Written Evidence submitted by The Chartered Institute of Management Accountants (CIMA)

About CIMA

The Chartered Institute of Management Accountants (CIMA), founded in 1919, is the world's leading and largest professional body of management accountants, with members and students operating in 179 countries, working at the heart of business. CIMA members and students work in industry, commerce, the public sector and not-for profit organisations. CIMA works closely with employers and sponsors leading-edge research, constantly updating its qualification, professional experience requirements and continuing professional development to ensure it remains the employers' choice when recruiting financially trained business leaders. Chartered Global Management Accountant (CGMA) is the most widely held management accounting designation in the world. It distinguishes more than 137,000 accounting and finance professionals who have advanced proficiency in finance, operations, strategy and management.

CIMA is a founder member of The Association of International Certified Professional Accountants (the Association). The Association is the most influential body of professional accountants, combining the strengths of the American Institute of CPAs (AICPA) and CIMA to power opportunity, trust and prosperity for people, businesses, and economies worldwide. It represents over 650,000 members and students in public and management accounting and advocates for the public interest and business sustainability on current and emerging issues. In the UK alone CIMA has over 80,000 members working across all sectors. With broad reach, rigor and resources, the Association advances the reputation, employability and quality of CPAs, CIMA and CGMA designation holders and accounting and finance professionals globally.

One of the core missions of the organisation is to develop research and analytical thinking of the challenges faced by both our management accounting professional but also the wider and global finance sector.

How much difference can government policy make to economic growth?

A Government can:

- Provide stability and certainty through its tax and regulatory policy by setting a clear path for multiple years. This will allow investors and businesspeople to plan with some confidence that regulation and taxation will not be radically changed in ways that make their investments unprofitable. Unexpected changes to taxes and regulation and confiscatory policies inflict real damage that costs jobs and economic growth.

- Use its public platform to foster relations with business to celebrate and promote business, innovation, and entrepreneurship. The attitude that the Government and opposition politicians take is a consideration for businesses when choosing where to invest and international capital and international talent is highly mobile. Individual firms may act in ways that warrant criticism but a hostile attitude to risk taking, enterprise and business as a whole will damage the economy. The government should of course when necessary enforce action to support the public interest and economic growth.

- Ensure that core infrastructure such as broadband, road, rail and port based are provided to a high standard either through direct public investment or by encouraging private sector led investment. Also, by creating a regulatory structure that ensures that investments in service improvements can be paid for by service users but a failure to maintain a good service and invest in updating the service will have costs attached to the provider.

- Provide an education, skills and training platform that delivers the skills businesses need from the domestic workforce to compete on the world stage, create productive companies and deal with globalisation and digitalisation.

- Ensure the population is healthy and active to participate in the wider economy by implementing the right health and care policies.

- Individual Governments are competing to attract investment and Government's need to ensure their policy is consistently the most pro-growth and pro innovation in each policy area. It is important to get the comparison group right to benchmark UK performance. Very often the UK will benchmark against major European countries such as France and Germany but in many areas, this is not the right approach.

    - In contrast, the Government should benchmark its policy against the best in each subject area e.g. for tech policy this might be Israel or the United States and for corporate tax policy this may be Ireland and in terms of Government to business relations it could be Singapore. The government should be looking to compare the UK with best in class for each policy area and not just our nearest neighbours.

<u>What are the causes of the gap in the UK's level of productivity compared to other advanced economies, and why has productivity growth been persistently weak in the aftermath of the 2007-09 financial crisis?</u>

- The UK has a long tail of unproductive firms which could be due to a variety of different reasons:

    - Interest rates were reduced to prevent an economic depression, which is understandable and has clearly worked in preventing the realisation of a larger and more destructive recession. However, the side effect has been to allow many low productive firms to survive, and this has trapped skills and capital in businesses which are underperforming.

        - Capitalism requires some creative destruction and disruption; less productive firms failing is part of the reason the economy's overall productivity increases.
        - If less productive businesses survive it stops labour and capital being reallocated to businesses that are more productive and could use these resources to grow further.

    - The UK with its competitive advantage in financial services and outsized financial services sector compared to its economy has been more hit than other nations that have larger manufacturing or agricultural sectors.

