



Pointmaker

WHO WILL CARE FOR GENERATION Y?

THE BABY BOOMERS' LEGACY

MICHAEL JOHNSON

SUMMARY

- This paper concerns the plight of Generation Y, which could be the first generation to experience a quality of life below that of their (baby boomer) parents. The latter have become masters at perpetrating inter-generational injustice, by making vast unfunded promises to themselves, notably in respect of pensions. Indeed, such is their scale that if the UK were accounted for as a public company, it would be bust. In any event, Generation Y will have to foot the bill.
- To evaluate the scale of the problem, the Treasury's Whole of Government Accounts (WGA) are considered. By including many of the nation's unfunded promises, they are closer to company accounting than the National Accounts; consequently, they are more useful for assessing the long-term sustainability of our public finances.
- The gap between the nation's assets and liabilities grew by an unsustainable 51% in the five years to end-March 2014, to £1,852 billion. At 111% of GDP, this is equivalent to £70,000 per household, and is £450 billion more than the National Accounts' nearest equivalent, the public sector net debt. The WGA, however, excludes the State Pension, the largest of all unfunded liabilities (roughly £4,000 billion). Include it, and the burden per household rises to £221,000.
- Reining back on unfunded promises means either stop making them, or fund them now, which would require higher taxation (or additional cuts in public spending). Pre-election pledges have limited the scope for raising rates of taxation, leaving the Chancellor with little choice but to cut tax reliefs and exemptions. This paper focuses on the £110 billion of expenditure reliefs, defended by special interest lobbyists; and also discusses the recent Public Accounts Committee's excoriating report into HMRC's general management of reliefs and exemptions.
- There are six specific proposals. Their expressed purpose is to improve transparency and put a brake on deferring costs, i.e. to arrest the accumulation of unfunded commitments that Generation Y, in particular, will otherwise have to meet. This paper does not contemplate the fate of Generation Z.



PROPOSALS

Proposal 1: The UK's Whole of Government Accounts (WGA) balance sheet should include a liability to represent future State Pension payments, based upon a realistic expectation of the future cash outflow, discounted using the UK gilt yield curve.

Proposal 2: Draft legislation which, if implemented, would produce unfunded spending commitments, should be accompanied by an Inter-generational Impact Assessment to quantify the impact on the young, i.e. future taxpayers.

Proposal 3: An Office of Fiscal Responsibility should be established, under the aegis of the Chancellor, to scrutinise the effectiveness and value for money of all tax reliefs and exemptions.

Proposal 4: All tax reliefs and exemptions should be subject to a five year sunset clause, after which they would cease. Lobbyists should be requested to present their cases directly to the proposed Office of Fiscal Responsibility, to ensure blue water between vested interest groups and ministers.

Proposal 5: Departmental budgets should be set both gross and net of expenditure on tax reliefs and exemptions, to ensure transparency as to the true level of financial support to each area of public policy.

Proposal 6: The Prime Minister should embellish his doctrine of personal, professional, civic and corporate responsibilities by adding a fifth category: inter-generational responsibility.

The generations: definition

Generation Y refers to those born between c. 1980 and 2000, i.e. aged between 35 and 15 today. They are preceded by Generation X (early 1960's to 1979 births) and the baby boomers, born between 1946 and the early 1960's.



FOREWORDS

Y: WE ARE MORTGAGING YOUR FUTURE

Lord Holmes of Richmond

As Mad Max returned to the big screen last month, following a 30 year break, perhaps we should all take some time to transpose those ideas into the economic desert and fiscal future facing Generation Y. This is exactly what Michael Johnson has done in this ground breaking, thought-provoking paper.

Through his use of Whole of Government Accounts (WGA), Mr Johnson has brought the future facing Generation Y into stark relief. The numbers are apocalyptic but real, and the path is clearly set out: it is likely to be a struggle not experienced by previous generations. Ultimately it is down to (political) choices. But, to be clear, we are currently choosing to leave Y with the tab.

Johnson makes six proposals to promote a fairer future for the young. All are thoughtful and worthy of serious consideration. They include the introduction of Inter-generational Impact Assessments, which should be adopted, and a visionary proposal to establish an Office of Fiscal Responsibility, to scrutinise all tax reliefs and exemptions. We currently suffer £110 billion of annual expenditure reliefs, covering special interests ranging from the prosaic to the exotic: their scrutiny is essential.

