THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Budget 2024 - LSE Research Briefing

Overview

- In the Budget on 30 October, the Chancellor set out a series of measures designed to plug the hole in the public finances while improving public services and underpinning long term economic growth.
- Key announcements included:
  - An increase in emplyer National Insurance contributions;
  - A change to inheritance tax threasholds;
  - An increase in strategic funding available to UK regions;
  - An increase in funding for education and schools.

Loosening Financial Regulation to Boost Growth

- Dr David Murphy from LSE's School of Law argues that, given the histoically low growth forecasts from the OBR in the 2024 Budget, the Government should revisit the "overly restrictive" financial regulation put in place following the 2008 financial crisis.
- He notes that the PRA's primary objective – to promote the safety and soundness of PRA-authorised firms – has created a "safety at any price" mandate which could be fulfilled by ensuring that regulatory burdens are so high that regulated firms seldom fail. Jonathan Hill, in the context of EU financial regulation, has this described as the stability of the graveyard.
- Dr Murphy notes that making it difficult for life insurers to invest in infrastructure projects, even though their investment needs often match the long-term profile of these projects, is preferred under this mandate, because it makes insurers a little bit safer.
- While it is unreasonable to complain that the PRA is doing what it was created to do, Dr Murphy urges policymakers to consider if that is what needs doing given the current challenges and ambitions**.** There have been various changes to regulators' mandates since 2008, including the secondary objective to facilitate effective competition, although these always are subsidiary to the primacy of ensuring "safety at any price".
- While revoking the Bank of England's operational independence is out of the question, Dr Murphy argues, he points to a huge distance between revoking independence and asking whether the current mandate best serves the needs of business and citizens.
- If, for example, the PRA's primary mandate was recast to focus on ensuring that the UK financial system provides key economic functions efficiently and robustly in all conditions, this would balance financial stability and efficiency: a failing firm cannot provide economic functions robustly, but a stable one does not necessarily serve the economy's needs. Such a mandate might better reflect the role regulators should play than the current "safety at any price" approach.

Removing Policy Banks from the Fiscal Rules

- Daisy Jameson and colleagues from LSE's Grantham Research Institute for Climate Change have looked at the **huge potential benefits of excluding the UK's policy**

banks (government-owned financial institutions like the National Wealth Fund, British Business Bank, UK Export Finance, that invest through loans, guarantees and equity, in commercial markets to help deliver government policy) **from the UK's debt rule.**

- Excluding policy banks from the UK's fiscal rules and allowing them to grow their balance sheet without artificial constraint would allow for the policy banks to borrow from the market, change the way they invest and become more activist in the market (although others, including measuring PSNFL and PSNW could have a similar effect). This would be in line with countries like France and Germany.

- They find that every £1bn a year of sustained additional investment unlocked by removing policy banks from the balance sheets could generate as much as £3.2bn in potential economic output**,** yielding as much as £1.9bn a year in additional tax revenue.

- You can read more on the blogpost here.

Inheritance Tax

- Dr Andy Summers, Dr Arun Advani, and James Forrester from LSE's International Inequalities Institute have analysed anomolies and gaps in the UK's Inheritance Tax system, and **set out a range of reforms that could raise revenue for the Exchequer by limiting the tax reliefs that currently disproportionately benefit the largest estates**, while increasing the tax-free Nil-Rate Band for most estates. Their work helped inform some of the decisions made in this Budget.

- Their research has shown that the vast majority of estates in the UK pay no Inheritance Tax, and even those that do often pay nowhere near to the 40% flat rate, due to the large number of individual **exemptions, allowances and reliefs** that estates can take advantage of to minimise their final tax owed.

- For example, the **spouse exemption** provides for the complete exemption of assets transferred to a spouse or civil partner, so that the first death within a married couple often means no tax is due at all. The Transferrable Nil Rate Band allows for the transfer of the £325,000 tax-free between spouses, while the Residence Nil-Rate Band, introduced in 2017, exempts the first £175,000 of residential property passed to a direct descendant. This allowance is also transferrable between spouses, meaning that many couples can pass on £1m to descendants free of Inheritance Tax.

- Also, only a quarter of those claiming **Business Relief** (which provides 100% Inheritance Tax relief on business assets and shares in qualifying unlisted and AIM-listed companies as well as 50% relief on controlling shareholdings in listed companies) on shares had been involved in management of the business as a director at any point in the five tax years prior to death (19% as close company director). This suggests most claims for Business Relief are by 'passive' investors rather than 'active' business owners.

- The analysis also finds that the UK system incorporates many smaller reliefs, each costing relatively little but heavily concentrating the benefits. For example, "heritage assets" are conditionally exempt from Inheritance Tax where the assets are deemed to be of "national, scientific, historic or artistic, scenic, architectural interest". 96% of this

relief (around £300m) was claimed by just 44 estates between 2018 and 2020, benefiting from an average of £7m in relief on an average estate size of almost £20m

- Options for reform include: **capping the spouse exemption at £10m; better targeting business relief at established schemes to incentivise investments; and abolishing the Residence Nil Rate Band (RNRB) whilst increasing the standard Nil Rate Band (NRB) by an equivalent amount.**

- The researchers further argue that the UK should look at successful international examples to inform a wholesale reform and improvements of Inheritance Tax.

- You can read more in the blogpost here and the policy paper here.

An Exit Tax for the UK

- **Dr Summers and Dr Advani have also made the case for the UK having an "exit tax" in a similar way to Canada and Australia.**

- They have noted that three quarters of leavers (by shareholding value) go to countries where they can sell their business without paying any tax on the gains they made whilst living in the UK, **meaning that by leaving the UK they can avoid paying CGT altogether**. This incentivises successful businesspeople to emigrate to save tax.

- Almost all of the UK's international peers already levy an" exit tax" on the gains of people who cease to be tax resident, including includes the US, France, Germany, and Japan. Within the G7, Italy is the only other country which does not have any CGT on emigrants.

- If the UK levied an exit tax, the authors note it could raise significant revenue without affecting most emigrants. The top 10 wealthiest leavers each year account for three-quarters (73%) of potential revenue, so the Government could afford to exempt anyone with gains below £1m.

- You can read more about the proposal here.