



Rt. Hon George Osborne MP
The Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

9 November 2012

FSB 2012 Autumn Statement Submission

Dear Chancellor,

The Federation of Small Businesses writes ahead of your Autumn Statement with a package of measures based on a rigorous evidence base for you to consider taking forward to the Budget. We believe that if implemented as a whole, and if clearly communicated in one place, this 'Plan for small businesses' will give the sector a boost to its confidence and thereby building on recent positive growth data. Our submission focuses on five areas that of key concerns to our members and to the wider well-being of the economy:

- 1. The overall policy framework for small business policy.** Over many years, our experience is that small business policy has been patchwork and subject to constant change. Stability and consistency is needed and as with our Budget submission earlier this year, we continue to advocate a UK Small Business Administration to anchor and deliver small business policy, especially around finance.
- 2. Access to finance.** While discussions carry on about demand and supply, and closely linked to our views on the small business bank, we urge you to look at building an environment which fills the small business funding gap and encourages a more diverse market in credit provision to small and medium-sized enterprise (SME). To encourage this diversity will, we believe, require both the creation of a small business bank and refocusing the regulatory approach through firmly embedding competition in the small business market as a key objective of the Financial Conduct Authority.
- 3. Taxation.** We continue to strongly support your efforts to bring simplicity to the tax systems for the smallest businesses. This would bring the twofold benefit of increased compliance and deregulation on a major scale, and we encourage you to be bold in any reforms. However, as we set out, the message sent out by HMRC is by no means always consistent with the goal of simplification. In addition we also ask you to look at policies to encourage employment, notably through an enhanced National Insurance Contributions (NICs) holiday

for small firms, and to capitalise on emerging confidence to cancel the 3p rise in fuel duty pencilled in for January.

- 4. Employment.** We continue to advocate a wider NICs holiday for small firms. Even under cautious assumptions, our economic modelling work with CEBR shows this has the potential to create 45,000 new jobs and add £1.3 billion to GDP. And in light of our recent report which demonstrates the overwhelming importance of small businesses in offering a pathway to employment for the unemployed and inactive – around nine in 10 of the unemployed will find a job in a SME – we think there needs to be a fundamental debate about employment policy. This includes reversing the normal pattern of developing policies and then thinking of exemptions for small firms who are the most affected – in reality, the current ‘think big first’ approach. We therefore urge you to look at how employment policies and regulations are formed and the level of bureaucracy within the Government when proposing new regulations.

- 5. Improving infrastructure.** We highlight three areas of infrastructure that are of high concern to our members and are the lifeblood to their economic activity: transport, access to high speed broadband, and energy. Each area has the need for high levels of investment but has the potential to boost growth both in the short and longer-term. They require your energy to see that market reforms are made and investment delivered.

We hope this is a helpful contribution to your deliberations to provide a powerful package of measures to boost confidence among our members and the wider small business community.

Yours



John Walker
National Chairman
Federation of Small Businesses

SUMMARY OF FSB POLICY PROPOSALS

Getting small business policy right

- Create a UK Small Business Administration (SBA) similar to that in operation in the USA, at the outset focusing primarily on access to finance and competition in the credit market

Access to Finance

- Build a Small Business Bank (SBB) operating at the wholesale level with an explicit remit to develop and promote competition in the small business finance market. The design of the SBB should be informed by the finance arm of the USA's SBA, in operation since 1953, which has supported the start-up of companies such as Nike, Apple, and Ben & Jerry's
- Increase transparency in the banking sector by requiring banks to publish how much they lend within specific geographic areas as they do in the US

Tax

- Move to cash-based accounting as a method to remove the smallest firms from the burdensome requirements of normal accounting processes, introducing this for firms with turnover below £77,000
- Develop tax impact assessments which use the same principles as other government department regulations: independent scrutiny, transparency and simplicity
- Major increase in communication from HMRC to small employers about Real Time Information
- Consider the implications for start-up businesses under the Universal Credit, especially around reporting profits and hours worked
- Halt Controlling Persons consultations and give urgency to simplify IR35, which has stalled
- Remove the proposed 3p per litre increase in fuel duty in January
- Significantly reduce or completely remove Air Passenger Duty, to boost the tourism trade
- Devolve and allow for a reduction of Corporation Tax to Northern Ireland

