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Treasury Committee

Jobs, growth and productivity after coronavirus: Government response to the Committee's Fourth Report

Third Special Report of Session 2022–23

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The Treasury Committee

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Third Special Report

1. The Treasury Committee published its Fourth Report of Session 2022–23, *Jobs, growth and productivity after coronavirus* (HC 139) on 4 July 2022. On 22 November 2022, we received a letter from the Exchequer Secretary to the Treasury containing the Government response.

2. The *Government response* contained information about the Government's policy on fuel duty which conflicted with the Chancellor's recent Autumn Statement. The *Chair of the Committee wrote to the Exchequer Secretary to the Treasury*, requesting clarification on the policy. The *Exchequer Secretary responded* on 23 November 2022, explaining that the original response contained a drafting error, and provided a revised version of the Government response. This final version is appended to this Report.

Appendix: Response from HM Treasury

Letter from the Exchequer Secretary to the Treasury, and attached Government Response to the Report

I am writing in response to the Treasury Select Committee's report, 'Jobs, growth and productivity after coronavirus', published on 4th July 2022. I would like to thank the Committee for the report and the recommendations made to support the Government's efforts to grow the economy. I would also like to thank the Committee for the patience and flexibility you have shown in awaiting a response, given recent circumstances. Responses to specific recommendations are set out in the annex to this letter.

The report is right to point out the challenges the UK economy has faced through the Covid-19 pandemic. I welcome the report's conclusion that many risks to long-term growth were mitigated by the decisive policy interventions taken in response, such as the furlough scheme. Many of these interventions were led from HM Treasury by the Prime Minister during his time as Chancellor. We continue to monitor issues that have arisen after the pandemic, such as labour market inactivity and the potential productivity enhancing opportunities rapid uptake of digital technologies may provide to businesses.

Since the committee's report was published, and like many countries, the UK continues to face profound global challenges, exacerbated by Putin's invasion of Ukraine and continued high energy prices. This has led to a record high 11.1% rate of inflation (CPI) in October 2022 - 1% higher than when the committee's report was published. Similar rates of inflation can be seen across similar developed economies, such as 11.6% in Germany and 16.8% in the Netherlands. These conditions have put prolonged stress on firms, who have found it increasingly difficult to plan for and absorb rising costs. As a consequence of these headwinds, the economic outlook has deteriorated, with the OBR forecasting an inflation driven recession.

On November 17th the Chancellor of the Exchequer delivered the Autumn Statement. The statement took the difficult but necessary decisions to demonstrate fiscal discipline, restore market confidence and support the Bank of England in bringing inflation down. However, against this challenging fiscal context, the government has demonstrated our

continued commitment to supporting the vulnerable. In addition to the Spring Statement 2022's 12-month cut to fuel duty rates, the government has brought forward further measures to fight rising costs for households and businesses, such as the Energy Price Guarantee, the Energy Bill Relief Scheme and the additional Cost of Living Payment. The OBR have noted that without the government's interventions to protect households from rising energy bills through the Energy Price Guarantee, the peak of inflation would have been 2.5% higher. These actions have restored economic stability, which is essential to giving businesses the certainty they need to invest and grow.

Even in this challenging context, the government remains committed to growth and has set out plans to do this by investing in people, infrastructure, and innovation. Over the coming year, we will work to optimise the UK's regulatory environment, particularly for the high growth and innovative sectors which will drive our future prosperity. This is the responsible way to grow the economy, boost living standards, and fund high quality public services.

JAMES CARTLIDGE

22 NOVEMBER 2022

ANNEX: HM Treasury's response to the report's recommendations

HMGs Growth Strategy and the Plan for Growth

This section is addressing recommendations in paragraph 44 and 45 *on making the Plan for Growth a successor to the Industrial Strategy, coordinating growth strategy across government, taking feedback and monitoring results to measure success.*

The Plan for Growth, while led by HM Treasury, is an overarching framework which helps to support a whole-Government approach to delivering long-term growth. The Plan for Growth is supported by a family of strategies, such as the 'National Infrastructure Strategy', 'Skills for Jobs' and the 'Innovation Strategy', each led by respective lead government departments.

Outcome Delivery Plans (ODP) are the primary way in which departments' progress against their core policy objectives and outcomes is measured, including where they are responsible for delivering elements of the Plan for Growth. There are measures across each strategic objective outlined in the Plan for Growth, including boosting connectivity, unleashing innovation and closing the regional attainment gap. Departments are required to report their progress to Cabinet Office and HM Treasury on a quarterly basis. These outcome focused metrics are discussed by departments and their corresponding HM Treasury spending teams and factor into discussions on funding settlement decisions.

