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Principles for the Budget 2012

1. Tax wealth not income

The UK remains unequal, in terms of both income and wealth. The poorest decile of the population now receive 1.3% of the country's total income, in contrast to the 31% the richest decile receive. In other words, the ratio of the income of the top 10% compared to the remaining 90% stands at 4.2 : 10. The equivalent comparison of wealth distribution currently stands at 100 : 10. This means that 10% of households have wealth below £8,800, and 10% above £853,000. The top 1% has total wealth of over £2.6 million.[1]

The Budget opens up a genuine opportunity to address these inequalities, stimulate economic growth and put dormant capital to use. The most effective way of doing this is through taxing wealth not income. While avoiding the unwanted consequences of high income tax – such for instance as, disincentivising profit maximizing and driving investors off-shore – tax on 'unearned' wealth could prove a successful way of raising finance without hampering economic recovery. A truly radical budget should therefore not only call for a revaluation of the property values unrevised since 1991 and introduce a tax paid in proportion to the value of property; it should also introduce a land value tax to generate extra income. These wealth taxes would have added benefits of stimulating land and property markets, as well as addressing jarring social inequalities. In this context, it is worth being reminded that nearly 70% of the land in the UK is currently owned by 0.6% of population.[2] These, and related topics, ResPublica intends to explore as part of its research into the Social Mobility agenda in projects such as *InterGenerational Covenant.*[3]

[1] Hills, J and others (2010) *An Anatomy of Economic Inequality in the UK - Report of the National Equality Panel,* Government Equalities Office [online] http://sticerd.lse.ac.uk/dps/case/cr/CASEreport60.pdf (accessed 20 March 2012).

[2] Donaldson, A, *Land Usage in the UK,* UK Land Directory [online] http://www.uklanddirectory.org.uk/land-usage.asp (accessed 20 March 2012).

[3] http://respublica.org.uk/item/New-Intergenerational-Covenant-Employment-opportunities-for-the-young-work-life-balance-for-older-people (accessed 20 March 2012).

2. Incentivise productive borrowing and saving

In recent years, debt levels have grown to unsustainable dimensions, both on the national level as well as the level of individual households. Average household debt in the UK (including mortgages) stands currently at £55,988. The average amount owed per UK adult (including mortgages) was £29,634 in January 2012 (roughly 122% of average earnings).[4] Yet, the government is not undertaking radical actions to promote saving; neither is it doing all in its power to eradicate the culture of borrowing on the national scale.

An announcement much welcome in the Budget would be a review of productive and unproductive uses of the tax relief on debt. In the current system, interest on debt is allowable against tax and many businesses use it as a means of 'embellishing' their budget sheets, rather than as a genuine tool for investment. Removing the tax relief for unproductive use of taxes in business would be a simple move towards changing the culture of borrowing. In terms of promoting the culture of saving and asset building on household level, the government could do much more to promote an asset-building agenda. A good first step would be to introduce a new platform to replace the scrapped Child Trust Fund, paid for by the reduction in tax relief on pension contributions for top-rate tax payers (a quarter of the £28bn of this relief goes to just 300,000 people). This would provide an effective civic instrument to boost savings, increase financial capability and promote responsibility, as was suggested in the ResPublica report *Asset Building for Children*.[5]

3. Democratise finance and unlock local borrowing

The banking system has been mortally wounded by the recent financial crash. Yet, rather than proposing a radical reform of the banking structures, following the Vickers Review, the UK government has decided to massively underwrite the system. In doing so, the Government has ignored the potential to utilise 'a quiet revolution taking place across the country' with a significant growth of the use of community vouchers, local bonds and peer-to-peer lending.

The Budget presents a unique occasion to re-assess how new models of localised finance can provide a new source of capital. ResPublica would welcome the introduction of new financial tools reliant on contributions from the public such as Public Finance Initiatives or Social Finance Initiatives, to supplement the traditional Private Finance Initiative. We also hope to see the Government announce its support for a nation-wide scheme of community vouchers – enabling people to make investments in local social projects on an associational basis. Moreover the Chancellor could consider using Local Authority Bonds, underwritten by land value capture mechanisms, to finance major infrastructure developments. We are currently exploring this in *Democratising Finance*, one of ResPublica's research areas.

[4] Debt-Simple (March 2012), "UK Debt Statistics", *Debt-Simple* [online] http://www.debtsimple.co.uk/uk-debt-statistics.shtml (accessed 20 March 2012).
[5] Gruescu, S and Middleton, S (2011), *Asset Building for Children with Disabilities*, ResPublica.

4. Promote hybridity in business models

The Government has repeatedly reaffirmed its ambition to promote a diverse range of business models, such as mutual, co-operatives and social enterprises. The Mutuals Taskforce was set up with the intention of supporting public sector staff who wanted to turn their services into "mutual pathfinders". More recently, the Government has undertaken a cross-Whitehall commission to investigate how it can support employee ownership in privately-owned businesses. Still, relatively little consideration has been given to new company models for co-operative and private sector partnerships. Indeed, supporting business models that combine business capacities with social goals – profit and not-for-profit collaborations - is still an uncharted territory.

