TheCityUK

The Rt Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

13 January 2021

Dear Chancellor,

TheCityUK is pleased to submit views to HM Treasury in preparation for the 2021 Budget.

It hardly needs stating that the Budget will be presented in extraordinarily difficult circumstances. The Covid-19 pandemic will be entering its 12th month, having already wrought unprecedented economic devastation in the UK (and elsewhere). Real GDP declined by 3% quarter on quarter in the first quarter of 2020, and a further 18.8% in the second quarter. Although it subsequently recovered some of those losses, growing by 16% in July-September[1], the renewed restrictions on business and mobility introduced in November-December 2020 mean that economic output will have continued to be constrained in the fourth quarter of 2020. Meanwhile, the introduction of a third national lockdown in January 2021 will ensure that the economic recovery is unlikely to start in earnest before the second half of this year, later than previously hoped.

The government's ongoing support to businesses and workers—absolutely critical, given the scale of the economic impact—will have a monumental impact on the public finances. It pushed public sector net debt to around £2trn at the end of November 2020, equivalent to 99.5% of GDP.[2] The debt-to-GDP ratio is forecast to rise to 105.2% in 2020/21, 108% in 2021/22 and 108.6% in 2022/23. On top of this, 2021 in a sense marks the first 'true' post-Brexit year, with the transition period having come to an end and a new UK-EU trade and economic relationship having been agreed. While the successful conclusion of trade negotiations in late 2020 was greeted with relief by businesses in all parts of the UK and Europe, TheCityUK is cognisant of the need for both sides to continue to develop the relationship in services in the years ahead, using the agreement as a foundation on which to build, and not a ceiling to future ambition.

In this context, the forthcoming Budget will have symbolic significance as well as economic policy impact. Government spending in the coming months must support not just near-term crisis-relief measures, but also areas whose strength will ensure the UK's continued economic competitiveness in an increasingly challenging economic environment. The financial and related professional services industry is keen to ensure that it can continue to maximise its direct and indirect contribution to the UK economy, and in this context, we offer the following proposals.

[1] Office for National statistics, 'Gross Domestic Product: Quarter on Quarter growth: CVM SA %', (22 December 2020), available at: https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/ihyq/qna

[2] Office for National Statistics, 'Public sector finances, UK: November 2020', (22 December 2020), available at: https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/november2020

Registered in England number 7088009. TheCityUK, Fitzwilliam House, 10 St Mary Axe London EC3A 8BF. T: +44 (0)20 3696 0101

Email: danielle.vaughan@thecityuk.com www.thecityuk.com

Adopt a consultative approach to the introduction of new tax measures that would prioritise economic growth that is sustainable in the long term

The UK-based financial and related professional services industry's tax contribution sits above the headline rate of corporation tax. Its contribution accounts for £11 of every £100 of tax paid to the exchequer; the banking industry alone contributed £39.7bn in tax in 2019, comprising corporation tax, business rates, employment taxes, irrecoverable VAT, the bank levy and the bank surcharge, while the UK insurance industry—the fourth-largest insurance and long-term savings provider in the world, pays nearly £12bn in taxes to the government.

Many of these taxes are not dependent on profits, meaning that firms pay regardless of how well their business is doing. Tax paid by firms is only one element of the industry's total contribution; the economic activity generated by the industry also leads to a significant tax contribution.

Government should target measures which prioritise economic growth that is sustainable over the long term, help create well-paid jobs, and further the UK's progress towards its international commitments on combating climate change. Positive actions that the government could take now include ensuring incentive structures are stimulating investment in the right way. This would help support the growth and create the jobs needed in the coming years, as well as provide additional tax revenue for the Exchequer, which will be absolutely critical for supporting the near-term spending on pandemic-related labour-market and social spending, and ensuring the medium-term normalisation of the public finances. Thought should be given to reforms which could increase the industry's economic activity in the UK. Regions across the UK benefit from employment opportunities offered by the industry and increased levels of activity will bolster overall tax revenues.

The quality of a country's tax system encompasses more than the final output of tax policy; it is also important to consider the way in which tax policy is approached, from how it is decided that the policy objectives can be met, to the announcement of change, approaches to consultation and legislative drafting. A stable and consistent approach to tax policy will have a positive impact on inward investment and the overall attractiveness of the UK's business environment. The government should use this opportunity to develop a long-term, strategic approach to taxation in the UK which aligns to its broader policy objectives, for example, by producing a 'Tax Roadmap' to help businesses plan for upcoming changes. In doing so, the government should strongly consider the need for simplification, by rethinking certain taxes rather than applying short-term patches which create further complexity. The UK's tax code has been widely reported to run at over 17,000 pages. In contrast, Hong Kong's tax code is less than 300 pages, allowing businesses to spend less of their resources interpreting and complying with complex regulation. While simplification itself may not drive additional tax revenues, clarity around the tax system may encourage businesses to operate in the UK, which would have the effect of increasing overall tax revenues. Taking a consultative approach is vital, as newly designed taxes sometimes introduce unintended consequences that create further complexity.