We need One Nation Conservatism now more than ever. If it is to be effective, inclusive, fair and, most significantly, fit for the future, it should encompass inter-generational considerations. Transparency is key to putting an end to deferring the inevitable; the piper must be paid. A final question to Generation Y: why should you suffer a standard of living lower than your parents?

THE TRUTH IS NOW OUT

Catherine Howarth, Chief Executive, ShareAction

You do not need to be a member of the hapless Generation Y to feel disturbed and surprised by the analysis in this pamphlet. The reality is that those of us in Generation X, and our baby boomer parents, have only been dimly aware of the societal injustice we are inflicting on the youngsters of today. But the numbers that Michael Johnson so skilfully brings into focus leave us with nowhere to hide. The truth is now out.

The evidence presented here ought to have a profound political impact, but this inevitably depends upon the willingness and ability of Generation Y themselves to discover their political voice and demand a new, fairer settlement. In the month when Mhairi Black, a highly articulate twenty year old, was elected to Parliament, it is impossible not to feel a little hopeful that change might indeed be possible. The six policies proposed in the pages of this pamphlet would be a smart place to begin.



INTRODUCTION

In the run up to the recent general election, we once again witnessed politicians fawning over the baby boomers and older pensioners. This is partly because the elderly are more inclined to vote than the young, but it is also a consequence of relentless lobbying. Consequently, no party was prepared, for example, to confront the State Pension's unaffordable triple lock guarantee.¹ In addition, ancillary benefits such as the winter fuel payment, the Christmas bonus, free prescriptions from 60 (England), free TV licences and subsidised (or free) travel were all left intact (and reaffirmed in the subsequent Queen's Speech). Inevitably, this will be at the expense of the young and subsequent generations: the silent majority.

1. GENERATION Y: ON THE RACK

Generation Y is faced with unaffordable housing,² college debts, fragmented careers, earnings and productivity stagnation, zero hours contracts, relatively thin occupational pension provision (including a DB desert for the private sector), a rapidly-retreating State Pension age and, perhaps most challenging of all, having to support an ageing population. In 2010, there were 3.2 people of working age for each person of State Pension Age (SPA) and over in the UK. Without recent rises in the SPA, this "old age support ratio" would drop to 2.0 by 2051.³ With them, it is projected to fall to 2.9 by 2051. But simply relabelling people as "workforce" rather than "pensioner" does nothing for their capacity to work.

And while a minority of Generation Y will be substantial beneficiaries of inheritance, they will also probably be living in a world of growing

wealth inequality. Theirs could be the first generation to experience a quality of life below that of their parents'.

2. EVIDENCE OF GENERATION Y'S PLIGHT

2.1 The UK's balance sheet

The Treasury's Whole of Government Accounts (WGA) is a single set of accounts consolidating the financial activities of the UK public sector. Closer to company accounting than the National Accounts, they provide a more realistic picture of the UK's financial condition. Unlike the National Accounts, the WGA has a balance sheet that includes many of the unfunded promises (i.e. liabilities) that the baby boomers have been making to themselves, notably public sector pensions (£1,206 in respect of the unfunded schemes, plus a £96 billion asset shortfall in the funded schemes, essentially the Local Government Pension Scheme). In addition, there are provisions for items such as nuclear decommissioning (£77 billion) and clinical negligence (£27 billion, up 69% in four years), and obligations such as PFI contracts (£33 billion).

Table 1 shows that the nation's net liability of £1,852 billion grew by 51% in the five years to end-March 2014 which is, of course, unsustainable. Clearly, part of this leap in the net liability is down to exceptional circumstances, i.e. the financial crisis and the unusually low interest rates that followed. The latter, for example, is partly responsible (through low discount rates) for the huge increase in the unfunded public sector pension liabilities (up by £130 billion in 2013-14 alone).

¹ The triple lock guarantees that the State Pension is increased each year by the higher of CPI inflation, average earnings or a minimum of 2.5%. It is expected to cost an additional 0.9% of GDP within 50 years (as opposed to simply uprating pensions in line with earnings). OBR; *Fiscal Sustainability Report*, July 2013.

² In 1991, 65% of 25 to 34-year-olds in England owned their own home; by 2012 this was under 45%. In the 35-to-44 age group, the figure has reduced from 80% to 60% over the same timeframe. Source: ONS.