        - UK productivity growth in the years prior to the financial crisis had taken place particularly in the areas most acutely impacted by the financial crisis and consequently the hit to the financial services sector has impacted the UK economy more.

    - Over the past few decades there has been a decline in labour market skills that businesses need.

        - This may change with the UK now having more controls on the UK labour market since leaving the European Union.

        - A mix of a low skilled labour force, reduced interest rates and under investment in upskilling and technology has led to the UK's productivity problem.

    - Until recently UK skills policy was not as high quality as that of our major competitors as the focus was on getting an increasing number of people to University and less on catering for the many young people who do not go to University.

        - The apprenticeship scheme and more recent announcements around lifelong learning are welcome, as is dropping the target around half of young people attending University.

        - Current policy could be producing more graduates than there are graduate positions available and the half of young people that do not go to University deserve a structured, respected and desirable alternative.

    - UK labour market policy has been more flexible than many of our European competitors. This means that more low skill workers are in employment in the UK and overall unemployment rates are much lower.

        - Paradoxically, lower unemployment figures can reduce the productivity figures where they are a measure of those in work. This is because less productive UK workers are in work in a way that similar individuals are not in France and Italy where they have higher unemployment figures.

    - The impact of globalisation must also be considered as many goods and services are outsourced and offshored to lower cost centres, which can have an impact on productivity.

<u>How successful has the Government's pandemic response been in protecting jobs to date, and how can it help reduce and mitigate the economic scarring effects of the pandemic going forward?</u>

It is too soon to tell how many jobs the business support programmes will have saved. This will only be discovered as schemes such as furlough are wound down. The measures will have reduced job losses caused by the pandemic, but their full impact is uncertain.

It is likely to be the case that some individuals that worked in the UK will have chosen to leave the UK during lockdown these jobs could be vacant now or could help reduce the unemployment figures as the positions are not filled by companies that have to cut costs.

The UK Government package of support to business during the pandemic was extensive. It was assembled in haste and needed to get the money out quickly, which at the time was the right course of action. Consequently, the controls were laxer than would usually be the case. There will be waste as loans will have been made to businesses that are non-viable and these will have to be written off.

One area where the UK Government could have done things differently is in ensuring that those in receipt of furlough could have been required to engage in training or skills development. This was a great opportunity, and this policy framework should be revisited if any support schemes are extended or reintroduced.

The long-term economic scarring of the pandemic will be reduced if the UK Government builds a supportive policy environment for viable businesses during the recovery stage. Increasing taxes on profitable enterprises to generate tax revenues to subsidise failing businesses will not help UK economic growth.

The UK needs its best businesses to go for growth. The UK needs capital and labour to gravitate towards them. The UK Government should work with the economic currents and concentrate on improving UK workers skills and building an attractive business environment rather than picking winners or subsidising loss-making firms.

Subsidising people to remain in jobs that no longer exist delays the inevitable to little benefit. The business environment has fundamentally changed. This means there will be business disruption, some jobs will be lost, and some businesses will close. It is understandable that this process will cause some distress, but Governments' can make it easier by creating a policy environment that helps strong and productive firms to grow and create new jobs.

The national debt is very high and putting this on a more manageable trajectory is very important so high current levels of support cannot continue for long. It is politically easier to keep extending the support schemes. There certainly should be no cliff edge in support. However, the support schemes will need to be wound down or the cost of them will weigh down the businesses the UK needs to grow. Doing this in a managed way with the least damage to viable firms is the next challenge for Government over the short to medium term.

Do economic statistics adequately capture growth in the modern economy, and what lessons can be learned from the pandemic about the measurement of economic activity?

Productivity statistics reflect the level and composition of employment as well as output. If the least productive people are employed, it brings down the average level of productivity. A different measure of productivity could allow a more precise analysis of where the productivity gaps with other countries are highest than using the average figure.

A better way of measuring productivity could be by income cohort. This would allow for a more effective comparison as skill levels are correlated with wages. Working on a wage cohort basis would prevent a higher employment rate of low skilled workers earning low wages bringing down the overall figure. It could allow more targeted skills policy to address productivity issues.