Employment

- Review the approach towards employment policies given that FSB research shows that nearly 90 per cent of people moving from unemployment into employment do so through a small or medium sized business
- Expand the current NICs holiday scheme to micro-businesses across the whole of the UK. This will increase employment by 45,000 jobs and add £1.3 billion in extra economic activity

Infrastructure

- To maximise its impact on growth and jobs, concentrate investment in roads on the backlog of repairs and maintenance
- To ensure all communities get access to a fast broadband connection, place a universal service obligation on internet service providers
- Spread the regulatory reforms in the energy and environmental areas over a longer period, and encourage a more competitive energy market through OFGEM

FSB 2012 AUTUMN STATEMENT SUBMISSION

1. Getting small business policy right

As with our submission to your Budget this year, we continue to argue for a far more joined-up and consistent approach to policymaking for small businesses. For too many years, the small business policy area has been subject to a range of confusing patchwork approaches that have often had minimal impact on the ground - a trend that continues to this day. We are firmly of the view that this needs to stop if well intentioned policies are to gain traction.

We again draw your attention to the lessons that can be learnt from the USA's Small Business Administration (SBA). This organisation, originally created in 1953, mirrors the FSB's stance that intervention needs to be structural, for the long term, be of scale and impact meaningfully on the conditions small businesses face day-to-day. The fact that firms such as Nike and Ben and Jerry's have started through the SBA's loan programmes is testament to its success.

If meaningful change is to be achieved, and a small business attitude truly ingrained in Whitehall and the rest of government machinery, there needs to be an authority dedicated to promoting and protecting the needs of small businesses. This would match the rhetoric heard over the last two decades or more, on the importance of small firms as the building blocks of long term economic wealth, with meaningful action.

We are therefore pleased that your proposal for a small business bank appears to replicate the finance arm of the SBA that has been working so effectively in the US. We now encourage you to look more broadly at the SBA model, how it has supported small businesses finance needs and stimulated competition in the market, to reform the institutional framework of the UK's small business policy in that light.

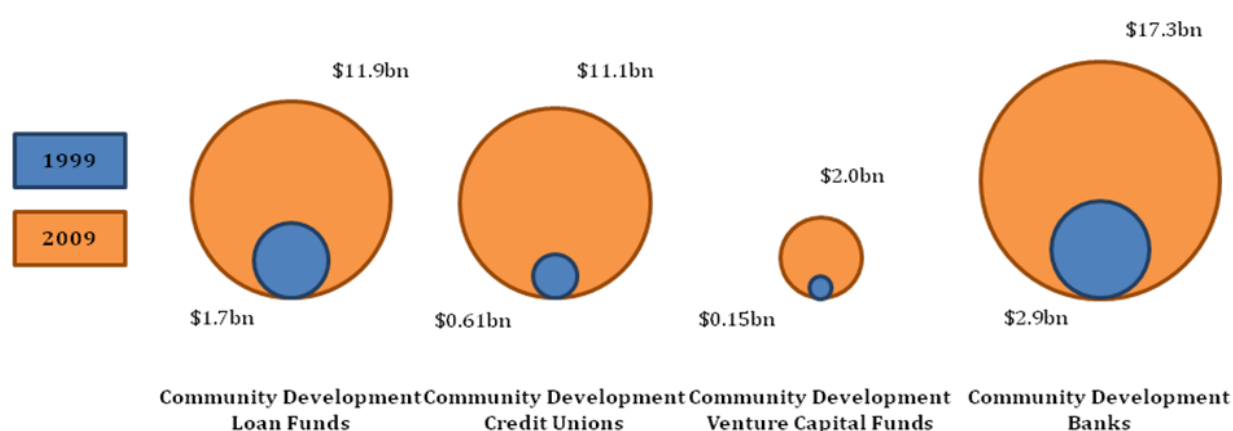
2. Access to finance

A Small Business Bank

The FSB sees your proposal for a small business bank as a seminal moment in small business policy in the UK. It has the potential to address long term funding gaps for small, growth businesses that existed before the recession and at the same time encourage competition and diversity in the sector. We therefore see this proposal as very much more than a simple cleaning up exercise of existing schemes and if properly implemented, would act as a policy 'anchor' that has been so lacking.