³ ONS Pension Trends; *Chapter 2: Population change (2012 edition)*.



But whatever the causes, the net liability, at 111% of GDP, is equivalent to £70,000 per household, and is £450 billion more than the National Accounts' nearest equivalent, the public sector net debt. It will increase again in 2014-15, not least because Network Rail, which has, for too long, pretended to be a private sector company, will find that its £34 billion net debt (March 2014) will be included for the first time.

2.2 Net expenditure

The National Accounts recognise cash payments and receipts, but cash items alone do not represent the full cost of public services. Non-cash items often include technical adjustments that hint at future cash consequences, with future implications for taxation. Once they are taken into account (Table 2), the National Accounts' current deficit, for example, more than

doubles, to become what the WGA terms "net expenditure".⁴

The net expenditure provides a more realistic indication of the extent to which we are living beyond our means; essentially we are mortgaging the future, and mortgages eventually have to be repaid.

2.3 A case study: public service pensions

Table 3 shows the WGA's reconciliation of its largest unfunded commitment, the public service pensions liability, which increased by a net £130 billion over 2013-14.⁵

The WGA attributes a £88 billion net expenditure to public service pensions for 2013-14, more than double the cash paid out in benefits, as reported

⁴ Ibid.

⁵ With thanks to the Treasury for their assistance in interpreting the WGA.

Table 1: The UK's balance sheet as per Whole of Government Accounts (£ billions)

	2009-10	2010-11	2011-12	2012-13	2013-14
Property, plant and equipment	£713	£714	£745	£747	£763
Gold, cash and other financial assets	£274	£255	£282	£311	£324
Trade receivables	£139	£145	£142	£139	£149
Equity in public sector banks	£61	£60	£41	£40	£43
Intangible assets	£36	£35	£35	£35	£32
Other physical assets	£26	£26	£26	£26	£27
Total assets	£1,250	£1,234	£1,270	£1,298	£1,338
Public sector pensions	£1,135	£961	£1,006	£1,172	£1,302
Government borrowing	£782	£908	£966	£996	£1,096
Financial liabilities	£313	£295	£374	£473	£491
Trade payables	£146	£148	£159	£154	£159
Provisions	£102	£107	£113	£131	£142
Total liabilities	£2,477	£2,419	£2,618	£2,926	£3,190
Net liability	£1,228	£1,185	£1,348	£1,628	£1,852
% GDP	83%	75%	83%	100%	111%

Source: HM Treasury; Whole of Government Accounts; March 2015.



in the National Accounts.⁶ This highlights the importance of understanding the meaning of the word “cost”: it is not simply headline (cash) items in the National Accounts, a point rarely discussed by politicians and media alike. To reinforce the point, consider the 2014-15’s National Accounts’ current deficit (£57 billion, provisional), some £16 billion smaller than the previous year’s current deficit. But the central government net cash requirement (CGNCR) for 2014-15 (£94 billion) is expected to be some £15 billion *higher* than for 2013-14, because of past years’ net expenditures coming due.⁷ Net expenditure items subsequently manifest themselves as cashflow demands, through taxation, on future generations (something that the OBR’s annual Fiscal Sustainability Report does raise when considering the future sustainability of the public finances).

But even the WGA does not provide the whole picture.

2.4 What of the State Pension?

Bizarrely, the unfunded State Pension, the largest of all unfunded liabilities at roughly £4,000 billion, is excluded from the WGA’s balance sheet because, unlike public service pensions, the Treasury deems it to be a benefit (i.e. “welfare”), not an obligation.⁸ The Treasury’s explanation to the author is that:

The estimate of the public sector pension liability is based on decisions that have already been made in the past regarding entitlement, and therefore a commitment to pay has been made that must be disclosed on the government balance sheet. However, the State Pension is different as the liability to make these payments arises according to the circumstances and legislation prevailing at the time of the claim. Any estimate of overall future payments would be subject to huge uncertainty as the payments will be paid at some point in the future without knowing the exact terms and conditions.⁹

⁶ Current and past service costs represent increases in the present value of liabilities from active members’ service in 2013-14. Net financing costs are the increase in PV of liabilities as benefits moved, during the year, one year closer to payment.

⁷ ONS; *Public Sector Finances, March 2015*, 23 April 2015.

⁸ According to the Treasury, all liabilities recognised in the WGA must follow the private sector’s International

Financial Reporting Standards: the State Pension does not meet the recognition criteria.