Given that hybridity can provide a solution to some problems deeply entrenched in the social enterprise sector – most notably, the problem of scaling up and raising funds - a new hybrid company structure should be taken into consideration by the Treasury and promoted in the Budget. As the first step, the Treasury should extend the Community Investment Tax Relief to a variety of socially important schemes. Currently, CITR is very narrow, applying only to financial institutions in “disadvantaged communities”. Expanded as a “social investment tax relief” it could help to jump-start share ownership in social enterprises. This issue has been raised by ResPublica on numerous occasions, most recently in an article by the Director of ResPublica published in the *Financial Times* – "‘John Lewis economy’ talk is never knowingly undersold.”[6] We intend to investigate in more detail the possibility and potential success of such models in delivering both social and economic growth.

5. Trade horizontally and think small

SMEs are major contributors to private sector employment. Empirical studies have shown that SMEs contribute to over 55% of GDP and over 65% of total employment in high income countries.[7] Yet, small and medium sized businesses face many challenges in today's economy. In many cases, the levels of market concentration and the uncompetitive behaviour across industries exhibiting oligopolistic tendencies limit the ability of new businesses and SMEs to grow and prosper. Despite the ambitions announced in the Open Public Services White Paper, SMEs also lose out to bigger players when it comes to government procurement and commissioning.

The Budget presents an ideal opportunity to address these problems. Building on the Open Public Services White Paper, the Chancellor could consider introducing a delivery infrastructure levy on prime providers delivering public services. This would encourage such organisations to, where appropriate, provide funding and support to sub-contractors. Commissioners should take into account the operational experience of not just the prime provider but of all the partners in a particular tender. Moreover, commissioners should reassess the rule that 50% or more of the contracts delivered should be delivered by the

[6] Blond, P (17 January 2012) "‘John Lewis economy’ talk is never knowingly undersold”, *Financial Times* [online] http://www.ft.com/cms/s/0/d9e2403c-4107-11e1-b521-00144feab49a.html (accessed 20 March 2012).
[7] Fida, B (2008) “The Importance of Small and Medium Enterprises (SMEs) in Economic Development”*, The Free Library by Farlex* [online]. http://www.thefreelibrary.com/The+Importance+of+Small+and+Medium+Enterprises+(SMEs)+in+Economic...-a01073924138 (accessed 20 March 2012).

prime provider, as argued by ResPublica in *The Civil Effect*.[8] Secondly, in order to address the difficulties SMEs face competing with large companies and multinational conglomerates, the Chancellor should consider simple yet effective steps, such as increasing the VAT business threshold up to £120, 000 per annum from the current £70, 000. Such a decision would help to provide cash-flow to the sector and allow SMEs to invest back into the business.

6. Drive economic growth through education

Education is the key economic driver. Higher levels of human capital are highly correlated with greater economic growth, increases in productivity and entrepreneurship. Indeed, there is compelling evidence that increasing school enrolment rates by one percentage point leads to up to 3% increase of GDP growth per capita. Higher education in particular drives innovation in knowledge intensive economies. For this reason, there is a serious risk associated with underperforming education system.

Given that in the current climate public resources are scarce, ResPublica would welcome the Chancellor giving a reinvigorating jolt to the education system by utilising private sector resources: both intellectual and financial. As part of its continued expansion of the apprenticeship programme, the government should open up the largely 'untapped' SME market (currently only 14% of the small business provide work-place learning opportunities, compared to 83% of organisations with over 5000 employees) and create a shared 'cloud' platform that would offer SMEs support in recruiting and managing their trainees.

The Government could also consider utilising the learning potential latent in the SME sector through intelligent commissioning of innovative technologies, as recently suggested by ResPublica at the event *Technology, Business and Growth: Next steps for the UK economy*. On the level of higher education, the Chancellor should introduce a nation-wide initiative granting businesses tax relief for 'sponsoring' research institutes devoted to delivering the final year tuition to undergraduates. Introducing this model of 2+ degrees would provide a quick solution to the scaling up of sandwich courses, as well as providing the much needed cash injection to the HE sector, while assuring good levels of integration between graduate skills and business needs.

In order to promote innovation, building on its decision to make Research and Development expenses tax deductible, ResPublica would like to see the introduction of further incentives for business to re-invest a certain percentage of its profit back into R&D activities (currently as much as 85% is paid out in forms of dividends to private individuals).

[8] Singh, A (2010) *The Civil Effect: Bringing efficiency, innovation and community capability to our framework of public services commissioning*, ResPublica.

7. The micro is the new macro

The rhetoric and commentary around the Government's 'Big Society' agenda has not materialised into a concrete policy programme at a local level. The Big Society debate needs to focus on tangible actions leading individuals and communities to engage in a 'muscular localism'. What is needed is a platform for localised community action that could produce aggregate effects.

The Budget ought to recognise the benefits of aggregating micro-level effects to achieve macro- level results. For example, creating an effective peer-to-peer lending facility for businesses would do much to mitigate the fall in SME lending and capital provision. By driving greater parental involvement in education of individual students, mass improvement in local schools can be achieved. Personalisation of social care for individual patients can dramatically alter the health outcomes for the entire nation. The Chancellor should call for a cross-departmental review to examine the potential for community projects, such, for instance, as those concerned with local energy production, to significantly contribute toward achieving national targets. ResPublica has recently forwarded such measures in the Green Paper: *Re-energising Communities: Transforming the energy market through local energy production*, which outlines a number of principles to enable communities to become active producers rather than simply passive consumers of energy.[9] We intend to extend our research into the energy market much further, and will be launching an investigation into the potential of 'associational' personal budgets upon the passing of the Health and Social Care Bill.

[9] Dobson, J and Julian, C (2012) *Re-energising Our Communities: Transforming the energy market through local energy production,* ResPublica.