Again, we draw your attention to USA's SBA as an example of how to structure state intervention in the small and medium sized enterprise (SME) finance arena, and the effect it has had in building

non-bank financial institutions through judicious interventions coupled with regulatory changes. The following chart illustrates that effect on developing community asset institutions in the US over a 10 year period that provide alternatives to mainstream banking institutions. It is through these community institutions that the SBA distributes a large proportion of its support to small businesses. In the UK, these institutions exist but on a much smaller scale with a penetration level of just over two per cent of the market compared to around 44 per cent in the US. The opportunities for the small business bank operating in the UK environment should be clear.



As our report of earlier this year shows, the US SBA and the UK's experience of enterprise policy provides reasons why a UK SBA could work. There is now a maturing understanding of which policies are likely to provide benefits for small businesses. Where the Government does intervene, evidence shows it is best served with simple and single branding which leads to superior management of expectations, simple measurement and lower costs to the taxpayer.

There is also greater recognition that enterprise policy is more likely to be effective when it follows a 'less is more' approach. One clear message from the FSB is that there are too many initiatives: what is needed are fewer interventions with higher individual impact. The counterfactual of the US experience, with a consistent approach over many years, clearly shows that continually changing central government support to small businesses is unhelpful.

Taking those lessons and applying it to the UK Business Bank, we would argue for the following principles to underlie the bank's design:

1. A degree of **independence** from the day-to-day running of Government and for it to have legislative powers to embed itself as the champion for small businesses. This means it should

work closely with financial regulators (the Financial Conduct Authority being key) to promote greater competition in the SME credit market both in banking and non-banking channels.

2. An initial tight focus on **core activities**. This should be in the provision of finance to small businesses, and particularly around 'patient capital' and micro finance. This will help firms which have little or no security and those needing long term finance.
3. A remit to **promote competition in the provision of finance** to small businesses, in particular non-bank sources of finance. For example, it should look at how it can help promote community development finance institutions as noted in the case of the US, and other non-bank channels of finance such as peer-to-peer lending with the aim of increasing their scale and providing greater diversity and competition in the market place.
4. It needs both **time** and close **measurement**, but not daily interference from Government. It should be target driven, allowed to devise its own products and recommend additional powers and resources if needed.
5. Finally, **the bank should act at the wholesale level**, as a second tier agency above retail banks. It would therefore not directly lend to small businesses or take deposits, but distribute loans through the existing banks. A similar model has been in place for many years in Germany (KfW), and has been more successful than the UK banking system in keeping credit flowing to small businesses during the recession.

Within this framework, regulation and the role of the Financial Conduct Authority (FCA) have a key part to play in improving access to finance and competition. It is vital that competition, as a structural aim for the FCA, is not diluted in favour of other objectives: the FSB believes that competition and stability are not separate pillars for the FCA, but one. Without competition, stability will not occur in the SME credit market and the threat of mass credit rationing will always lurk around the corner. It is also important for the FCA to look at actions on transparency and divestment which might foster more banks and SME credit providers. This should be looked at as a priority when the new regulator officially receives powers.

For transparency to work properly, banks need to open their books and show how they contribute to the communities they operate in, especially in economically deprived areas. Again, lessons can be drawn from the US where the Community Reinvestment Act (1977) has increased transparency with positive effects. The FSB therefore asks that either the Banking Reform Bill or the new regulator requires this information from deposit taking banks, to show consumers and other depositors how banks play their role in the community. We believe it would also encourage banks to work closely with credit providers that want to work in those areas and bring about the increase in scale to groups such as community development financiers. For this to work fully, you may wish to tie this transparency and level of activity to any regulatory approvals institutions may require.