⁹ With regards to the last sentence, the same could be said of public sector pensions: witness the recent changes resulting from Lord Hutton’s review which, by linking payment to the State Pension age, significantly changes (long-term) future payments.

Table 2: A single year’s net expenditure: 2013-14

	£ billion
National Accounts’ current deficit	£73
Plus: Public sector employee pensions	£49
Plus: Asset accounting (write downs, depreciation) and other	£17
Plus: Provisions, esp. nuclear decommissioning, clinical negligence	£10
Accounting deficit for the year (“net expenditure”)	£149



The State Pension liability would appear to escape the WGA on a technicality, but, that aside, it still has to be met, through taxation. Consequently, in the interests of transparency (to be clear, the WGA is a *transparency and accountability project of HM Treasury*),¹⁰ it should be included in the WGA. The UK balance sheet's net liability would then more than treble, to nearly £6,000 billion.

Proposal 1: The UK's Whole of Government Accounts (WGA) balance sheet should include a liability to represent future State Pension payments, based upon a realistic expectation of the future cash outflow, discounted using the UK gilt yield curve.

Include the State Pension in the WGA, and the UK's net liability leaps to £221,000 per household. Such a move would resonate with the opinion of Steve Webb, the former pensions minister, who suggested that the State Pension should be seen as a right, not a benefit, because "*it is yours by right, you have paid your national insurance contributions*".¹¹

2.5 Fortunately, countries and companies are different

If the UK's WGA accounts represented those of a company, it would cease to trade, such would be the extent of its negative equity. But unlike company shareholders, who can ignore a call for additional equity capital, taxpayers are obliged to pay up. Future taxation receipts is the invisible asset that plugs the balance sheet hole, equivalent to the overall net liability, albeit unspecified as such in the WGA. It represents a call on future generations, and assumes their compliance. Given the size of the tax burden heading their way, Generation Y could be forgiven for organising themselves and just saying "no".

2.6 Generation Y: embrace digital democracy?

In the summer of 2011, the Government introduced a new website for registering e-petitions, announcing that any e-petition that reaches 100,000 signatures would be passed to the House of Commons Backbench Business Committee.

¹⁰ <https://www.gov.uk/government/collections/whole-of-government-accounts>

¹¹ *Daily Telegraph*, 28 October 2014.

Table 3: Public service pensions, 2013-14

	£ billion	
Current and past service costs	£39.0	Non-cash
Net financing costs	£49.1	Non-cash
Total WGA net expenditure	£88.1	
Actuarial movements used to value liabilities	£83.5	Non-cash
Cash benefits paid as per National Accounts	-£36.0	Cash
Net contribution (from HMT to plug cashflow gap)	-£8.0	Cash
Transfers in / out (net)	£2.4	Cash
Total net increase in liabilities	£130.0	



Indeed, any petition with a million signatures would allow members of the public to table a Bill that could end up being debated and voted on by MPs.¹²

Baby boomers have used this to good effect. In 2012, sufficient signatures were garnered to trigger a backbench debate in the House of Commons, the call being for a Minister for Older People. The debate was lost, but the initiative hinted at the potential of digital democracy. Maybe Generation Y should petition for their own minister to represent their long-term interests, not least to pursue mechanisms to counter baby boomers' innate talent for kicking the financial can down the road.

3. INTER-GENERATIONAL FAIRNESS TO THE FORE

Common sense suggests that the on-going perpetration of inter-generational injustice, conducted largely by stealth and over long timeframes, cannot continue unchecked. If we are to tackle it at source, then a simple intervention mechanism is required right at the heart of the legislative process.

All prospective legislation is accompanied by a regulatory Impact Assessment (IA), an evidence-based document designed to improve the quality of regulation by quantifying its costs and benefits. In the UK, IAs place a particular focus on reducing unnecessary burdens on business, although they can also be used to assess the economic, social, and environmental effects of public policy. IAs do not, however, explicitly quantify the extent to which costs are being deferred, i.e. the impact on the young, as future taxpayers.

In light of the potential plight of Generation Y, and subsequent generations, the Government should introduce Inter-generational Impact Assessments (IIA). Their expressed purpose should be to arrest (in real terms) the accumulation of unfunded commitments that the young would otherwise have to meet. At the very least, they should highlight prospective legislation's cost consequences for future generations.

