to unlock the necessary private investment in energy infrastructure over the coming decade there will need to be far greater clarity and certainty in the policy and regulatory regime. Investors remain uncertain about potential returns and the longer the uncertainty continues the greater the risk that the necessary investment will not be in place to stop 'the lights going out' over the coming decade. Energy investment could be improved by changes to the regulation of utilities[6] and a clearer indication from the Government as to the long term energy mix and the level of support to be made available through mechanisms such as the Climate Change Levy.

However, energy policy certainty must not come at any price. A central aim of policy must be to avoid putting British business at a competitive disadvantage as a result of higher energy costs than our competitors. For example, the proposed changes to Air Passenger Duty – in the name of tackling climate change – seriously threaten the aviation freight sector in the UK and should not be implemented.

9. Extending reform of Corporation Tax

The Coalition Government is committed to reducing the main rate of Corporation Tax to 24 per cent – the lowest ever level in the UK. Whilst the IoD strongly supports this policy we believe that it will not be sufficient in the long term. The IoD is calling on the Government to move beyond the 24 per cent commitment with a call to reduce the main rate to 20 per cent by 2020. Clearly there will be another General Election in 2015 which could result in a

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[6] D. Helm, *Utility regulation, the RAB and the Cost of Capital,* University of Oxford, 6th May 2009.

change of Government, but if the Coalition were to articulate an intention to move below the 24 per cent rate as and when it is able, it could help boost confidence in UK plc as a location for inward investment in Europe. The move towards a 20 per cent rate would need to be financed by further public spending restraint – covered by the long term fiscal target below.

10. A long term fiscal target

A wealth of academic and empirical evidence[7] reveals that higher taxes slow economic growth. However the scale of the budget deficit leaves the Government with little room for tax reductions over the course of this Parliament. Despite this constraint, the Coalition Government could help create a long-term positive vision for the UK economy by making an explicit commitment to reduce the ratio of public spending to GDP to 35 per cent by 2020. At present OBR/HM Treasury are projecting a ratio of 40 per cent of GDP by 2015-16. Implementation of a long-term 35 per cent commitment would obviously depend on fiscal circumstances and the outcome of the General Election. However, as a declaration of intent and direction of change, it could help boost long term confidence in the UK economy.

[7] See: *The negative impact of taxation on economic growth*, Graeme Leach, REFORM.