In addition, it would be useful to set clear rules around the calculations being made about economic growth and the trade-offs being made in the name of public health transparent. No thorough economic impact analysis of the pandemic response measures has been released so it is difficult to estimate the value of existing lockdowns compared to other measures or no response. It is difficult to assess the pandemic's impact on growth absent the cost of Government controls or whether other approaches would have been cheaper or better. A fuller analysis would allow policy makers to better prepare and support businesses in recovery.

There is also a need for more real-time data so lessons can be learnt sooner and the impact of certain actions and policies can be quicker judged and those that are working can be expanded and those that are not or harming economic growth and productivity changed or stopped.

What policies are effective in helping people to reskill, move between occupations and sectors and take advantage of new opportunities? How could these be best implemented in the aftermath of the pandemic, and as technological developments such as artificial intelligence change the nature of work?

Increasing output allows for higher wages to be paid and thus a focus on where low skilled roles can be made more productive is advisable. There must also be a recognition that some low skill roles will need to be replaced by technology. Recognising the latter means there can be better concentration on how to reskill these individuals in advance. Measuring economic activity needs to be geared towards providing the information the state needs to fulfil its role of working with economic trends to best equip all its citizens with the skills needed to make economic progress.

It is very important to not blur the divisions between low skilled and high skilled work and the Government should resist pressure to do this. There is some controversy about defining what roles are low skill. Many key societal roles pay low wages and are by their nature less productive. This is no reflection on the individuals involved. The association of skill level with 'value' and 'worth' is regrettable. All societies require some individuals to perform low skill and thus low wage jobs. However, an honest appraisal of the growth of low skill work will allow us to better design measures to increase productivity.

Individuals are increasingly responsible for their personal retirement saving and jobs for life are increasingly rare. However, existing UK skills policy is heavily linked with employers and incentivising them to provide opportunities for retraining. This contrasts with existing employment practice where people are more responsible for their careers and frequently change workplaces.

- Employers may have less incentive to invest in employee skills when the workforce is highly mobile as they cannot ensure those skills benefit their company rather than their competitors.

- There is no incentive to invest in skills not directly relevant to a worker's current employment, which means employees looking to change careers have no assistance to develop new skills.

- Another challenge is ensuring UK workers change their attitudes to learning and reskilling. CIMA last year produced some research titled Mind the Skills Gap, the research found that only 3 in 10 employees of SMEs had engaged in skills training and career development in the last year. The same research also showed that two thirds of SME employers said that the pandemic had highlighted skills gaps in their organisation.

This shows a gap between employees and employers needs and attitudes to reskilling and training that needs to be closed.

- Introducing a rebuttable right to retrain would encourage UK citizens to raise training issues with their employer more easily and create a bias towards more training and skills development and not less as we explained in CIMA's Budgeting for Recovery report.

- Expanding the apprenticeship scheme and promoting its benefits as an attractive alternative to a University education for people seeking to enter high skilled professions such as accountancy will deliver real benefits to the economy.

Is the Government doing enough to encourage corporate investment?

The increase in overall corporation tax rates is concerning but the balance with the reliefs is difficult to determine. The effective rate of corporate tax is more important than the headline rate because it is what corporations are required to pay that matters. The new super deduction is very valuable but temporary, it could bring forward investment but if it is to help permanently increase business investment it would need to be made permanent. If this scheme proves to encourage businesses to invest in technology and machinery that helps improve productivity it should be reviewed and potentially kept to boost investment.

Is the "Plan for Growth" an adequate replacement for the "Industrial Strategy"?

We regret that the Industrial Strategy has been replaced. We believe the government should put focus and effort into producing a country wide and sector by sector productivity strategy to increase the UK's lagging productivity and the levelling up agenda.

The UK's productivity challenge existed long before the last financial crisis in 2008. That crisis just exacerbated the productivity problem further as is the pandemic likely to have too. For a number of decades, the UK has not had a good Industrial/Business Strategy, and this has not helped to increase productivity.

If the government is serious about improving UK productivity both at a business, regional and national level and driving sustainable economic growth and real wage growth they will need a stronger strategy than their Plan for Growth and we believe one that solely focusses on improving and strengthening productivity.

Are we in a period characterised by long-term low economic growth (secular stagnation), and if so, what are the implications for Government economic policy?

The world is not experiencing low growth. World economic growth rates remain broadly stable at between 2-3 per cent and have done for many decades with occasional big swings around economic recessions. However, whole areas of the world are fast catching up with the west and living standards are increasing dramatically. Western nations are, absent the pandemic, experiencing low economic growth post financial crisis, and this could continue.