Proposal 2: Draft legislation which, if implemented, would produce unfunded spending commitments, should be accompanied by an Inter-generational Impact Assessment to quantify the impact on the young, i.e. future taxpayers.

A key objective for IIAs would be to improve transparency, a pre-requisite for any meaningful debate about how longer-term unfunded commitments are to be met – and by whom. The process of producing an IIA would hopefully include a long-term cashflow forecast of the unfunded liabilities, to encourage parliamentarians to appreciate the consequences of their proposals better. In the meantime, the risk is that the perpetration of inter-generational injustice will continue unabated.

One indication that IIAs were having an impact would be a marked slowdown in the rate of accumulation of unfunded promises. But an unfortunate corollary would most likely be rising taxation (or further spending cuts). And therein lies a multitude of challenges.

¹² However, the Committee will only consider a possible debate if at least one MP applies to have it debated. In addition, the petition still has to meet the criteria set out for backbench business debates.



4. THE CHANCELLOR: IN A TAXATION STRAITJACKET?

4.1 A game of parliamentary chicken

In the final Prime Minister's Questions (PMQs) of the last Parliament (25 March), the leaders of the two main parties engaged in a game of (pre-election) Parliamentary Chicken. Who could name the most taxes that they would *not* raise, were they elected? In other words, just how far into the future could they push the tax rises that common sense suggests are actually required more or less immediately?

The outcome is that both the Conservatives and Labour ruled out increasing the basic and higher rates of Income Tax, and the rates of National Insurance and VAT. Given that these taxes account for 60% of total annual tax revenue, the game's loser is the Chancellor, his fund-raising flexibility seriously curtailed. As an aside, not to be outdone, the Lib Dems' Nick Clegg subsequently added Corporation Tax to the list, something that the new (Conservative) Government is unlikely to contemplate anyway. Including business rates, this accounts for a further 15% of tax revenues, so some 75% of the

tax base has (arguably) been excluded from any rate rise, at least in the near-term.

4.2 An escape route: tax reliefs

Nick Clegg was careful not to entirely box himself in, going on to say that "*there are other taxes and other tax loopholes that we can increase or close in order to balance the books*". This could have been an oblique reference to tax reliefs: reducing them has, certainly in the short-term, a similar impact on Treasury cash flow as increasing a tax rate. There are plenty to choose from: the Office of Tax Simplification (OTS) reports some 1,156 different tax reliefs and exemptions, a net increase of 114 since 2010, divided into five categories (Table 4).

HMRC divides these into three broader categories, expected to cost a total of £371 billion¹³ in 2014-15, the equivalent of 61% of expected total tax revenues of £602 billion,¹⁴ comprising:

- (i) structural parts of the tax system (such as the Personal Allowance and the NICs thresholds), expected to cost £177 billion;

¹³ HMRC; *Estimated costs of the principal tax expenditure and structural reliefs*, December 2014.

¹⁴ Comprising: Income Tax £163 billion, VAT £111, NICs £109, Corporation Tax £42, Council tax £28, Fuel duties

£27, Business rates £27, the rest £95 billion. Source: HM Treasury; *Budget 2015, Table C.3: Current Receipts: OBR forecast for 2014-15*, March 2015.

Table 4: The number of tax reliefs and exemptions (as at March 2015)

Structural reliefs – define the scope of a tax, avoid double taxation	563
Special cases – exemptions or reliefs for special interest groups	380
Targeted reliefs – to influence behaviour, e.g. encourage investment in R&D	131
Thresholds: e.g. to exempt transactions under a certain amount	62
International agreements	20
Total	1,156



- (ii) “tax expenditure” reliefs, designed to relieve tax for particular special interest groups, or activities to achieve social or economic objectives (£110 billion); and
- (iii) reliefs that combine elements of both structural and expenditure reliefs (£84 billion).

The Appendix provides further detail.

Tax expenditure reliefs probably offer the most potential for cost savings. At £110 billion for 2014-15, the cost exceeds public sector net borrowing (£87.3 billion, provisional), is not much less than 2013-14’s Total Managed Expenditure (TME) outturn for Health (£115 billion), and is more than the combined TME for Education (£56 billion) and Defence (£43 billion).¹⁵

Pensions-related relief (£35 billion) is the largest expenditure relief item, so it is no surprise that reducing it featured in most of the parties’ manifestos for the recent general election. And, significantly, the case for cutting back on reliefs was recently reinforced by the powerful Public Accounts Committee.