3. Taxation

Tax Simplification

Our member surveys show that one of the largest regulatory burdens our members face is HMRC compliance and administration. That is why we wrote to you in February 2012 encouraging the adoption of tax simplification proposals which would remove many millions of small businesses from the normal accountancy regime that, for the most part, do not relate to the realities of the day-to-day operations for the smallest of businesses. By doing so the twin goals of deregulation for small businesses and increased compliance could be achieved. We therefore continue to urge you to be bold in these reforms and that the £77,000 turnover threshold is established as a lower threshold, thereby delivering these goals.

Tax Impact Assessments

While tax compliance cannot be classified as regulation and is therefore outside the regulatory development process, there are lessons to be learnt from the work of the Regulatory Policy Committee (RPC). Deregulatory policy should carry over to the tax policy development process of the RPC principles of transparency, simplicity and independent scrutiny within the development of tax policies.

There are two key changes that could be made:

1. Firstly, all tax impact assessments should be subjected to **independent scrutiny** at both consultation and final stage by a body external to HMRC – as is the case for all other Government departments. Potentially this could be through the office of Tax Simplification (OTS), or some components of it. It would have the expertise to be able to fully scrutinise the impact assessment and understand how businesses will implement the change.
2. Secondly, there are a number of aspects of a **regulatory impact assessment** that could be included in a tax impact assessment in a more significant way. We believe that this information could ensure that all tax policy changes are fully thought through and scrutinised. In the long-term these suggested changes could mean that reviews, such as that which the OTS has undertaken, would not be necessary. Getting tax policy right from the outset is the next step.

Universal Credit and Real Time Information

Getting people off welfare and into work is an important factor in unlocking the dormant part of the labour market and reducing the nation's debts. The key Government policy for this is Universal Credit coupled with Real Time Information (RTI) payroll returns.

Under Working Tax Credit, self-employed people could sensibly use the same generally accepted accounting practices as working out income tax self-assessments. We are therefore disappointed that under the planned Universal Credit draft regulations those advantages will be lost, with self-employed individuals having to recompute their earnings each month on an adjusted cash basis. This is entirely at odds with current accounting methods and HMRC's 'simplified' cash basis that comes into force in April 2013. This will not only create substantial extra administrative burdens for small businesses, but force claimants to report to the Department for Work and Pensions (DWP) on the basis of an inaccurate view of how their business is actually doing. Worse still, the regulations could see the real income of self-employed earners falling sharply, making it uneconomic in some cases for them to continue to work.

In their current form, we therefore believe the proposed regulations will discourage entrepreneurship and undermine the efforts of Government to get low to middle income individuals into self-employment. The risk of noncompliance among the small business sector is also heightened by these regulations.

In addition to this, many small businesses are still unaware of RTI. Recent FSB research shows that a quarter of firms still do not know there are major changes to the way they will have to report payroll from April 2013. This is worrying as the penalties regime will not take this into account, and more importantly, the Universal Credit will not work properly. As you did with auto-enrolment for pensions, more time needs to be taken to inform small businesses of these changes so they can make adjustments. Additionally, HMRC needs to heavily increase communications as the current campaign has failed to get small firm's attention.

IR35 and Controlling Persons

The position of both Coalition partners prior to 2010 was that IR35 either had to be removed or be made simpler to understand for contractors and small businesses. The FSB's position has always been that this piece of legislation was, at best, disproportionate and needed to be simplified. We have always accepted that some form of regulation was needed to counter the practice of individuals leaving full time employment to return to the same company as a contractor and thus, reducing the tax liabilities for the company and the individual.

Our concern has been that IR35 spread the net far too wide resulting in contractors, running legitimate businesses, having to resort to accountants and lawyers to show they were in business of their own account. As you would agree, this leaves small contractors in a precarious position. We

are still some distance from a position where companies know, with certainty, where they stand and little or no progress has been made through the working group you set up.

As well as the direction of travel regarding IR35, the FSB is of the clear view that the Controlling Persons consultation is a further step in the wrong direction. We are deeply concerned about how bad publicity has led to a change in the tax system which will have a detrimental impact on the self-employed, consultants and small firms. As many groups have suggested, there is adequate protection from personal service companies acting to minimise tax liabilities through the IR35 regime. We do not understand how this fits into the tax simplification roadmap.