The low growth in the west is partly because we start from a higher economic base as mature economies. It is partly due to policy preferences as nations prioritise policies such as environmental standards and labour protections over economic growth. Higher welfare protections, earlier retirement, shorter hours etc are valuable things to have but they are likely to reduce overall economic growth. The UK could decide to have lower standards and have higher growth but like most western nations there does not seem to be much public or political appetite for this.

The accumulated burden of regulation that mature economies have is also an issue as it imposes costs on business, reduces innovation and in a rapidly changing technological world can quickly become out of date. Having a permanent review of existing legislation and more sunset clauses in new legislation would help the UK to avoid regulatory issues. The UK could take further decisive steps to increase economic growth by simplifying the tax code, reducing taxes that impact growth and being clear about the future direction of tax and regulation policy.

Declining populations will also affect the overall economic growth rate and size of western economies although it does not translate that it will necessarily make the populations poorer if managed effectively. Provided economic growth exceeds population growth the UK will continue to become richer per capita and this rather than the overall GDP growth is what matters.

Measures the UK could consider that boost long-term economic growth include:

- Raising the retirement age.
- Support with childcare costs to encourage greater workforce participation rates.
- Immigration policies that give preference to high income and high skill immigrants to come to the UK to ensure they are lifetime net contributors such as with the Hong Kong.
- Investing more in skills and training to boost productivity during peoples working life.
- Extension and expansion of tax advantages for investment in technology and R&D.
- Investing in higher skills from schools through to lifelong learning.
- Creating skills clusters across the UK.
- Increased flexible working to make it easier for people to remain in the workforce or enter it.
- More focus on the development side of R&D.
- Investment in key infrastructure such as high-speed broadband, road and rail.
- Incentivising investment in industries and sectors likely to provide global economic competitive advantage such as pharmaceuticals, life sciences, technology, high-tech manufacturing, fintech, professional services, etc…
- A trade policy that supports more UK businesses to export. A 2017 speech given by Andrew Haldane, Chief Economist of the Bank of England, said ‘firms which export have systematically higher levels of productivity than domestically-oriented firms, on average by around a third.’ If more UK firms could start exporting this could improve productivity and with it economic growth.

Macroeconomic policy

<u>What are the roles of monetary policy and fiscal policy in stabilising the business cycle and promoting growth in the post-pandemic economy?</u>

<u>Monetary Policy</u>

Monetary policy should be used to keep inflation low and stable. The aim should be to avoid deflation but prevent inflation getting too high. The 2 per cent target is the right one.

Using monetary policy to try to devalue the currency to achieve greater competitiveness is not advisable because it further compounds the UK’s productivity issues by making lower margin work profitable.

Nor is there value in trying to preserve an artificially high exchange rate this will make otherwise profitable businesses unviable and is not sustainable in the long run. A freefloating exchange should be preserved, and monetary policy should not be geared to preserving any exchange rate.

Sound money and stable prices will promote confidence in the UK economy and its management better than attempts to meet artificial exchange rate targets.

Fiscal Policy

Fiscal policy can help support demand in times of economic crisis. However, many countries have become increasingly dependent on permanent large-scale stimulus. This will put the UK and similar economies in a very difficult situation if there is another negative economic event like the financial crisis or pandemic.

The UK Government should not accept a permanently higher debt level. When wars end there is often a 'peace dividend' as forces are demobilised, and production geared to other purposes. Similarly, the temporary pandemic support provided must end if the UK is not to continue along a path to much higher spending and taxation levels going forward.

It is right that largescale support was provided during the pandemic. A multi-year period of gradual retrenchment would now be advisable to bring public debt levels down to a more manageable level. This should not be done solely through tax increases as these will reduce economic growth and the incentive to invest in a business. Healthy GDP and productivity growth could shoulder some of the burden.

There is considerable scope to further increase public sector productivity, and this should be the priority. There has been a lot of discussion about tax increases or public spending reductions but very little about the disposal of state assets. In Budgeting for Recovery, CIMA recommended that the UK Government review its asset base and existing obligations such as unfunded pension liabilities. This is good policy and could result in the disposal of assets that would help reduce the UK national debt. It also might promote realism about the level of UK debt and what expenditure is sustainable.