4.3 The Public Accounts Committee rides in

Within 24 hours of the final PMQs of the last Parliament, the House of Commons’ Public Accounts Committee (PAC) published a damning assessment of HMRC’s management of tax reliefs.¹⁶ The upshot is that HMRC rarely, if ever, assesses whether tax reliefs are an economic, efficient and effective way of meeting the intended policy objectives. Some of the PAC report’s observations, referencing some draw

from an earlier report from the National Audit Office (NAO),¹⁷ are breath-taking:

- HMRC does not maintain or publish a complete and accurate list of tax reliefs setting out what each is intended to achieve. It publishes a list of 398 tax reliefs: contrast this with the OTS’s 1,156 reliefs (and even the latter does not include some major items, such as relief provided for capital gains realised by pension funds);
- of the 398 reliefs on HMRC’s list, only 50% (i.e. 196) have discernible social or economic objectives. Of these, the cost of 53 of them (27%) is unknown, HMRC does not publish cost data for 82 of them (42%), and the cost data for many of the others is inaccurate;
- published costs can significantly exceed forecasts. The PAC cited the example of Entrepreneurs’ relief, the cost of which exceeded HMRC’s forecast by £2 billion; and
- the PAC report also highlighted systematic use of some reliefs for tax avoidance,¹⁸ and other substantial abuses, facilitated by HMRC’s and HM Treasury’s lack of curiosity about tax relief costs, as well as the complexity of the system.

All of this is extraordinary. As a result, Parliament has little insight as to whether reliefs are working as intended, their cost and whether they represent good value for money. The sooner that such financial largesse is reined in, the less pressure there will be on Generation Y.

¹⁵ See: www.gist.cabinetoffice.gov.uk/oscar/2013-14

¹⁶ House of Commons Committee of Public Accounts; *The effective management of tax reliefs; forty-ninth Report of Session 2014–15*, 26 March 2015.

¹⁷ National Audit Office; *HMRC – The effective management of tax reliefs*, 21 November 2014.

¹⁸ Notably Share Loss relief, Business Premises Renovation Allowance, and Film Tax Relief.



5. UNFORTUNATELY, DEMOCRACY IS BEING HACKED

Tax reliefs and exemptions often represent the ideal outcome for lobbyists (including trade bodies) pursuing narrow, self-interested, agendas, typically at the expense of the silent majority and the public interest. The 380 expenditure reliefs, in particular, are designed to relieve tax for particular special interest groups.

To be clear, lobbyists are seeking to shift decision-making powers from politicians to business interests and markets, i.e. to facilitate the encroachment of concentrated wealth into the democratic arena. This inevitably puts pressure on politicians to focus on short-term horizons, undermining the public's confidence in them, the democratic process and market capitalism. It also raises questions about how political parties are funded. Meanwhile, the future (i.e. Generation Y and subsequent generations) gets short shrift.

6. AN OFFICE OF FISCAL RESPONSIBILITY IS REQUIRED

Taxpayers deserve regular, thorough, systematic scrutiny of the effectiveness and value for money of *all* tax reliefs. And while the PAC's report makes some recommendations aimed at improving the process by which HMRC executes its oversight of tax reliefs, the question remains as to whether HMRC is best placed to do this. The role may be more appropriately conducted from within the NAO (the word "audit" has the right feel about it), or an enhanced OTS. Initially established only for the lifetime of the recent Parliament, the OTS is now up for review; it could be expanded (the current staffing is meagre) and perhaps rebranded as the Office of Fiscal Responsibility (OFR). The continuation of a tax simplification agenda should also be included within its remit.

Proposal 3: An Office of Fiscal Responsibility should be established, under the aegis of the Chancellor, to scrutinise the effectiveness and value for money of all tax reliefs and exemptions.

Perhaps tellingly, an OTS blog from 2014 states that *when we published our review of tax reliefs in 2011, we had only reviewed in depth 155 of the 1,042 reliefs we had then found. We always envisaged returning to the area in the future, not least because one of our key findings was that there was a need to have a system that reviewed existing reliefs to test their operation and continuing validity. We have kept up our list of reliefs to facilitate a further review but at present it is not a project we have the resources to undertake properly.*

Irrespective of which body were to perform such a role, it should be properly resourced, and include both technical and behavioural change analysis capabilities. By investing a relatively small amount (£10 million?) in a team to review tax reliefs, the Treasury could create an opportunity for a potential 100-fold return.