Government and industry must work in partnership to advance sustainability goals

Issues of environmental and social sustainability have gained increased prominence in the last year, and the government—including HM Treasury itself—has made clear its commitment to encouraging environmentally-sustainable economic growth. For example, the UK was the first country in the world to legislate a net-zero carbon emissions target, and in December 2020 it published a new Energy White Paper, which builds on the Ten Point Plan announced by the Prime Minister and sets out specific strategies for transforming the domestic energy system to be consistent with net-zero carbon emissions by 2050. The government has the opportunity to use its hosting of COP26 in November to position the UK as a global leader in green finance and sustainability initiatives. We are pleased to see the government's recognition that COP26 "provides the opportunity to drive further ambitious action on climate change and unite the world on a path to a net zero economy, including through our COP26 Energy Transition Campaign and co-leadership of the Powering Past Coal

Alliance".[3] Adding to this, we would encourage the government and industry to establish joint working groups to focus on international cooperation and agree consistent methodologies for measuring the effectiveness of national initiatives in addressing climate change. Such cooperation could help maximise the effectiveness of various national initiatives and ensure that best practice and innovative solutions are shared more widely. After all, while governments set long-term policy frameworks, it is the actions of private sector firms that will help meet targets.

The primary focus in this long-term policymaking should be ensuring that the right incentive structures are in place. Incentive structures are often insufficient for businesses to promote sustainable investments over non-sustainable ones. Notwithstanding the fact that there are financial and reputational risks involved in not addressing sustainability issues, businesses are often deterred by the higher up-front investment costs associated with sustainable investments, and/or a lack of (real or perceived) higher returns associated with these investments. Government policies in areas such as governance as well as tax could help incentivise businesses to adopt sustainability-focused practices. Policy and fiscal certainty around the necessary infrastructure investments will also be critical. We would urge the government to ensure that new infrastructure incorporates green principles from the outset.[4] Much of the financing required to develop low-carbon infrastructure will inevitably come from the private sector, but government investment will be critical in certain areas, such infrastructure focused on adaptation and resilience. Finally, reporting obligations combined with penalties for poor performance are likely to lead to more concrete results, in particular, if coupled with support to help companies and regulatory adjustments that enhance major UK funds' and institutions' ability to deploy capital to such projects.

Accelerate development of digital infrastructure

One of the most dramatic shifts triggered by the pandemic was the near-instant and -comprehensive move from physical provision of services to digital. Although this change had already been underway, the need for social distancing and restrictions on mobility over the past year have vastly accelerated the transformation; that the shift has generally been successful means that 'new' ways of working, and of producing and consuming services digitally, are likely to endure even once the pandemic has receded. But the pandemic has also highlighted the 'digital divide' between those with access to high-quality mobile and fixed broadband networks and those without. The existing speed and availability of key infrastructure in the UK, such as broadband, lags most other leading financial centres, putting at risk growth, attractiveness and ability to innovate.

Digital infrastructure is a core requirement of a technologically enabled financial and related professional services industry. Throughout the pandemic the industry has depended on public digital infrastructure such as mobile and fixed broadband infrastructure to keep the economy running, power remote working, and manage digital interactions between firms and consumers. It is vital the UK government provides access to high-quality digital infrastructure, so that individuals and households can benefit from digital financial services and more flexible, remote working opportunities. It is also vital in maintaining the resilience of the UK's financial system, which is increasingly reliant on technology. Ensuring the UK has access to high-quality digital infrastructure means businesses can operate quickly and reliably.