Does the inflation target remain fit-for-purpose, especially in a world where interest rates may be 'low for long'? Should the MPC target anything else?

A target of 2% is a good one. Higher rates of inflation erode real wages with damaging social effects and deflation would encourage people to delay purchases reducing consumption. This is particularly acute among workers with little opportunity to generate real wage growth through their jobs... Tolerating a much higher level of inflation would not impact people on index linked incomes or highly skilled workers who can demand and achieve matching pay increases. For those on lower pay and fixed incomes it would be deeply damaging. Adding multiple extra targets for the MPC would also downplay the importance of their key role in ensuring low inflation.

What evidence is there on the relationship between the scale of the public debt and economic growth?

Higher levels of public debt crowd out private investment and this reduces long-term economic growth. The exact level of public debt that is dangerous and the reduction in GDP is difficult to discern but many studies suggest it is significant.

The Reinhart–Rogoff study Growth in a Time of Debt found that when "gross external debt reaches 60 percent of GDP", a country's annual growth declined by two percent, and "for levels of external debt in excess of 90 percent" GDP growth was "roughly cut in half."

Subsequent IMF studies have supported the reports general thesis that higher levels of debt reduce economic growth.

The current situation cannot continue indefinitely, when interest rates rise those countries with high levels of public debt could experience financing problems. Efforts to address the debt level may damage these countries' ability to provide essential services.

Even absent a crisis the higher the national debt the lower the capacity for the Government to finance productive investments in skills and education as more and more revenues go to debt servicing. Consequently, it is prudent to put the UK Government debt on a sustainable footing and have a plan to reduce it over time.

Not all public borrowing is the same - the separation between public spending that is 'investment' and that which is 'consumption' needs to be properly defined and used to guide borrowing decisions.

- Public debt that is used to subsidise unproductive/less productive investment or consumption damages economic growth takes money out of the private economy and reduces the UK's productivity.

- Public debt taken on at low interest rates and used to finance high yielding physical infrastructure such as roads, housing, energy, or port infrastructure can enhance long-term economic growth rates.

So, not all debt is equal in its affects. The blurring of the division between investment and consumption and the tendency to reclassify most public spending as 'investment' is unhelpful and should be resisted.

Different countries have different capacities to sustain public debt reflecting the size of their economies, whether it is funded by domestic citizens or international investors and the status of their national currency. Also, the levels that can be sustained depend on how the debt is structured e.g. whether it is index linked and whether it is long duration. Locking in the borrowing at low interest rates for a long duration will help reduce the impact on UK economic growth of the current high debt levels. However, public debt becomes increasingly a problem and dangerous if productivity and sustainable growth do not occur.

Is a return of inflation a risk to the economic recovery?

Inflation levels remain low but could easily increase rapidly as huge Government stimulus in the US and to a lesser extent the UK meets a market which is already emerging rapidly from the pandemic as pent-up consumer demand is released. The UK Government should review its spending plans considering the recovery rate of private economic growth and where possible trim public spending if the private sector economic recovery is robust.

There are also other factors that governments can have little to no control over that can cause risks too such as oil price changes.

Can monetary and fiscal policy improve employment, growth and/or productivity outcomes by 'running the economy hot'?

The suggested advantages in this approach are that it could encourage employment among underrepresented and disadvantaged groups, boost investment in technology to increase productivity and encourage employers to invest in developing the skills of their workforce to retain them as the labour market would be tight. Advocates also suggest it would increase wages as companies competed for scarce labour.

However, running the economy hot is likely to increase the volatility of future economic downturns as countries enter future recessions with fewer resources to engage in counter cyclical spending. Also, it would most likely reduce real pay for most UK workers. This is because it causes inflation, which reduces the cost of labour by lowering real wages. Employment might increase but it would be at the cost of lower real wages for the employed.

A better policy would be to focus economic policy on controlling inflation, increasing UK productivity levels, reducing public sector waste, enhancing economic opportunities in all regions and matching the efficiency levels of the most effective overseas Governments. There should also be more of a concentration on boosting GDP per capita rather than the overall size of the economy or the growth rate which could be merely a reflection of an increase in the UK population and not an increase in the UK standard of living.

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