In addition, projects which are part of the Government Major Projects Portfolio–due to their value, significance, or novel nature–are subject to a regular monitoring regime involving the Infrastructure and Projects Authority, Cabinet Office and HM Treasury. This follows and supplements the usual HM Treasury process for scrutinising proposals, including the Treasury Approval Panels and spending control processes.

Productivity after Coronavirus

This section is addressing recommendations in paragraph 65, 72, 92 and 100 *on productivity enhancing opportunities and challenges after Coronavirus; addressing the investment shortfall through tax incentives and policy certainty; economic opportunities as a result of Brexit and supporting firms affected by changes in trade between the UK and EU; and Help to Grow funding moving forward.*

Productivity growth has slowed in the UK since the Global Financial Crisis. As the report raises, this issue was exacerbated by the COVID19 pandemic and the public health measures in response, such as businesses indebtedness and individuals withdrawing from the labour market. The government continues to monitor these. Increasing productivity is vital for accelerated and sustained economic growth and that is why government has announced a package to reform and invest in the key supply side drivers of productivity gains.

Infrastructure and investment

Firstly, the government has brought forward a package of measures to ensure public investment remains at historic levels and continues to deliver projects which will boost growth and productivity. The Autumn Statement protects the public capital budget at record levels, meaning government will invest over £600 billion over the next five years. The government will ensure transformative growth plans for our railways are protected by committing to HS2 to Manchester, core Northern Powerhouse and East West Rail. The government will deliver digital infrastructure investment through Project Gigabit, new nuclear power, including Sizewell C (subject to final agreement), and the roll-out of cheap, clean renewables despite the challenging fiscal circumstances. Infrastructure spreads opportunity and prosperity across communities by connecting people to new jobs through faster and more reliable routes and secures the UK's energy independence. Public investment in high quality infrastructure is therefore crucial for raising productivity and should be protected.

Additionally, private investment remains crucial for boosting productivity in the UK. The economic stability and market confidence that the Autumn Statement has provided are key for this, but so is policy continuity. That is why the government has reconfirmed a number of measures to ensure the UK's tax and regulatory systems incentivise private investment. For example, by setting the Annual Investment Allowance (AIA) at its highest permanent level from 1 April 2023, reducing the burden of business rates by providing £13.6 billion of support over the next five years and keeping the UK's headline Corporation Tax rate internationally competitive at 25% and protecting 70% of actively trading companies at 19% with the Small Profit Rate.

Innovation

Science and innovation are some of the UK's greatest strengths and the government has bought forward measures to enable our innovative firms to invest. Government spending on R&D plays a crucial role in further stimulating private sector investment. Public spending on R&D will increase to £20 billion a year by 2024–25, a cash increase of around a third compared to 2021–22. This is the largest increase in R&D spend ever over a Spending Review period.

The government will support the UK's most innovative companies and leverage in private sector investment through confirming the continuation of the Innovate UK programmes and increasing funding for the UK's 9 Catapults by 35% compared to the last 5-year funding cycle. These will continue to support innovation and commercialisation by providing access to world-leading facilities, skills, and equipment across the UK.

As part of the ongoing review of R&D tax reliefs, the government is reforming the reliefs to ensure taxpayers' money is spent as effectively as possible. There is significant potential for error and fraud in the small and medium-sized enterprises (SME) scheme, with the generosity of the relief making it a target for fraud. By contrast, the separate R&D expenditure credit is better value but has a rate that is less internationally competitive. The government is therefore rebalancing the rates of the reliefs.

As set out in the Autumn Statement, the government is committed to ensuring cutting-edge, innovative firms have access to finance to invest. As previously announced, the government is increasing the generosity and availability of the Seed Enterprise Investment Scheme and Company Share Option Plan. The government remains supportive of the Enterprise Investment Scheme and Venture Capital Trusts and sees the value of extending them in the future.

Taken in combination these access to finance, investment incentives and business support measures provide firms with the certainty and support they need to increase their level of investment, including in productivity maximising technology. The government has noted the committee's evidence on the design of the super-deduction.

Help to Grow

The government is committed to helping small businesses across the UK realise their potential. As the Report notes, around £520m was allocated to both Help to Grow schemes at Spring Budget 2021. Further funding was allocated at SR21, and any future funding decisions past 2024/25 will be a matter for the next Spending Review in the usual way.

Additionally, as announced at Autumn Statement, the government will help more small and medium sized manufacturing firms boost their productivity through advanced digital technology by extending the Made Smarter Adoption programme to the East Midlands. This follows the positive feedback the Made Smarter Adoption programme has already received in the North East, West Midlands, North West, and Yorkshire & the Humber.

Brexit opportunities

The government is committed to taking advantage of the opportunities that Brexit provides. The Autumn Statement announced that the government will move rapidly to review retained EU law in key growth industries–including digital technology, life sciences, green industries, financial services, and advanced manufacturing.