The government should ensure commitment to its promise to "[work] with industry to target a minimum of 85% gigabit capable coverage by 2025, but will seek to accelerate roll-out further to get as close to 100% as possible".[5] Efforts to accelerate roll-out to meet this target earlier than 2025 would help ensure that digital infrastructure is not a barrier to the UK's economic recovery. We also

[3] HM Government, 'Powering our net-zero future', December 2020, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945899/201216_BEIS_EWP_Command_Paper_Accessible.pdf

[4] For details, see TheCityUK and Imperial College Business School, 'Financing low-carbon infrastructure' (November 2019)

[5] HM Treasury, 'National Infrastructure Strategy', (25 November 2020), available at: https://www.gov.uk/government/publications/national-infrastructure-strategy

note the pledge to "[invest] £500 million, matched by industry, to deliver high-quality 4G mobile coverage from at least one operator across 95% of the UK by 2025".[6] But we would also advocate for the rollout of 5G connectivity more widely than the main urban areas in which it is already available.

Align training to industry needs and future skills

Another impact of the pandemic has been a fundamental reshaping of labour markets, and addressing the long-term impact of this reshaping and the continued evolution of labour demand will be a major challenge. The financial and related professional services industry continues to retain talent and provide opportunities with well-paid jobs (industry employment is over 2.3m across the UK) that people can perform from home, with initial research suggesting only 2% of financial services staff have been furloughed during the pandemic.[7] But the acceleration of technology and digital adoption for customers and employees has been particularly rapid, and 30% of financial services workers have said they need more digital and technology expertise to fulfil their roles as a result of the pandemic[8].

Government investment in skills and training needs to be aligned with the skills needs of business and accessible to ensure that training opportunities are taken up deliver the greatest possible impact. Recent government announcements on investments in training are welcome. The 'lifetime skills guarantee' for adults without an A-level or equivalent qualification has potential to be transformative for the UK's financial services sector. Nearly 300,000 employees, the majority based in the North East, North West and Yorkshire & Humber, stand to benefit from this initiative, potentially boosting their skills and enhancing their current and future employability.[9] The government should ensure that the skills provided through this initiative as well as increased flexibility around apprenticeships in England meet future skills needs. The Financial Services Skills Commission is working with industry to publish a 'Future Skills Framework' to define these future skills needs. For its part, the industry can try to help mitigate rising unemployment by reskilling employees to cater for roles created by an increasingly virtual world. Reskilling in areas of technology, data, sustainability, and remote and digital tooling will help future-proof the UK domestic workforce against future crises, and strengthen the competitive position of the industry internationally, allowing it to make a stronger contribution to the domestic economy.

Continue to invest in regulatory diplomacy - boosting our international trade links and influence on the world stage

The future prosperity of the UK will be highly dependent on forging effective new trading relationships as an independent trading nation. Although there will rightly be a focus on ensuring value for money on public spending given the costs of tackling Covid-19, investment in economic diplomacy, trade policy and international development (including the FCDO Prosperity Fund) need to be seen in terms of long-term value creation and the projection of soft power.

The UK's vast network of diplomatic missions is a national asset and investing to maintain and strengthen resourcing should be a priority. This investment should include the deployment of specialist staff who have a deep understanding of some of the UK's key export sectors within relevant missions. To this end, we would encourage the placement of dedicated financial services

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[6] Ibid.

[7] HM Revenue & Customs 'Coronavirus Job Retention Scheme statistics, December 2020. Available at: https://www.gov.uk/government/publications/coronavirus-job-retention-scheme-statistics-december-2020/coronavirus-job-retention-scheme-statistics-december-2020#employments-furloughed-over-time-by-industry

[8] KPMG & Financial Services Skills Commission ' The Future of Work: Lessons from a pandemic' October 2020 available at: https://assets.kpmg/content/dam/kpmg/uk/pdf/2020/10/the-future-of-work-lessons-from-a-pandemic-october-2020.pdf

[9] Financial Services Skills Commission analysis based on ONS annual Population Survey, October 2017.

related staff in diplomatic missions in priority financial and related professional services markets wherever practicable. Diplomatic staff with a deep understanding of financial issues will help to build market access and maintain ongoing engagement with financial regulators in these markets.

The UK's future prospects will also inexorably be tied to its ability to exert influence in global forums, shape global standards, and advocate for the reinvigoration of the rules-based order. The UK's multilateral missions (e.g. UKMIS, UKDEL) will have a leading role to play in achieving these aims and investing in their resourcing will also be crucial. Our multilateral missions have sometimes been under-appreciated, in part because the agenda of multilateral institutions can be slow-moving, but they are critical to helping the UK shape global standards on economic and financial issues. The opportunity these Posts provide for the UK to build coalitions and alliances, test and lead opinion, and to give staff exposure to concomitant skills and experience cannot be underestimated.

We look forward to having the opportunity to discuss these proposals with you in more detail.

Yours sincerely,

Miles Celic
Chief Executive Officer| **TheCityUK**