To be clear, decisions on tax policy and legislation should remain a matter for the Chancellor: the OFR's role would be to provide him with recommendations. It could perhaps start by absorbing the recommendations contained within past NAO and PAC reports, and then establish some principles and a framework to guide its approach to assessing each relief's effectiveness and value for money.

The OFR should exude an ethos of fiduciary duty towards current *and future* taxpayers, and aspire to a reputation for independence akin to that of the OBR. If it achieves this, it would help close what is currently a significant accountability gap between Parliament and the people (particularly *future* taxpayers). In the meantime, the



unbecoming public squabbling between the Treasury, HMRC, NAO and PAC, over the process for assessing tax reliefs, should cease. The state needs to act as one team; disagreements should be kept behind closed doors.

7. A FIVE YEAR SUNSET CLAUSE ATTACHED TO ALL TAX RELIEFS

So, where to start? An obvious approach would be to first review the largest reliefs: HMRC's list of structural reliefs and tax expenditures each include 46 items that cost more than £50 million a year.¹⁹ But then there are many "minnows" which, in aggregate, account for tens of £ billions each year: *all* reliefs and exemptions need to be examined, as a matter of course. This could be achieved by attaching a five year sunset clause to all tax reliefs and exemptions, distributed throughout a five year parliamentary term to even out the OFR's workload. After five years, each tax relief and exemption would automatically drop dead, and it would be for ministers and lobbyists to periodically remake the case for them. For some of the structural reliefs, this should be a purely perfunctory exercise.

Lobbyists should be requested to present their cases directly to the OFR, which would provide some blue water between vested interest groups and ministers. Such separation is also, surely, a pre-requisite for an honestly functioning, transparent democracy?

Proposal 4: All tax reliefs and exemptions should be subject to a five year sunset clause, after which they would cease. Lobbyists should be requested to present their cases directly to the proposed Office of Fiscal Responsibility, to ensure blue water between vested interest groups and ministers.

8. DEPARTMENTAL BUDGETS

One of the most striking revelations contained within the PAC's report on the effectiveness of tax reliefs is that departmental annual budgets are set *without* taking into account the cost of relevant tax reliefs. This disconnection is extraordinary, and surely leads to resource misallocation, as well as rendering meaningless any value for money exercises.

Proposal 5: Departmental budgets should be set both gross *and* net of expenditure on tax reliefs and exemptions, to ensure transparency as to the true level of financial support to each area of public policy.

9. CONCLUSION

Ideally, all pensions and other age-related services should be pre-funded, along with other expenses that we know will materialise in the future, such as nuclear de-commissioning costs. But there is little evidence to suggest that the baby boomers are willing to halt the torrent of unfunded promises that they are making to themselves. Consequently, it is down to Generation Y to raise the issue, including encouraging politicians to think beyond the horizon of the next general election. A start could be made by persuading the Prime Minister to embellish his doctrine of personal, professional, civic and corporate responsibilities by adding a fifth category: inter-generational responsibility.²⁰

Proposal 6: The Prime Minister should embellish his doctrine of personal, professional, civic and corporate responsibilities by adding a fifth category: inter-generational responsibility.

¹⁹ NAO; *The effective management of tax reliefs*, November 2014.

²⁰ *Built to Last; the aims and values of the Conservative Party*, 2006.



APPENDIX

Principal tax expenditures and structural reliefs, 2014-15

Structural reliefs	£ billion	
Income tax personal allowance	£86	
NICS thresholds and contracting out rebates	£57	
VAT refunds	£17	
Double taxation relief and foreign dividends exemption	£15	
Three other categories	£2	
Sub-total	£177	
 Tax expenditures		
Pension schemes' Income Tax relief and employer NICS rebates	£35	
Zero-rating of VAT on food	£17	
Capital gains exemption on disposal of main residence	£13	
46 other categories	£45	
Sub-total	£110	
 Hybrid*		
Capital allowances	£24	
Inheritance tax: nil rate band and surviving spouse exemption	£23	
VAT exemptions	£20	
15 other categories	£17	
Sub-total	£84	
Total, £ billion	£371	

* i.e. reliefs or exemptions with both tax expenditure and structural components



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