This work is already underway in several of these sectors, such as financial services. The UK is the world's second largest exporter of services and the UK remains a net exporter of services to the EU. That is why the government has taken steps to regulate UK insurance firms through reforming Solvency II. This will provide the UK with regulation tailored to the needs of the UK insurance sector, while unlocking of tens of billions of pounds for investment in productive assets like infrastructure.

To progress this program of work the government will task the Government Chief Scientific Adviser and National Technology Officer, Sir Patrick Vallance, to bring together the best minds to advise how the UK can better regulate emerging technologies, enabling their rapid and safe introduction. This will ensure that post-EU exit, the UK is the best regulated economy in the world that encourages prosperity, innovation, and entrepreneurship.

Since the introduction of the Trade and Cooperation Agreement (TCA) the share of goods trade with the EU has remained relatively unchanged, suggesting that businesses are adapting to the change in trading status with the EU. The government provided extensive support for exporters as the UK left the EU to ease the transition. For example, in November 2021 the government refreshed its offer to exporters in the 12-point Export Strategy, which sets out a range of support for exports, including the DIT Export Support Service and HMRC-led grant support. DIT continues to provide grant support through its Internationalisation Fund and for tradeshows. DIT is considering how best to enhance the government's support offer from 2023 onwards.

Jobs after Coronavirus

This section is addressing recommendations in paragraph 121, 131 and 132 *on Labour market inactivity after COVID19; addressing gaps in the UK's skills and easing labour shortages; and the Apprentice Levy in England.*

In the Autumn Statement, the government also set out the challenging labour market post-COVID19. Since the 2008 Global Financial Crisis, much of the UK's growth has been driven by an increase in the number of hours worked. This was partly due to falling unemployment–which is now close to its lowest rate in 50 years–and increased labour market participation after 2008. However, since the COVID19 pandemic this trend has reversed.

Labour market inactivity

Despite low unemployment, there are now 630,000 more inactive working age individuals in the labour market than there were pre-pandemic, primarily driven by those aged over 50 leaving. Amongst the 50–64 cohort the inactivity rate now stands at 27.3%, 2.1ppts higher than pre-pandemic. As the report sets out, this fall in participation amongst workers is a risk for the UK's economic stability–as labour market tightness and its associated pressures on inflation create the risk of a higher interest rate peak. This shortfall of labour is also dampening the UK's growth, as businesses struggle to fill roles and the productive capacity of the economy is reduced.

There does not appear to be one single cause driving older worker inactivity, and a recent ONS survey of recently inactive people aged over-50 highlighted retirement, redundancy, changes in lifestyle, caring responsibilities, and illness as some of the most common reasons. To understand what action should be taken as a result of the rise in economic inactivity, the Department for Work and Pensions will thoroughly review workforce participation concluding in early 2023.

Immigration

Since leaving the European Union (EU), the government has introduced a new points-based system to refocus the immigration system towards securing the skilled labour

businesses need to stay competitive and innovative. In Build Back Better: our plan for growth the government announced plans to introduce attractive and competitive visa offers, both new and reformed, to achieve this. So far, we have launched an improved Global Talent visa (May 2021), the Global Business Mobility visa (April 2022), the High Potential Individual visa (May 2022), and the Scale-up Worker visa (August 2022). The government will also launch a new Global Talent Network by the end of the year and a reformed Innovator visa in spring 2023.

The government recognises inward migration can ease short-term skills gaps; it continues to monitor labour market pressures in key sectors and take appropriate action where necessary. However, immigration will not be the long-term solution to addressing labour shortages, and reform within industry is vital. The government wants to see employers make long-term investments in the UK domestic workforce to ensure it is equipped with the skills necessary to maximise productivity, drive economic growth, and build a high-wage, high-skill economy.

Skills

It is crucial that over the long term, the UK's domestic workforce is equipped with the skills necessary to maximise their productivity and drive economic growth. That is why the government is taking steps to ensure the education system provides the skills current and future employers need, for example through T-Levels, Higher Technical Qualifications and Skills Bootcamps. To maximise the impact of these commitments, Sir Michael Barber has been appointed to advise the Chancellor of the Exchequer and the Secretary of State for Education on the implementation of current reforms.

The government has already transformed apprenticeships–which are jobs with training for anyone of any age–to align with employer needs. Combined with the introduction of the Apprenticeship Levy, the government has created hypothecated funds to support employer investment in the high-quality training an apprenticeship can deliver. Where these funds are not spent by levy payers, they are allocated to non-levy paying employers who receive support for 95% of the cost of high-quality apprenticeship training.

There will not be a formal review of the Apprenticeship Levy or system at this time. The government is committed to protecting the quality of apprenticeship training and improving the system to respond to the legitimate concerns raised by employers. The government will ensure that apprenticeships continue to meet the needs of employers.