Fuel duty

Fuel duty remains a totemic issue for our members. They are facing the prospect of a further 3p per litre fuel duty increase in January 2013, which will act as a drag on growth and paint the Government as unsupportive. FSB research shows that 79 per cent of members believe their business is being negatively impacted by the high cost of fuel and 62 per cent said they have to increase prices due to fuel costs. More than a quarter said they have frozen wages due to the cost of fuel. The FSB is therefore recommending you scrap the scheduled 3p per litre increase which will undoubtedly undermine confidence at this critical time, and to look again at introducing a true fuel duty stabiliser.

Air Passenger Duty

The level of Air Passenger Duty (APD) has resulted in a sustained negative impact on business and leisure travel. With tourism one of the UK's greatest export earners, which is likely to see a boost following the Olympics, APD should be significantly reduced or scrapped. The International Air Travel Association reported in June 2012, that UK passenger numbers have declined over the past four years at a period when Germany, France, and the Netherlands saw growth of between two and four per cent. When APD was restructured in 2008, the rationale given was to help reduce CO₂ emissions. However, with the inclusion of the aviation sector into the European Emissions Trading Scheme in 2012, a strong case can be made for a significant reduction, or scrapping of the APD.

Northern Ireland

When we wrote to you in March 2012, Northern Ireland had already had 50 consecutive months of negative growth and property prices had dropped by 50 per cent in four years. It is of immense concern that the latest figures show this is now 58 consecutive months making the need for a major policy shift all the greater. The private sector is ambitious to grow and is proving successful; but it is starting from a very small base and will need a new paradigm in which to transform the economy from reliance on the public sector to private.

There remains one policy measure that has united all of Northern Ireland's business organisations and political parties, and on which we understand that the Joint Ministerial Working Group has now also reached agreement: the devolution and reduction of corporation tax. We would recommend that Northern Ireland's unique circumstances be recognised and that this power is transferred at an affordable rate as soon as possible to help the private sector deliver the change that is so desperately needed.

4. Employment

The overall approach to labour market regulation

The FSB welcomes the Government's recognition of the detrimental effect employment protection legislation can have on hiring intentions. Streamlining employment tribunal procedures and introducing claimant fees are to be applauded, as they significantly improve the current tribunal process. We also believe that the proposed use of settlement agreements should help employers resolve workplace disputes in a way that is fair to the employer and employee alike, and we look forward to developing these proposals with Ministers.

While these measures demonstrate a commitment by Government to work with small employers, a 'one-size-fits-all' policy approach continues to drive policy initiatives. In many instances this is because the numbers placed in work or trained are more easily increased in a larger business and because on the whole, large firms are easier to communicate with compared to the small business community. But at its heart is a continued misunderstanding about the challenges the vast majority of businesses face in their day-to-day operation. Until that is truly taken into policy design, small firms will struggle with new policy initiatives that, while having the best of intentions, may indeed have the effect of deterring entrepreneurial activity and job creation.

The impact is these employment policies are most likely to not hit the neediest. As shown by recent FSB analysis of Labour Force Survey data over a period of 15 years, small businesses have the highest propensities to recruit individuals facing disadvantage in the labour market: nearly 90 per cent of unemployed people who get a job in the private sector do so by finding work in a small business.

If small firms are to continue to be growth generators and carry out this vital social function, a full and frank debate is needed about developing a new approach which is sensitive to the needs of small firms and their employees.

In the interim, more work could be done on specific areas where small firms and start-ups could be exempt from certain statutory regulations, for example the plans to extend the right to request flexible working and onerous auto-enrolment pensions requirements that will entail significant administrative and financial costs for small employers. Expanding exemptions to firms with less

than 49 employees – as is the case with many sector-based industry regulations in the US – may encourage a greater number of small firms to take on additional workers and should be given serious attention by policymakers.

Boosting employment: a broader NICs holiday

While the aim of the current regional NICs holiday scheme for small businesses is laudable, it is widely recognised to have had minimum effect with take up rates of around six per cent. The scheme should therefore be revised, better publicised, and thresholds increased.

We agree with the logic of the current scheme: a reduced tax liability for start-up firms should encourage greater levels of employment where take-up has occurred. However we believe that a long-term scheme which gives employers that have less than four staff a tax break for the next three hires will have far more positive benefits. Using conservative assumptions, our research with CEBR shows that if this initiative was across the UK, it would generate an extra 45,000 jobs and an extra £1.3billion in economic activity over the next three years. It would also send the clearest signal to employers that the Government is prepared to support their efforts in job creation. We have shared the full research with your officials.

Start ups and self-employment

Providing budding entrepreneurs with the necessary tools to start up and grow their businesses is critical if the UK is to develop the enterprise culture we all want to see. As part of achieving that, we would encourage you to explore greater incentives to support self-employment. For many self-employed people accessing finance remains a key problem, and while start-up loans are an idea we have welcomed, there is a case for extending the sums available and the payback period.

Furthermore, and as mentioned above, the Universal Credit reforms also need to be rethought to prevent significant financial penalties and administrative burdens falling on self-employed persons on low incomes. As they currently stand, there is a risk that DWP's Universal Credit plans will discourage people from starting up their own business and, worse, push existing self-employed individuals into the informal economy.

5. Infrastructure

Transport

In the FSB's view the Government should give priority and funding to maintaining and improving the current local road network rather than focus on large new road infrastructure projects. Tackling the maintenance backlog on these roads will help small businesses and lead to significant job

creation in the short term. We accept significant road improvements are needed in the medium to long-term, but the maintenance backlog is of more immediate concern.

Over recent years council budgets for local road programmes have been reduced, and a continued tightening of council spending power will ensure that conditions on local roads will only worsen unless additional measures are put in place. A temporary 'Road Repair and Renewal' fund for local roads could help to address the deficit in local road maintenance and pay for some of these wider enhancements, with considerable gains for transport and the economy as a whole.

With little risk of opposition and no lengthy planning or land acquisition processes to complete, maintenance projects would also start more quickly and exert a stimulus-effect more rapidly than new road building.

Energy Markets

The challenges of upgrading the country's energy infrastructure and meeting carbon reduction targets mean that energy bills are going to rise at a time when small businesses simply cannot afford it. Reform of the electricity market, investment in the electricity distribution network, and the introduction of a carbon price floor are all going to jeopardise the UK's ability to compete with other leading European economies during these difficult economic times.

Difficulty in switching suppliers, getting locked in to uncompetitive rollover contracts, and finding it hard to compare tariffs, limit the competitive workings of the retail energy market and the ability of small firms to access lower prices. The FSB believes that OFGEM, the energy regulator, only partially addressed these issues in its recent review of the retail market and more work needs to be done to give small businesses the fair deal they deserve in the energy markets.

The FSB appreciates the urgent need to secure investment in a new generation of nuclear power stations and other low carbon means of electricity generation to ensure the UK's energy security. However, in order to limit the increase in costs associated with these reforms, we believe there must also be radical changes to increase the competitiveness of the retail energy market for small businesses. There is an overwhelming case to look at the timing of these and other environmental reforms, and to see whether they could be spread out over a longer timescale and thereby make them more manageable for businesses.

Broadband

Superfast broadband provision is inadequate in terms of both bandwidth and availability, especially in rural areas. Businesses in rural locations with an insufficient broadband connection or no broadband cannot fulfil their full business potential. To overcome this barrier, the FSB suggests that the time has come for a universal service obligation to be placed on one of the internet service providers (ISPs).

In terms of the structure of the market the FSB believes it is problematic that one single ISP is currently securing every contract from Broadband Delivery UK, but only provides broadband services where it is commercially profitable. With a universal service obligation the ISP that wins the contract would have to provide broadband services everywhere, whether it is profitable or not. Small rural businesses without broadband (which represents one in 10 firms in rural areas) at present would be able to innovate and take advantage of the opportunities that comes with digitalisation.