



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

Dear Chancellor,

The Federation of Small Businesses (FSB) supported the action to tackle the nations deficit and public sector over-spending, however small businesses wanted to see the Government take similar action to promote private sector growth at the same time. While we await the Budget, small businesses continue to lack confidence, freeze employment intentions and experience reductions in revenues.

The Government must now take decisive action and give a clear narrative to show that small businesses will be the focus of economic recovery.

The FSB is concerned that while growth remains weak and looks to be stalling, job creation will be slow at best. The FSB's Voice of Small Business Index Q4 2010¹ showed that the employment intentions of small businesses weakened in the last quarter of 2010 signalling that the labour market recovery continues to lose momentum. Worryingly, the narrowing in spare capacity within small businesses is in line with weaker performance expectations.

The foundations of the economy need addressing as well as individual measures. The FSB has been calling, since before the recession, for Government to look at the banking sector in terms of competition in the SME market. We welcome the Independent Banking Commission and hope its recommendations will stimulate more new banks in the UK market.

Another factor in boosting entrepreneurial activity is regulation. The FSB supports many of the regulatory measures that this Government has committed to implement. Yet nine months later businesses have not yet seen the results of these changes. There is a lack of transparency in the progress of regulatory reform.

The introduction of the One in One out process was heralded as a major regulatory reform measure when it was introduced in September 2010. However, there has been no cohesive attempt to make businesses aware of how well this system is

¹ FSB Voice of Small Business Index Quarter 4, 2010; http://www.fsb.org.uk/frontpage/assets/q4_per_cent2010_per_cent20voice_per_cent20of_per_cent20small_per_cent20business_per_cent20index_per_cent20- per_cent20jan_per_cent202011.pdf



working or what the methodology is. The Government needs to publish soon the promised forward plan for all upcoming regulations.

Alongside greater transparency, the introduction of a moratorium on employment regulation for the next year would make a tangible difference to the lives of small firms. Past Governments have tended to make small changes on the fringes of regulation – it is time for bold, decisive actions.

With external factors such as inflation and fuel prices also playing a negative role in the UK economy, small businesses need the Government to show leadership and help private sector wealth makers and job creators. The proposals in this letter Budget look at three key elements for small businesses:

- Avoiding a jobless recovery
- Better use of the tax system
- The Green economy

Avoiding a jobless recovery

Policy makers know that a recovery without jobs will be bad for the UK. The Government's deficit reduction plan for growth implies increased private sector jobs, which in turn reduce unemployment costs. However, the conditions for the private sector to create these jobs must be conducive to growth.

Government can create these conditions by firstly extending the Government NICs holiday scheme extended to existing micro-businesses². This will not only show that Government is helping those businesses with experience in hiring and trading, but give micro-businesses the added incentive to hire new staff. It is cheaper to move people into work through this scheme than to have them unemployed. Over 40 per cent of businesses would hire new staff if employers NICs were reduced³.

Under the FSB's proposals, businesses that have between zero and four staff will in the next financial year pay no Employers National Insurance on the first, or next three employees it hires.

² NICs holiday scheme, FSB Proposal; http://www.fsb.org.uk/frontpage/assets/fsb_per_cent20-per_cent20nics_per_cent20holiday_per_cent20scheme_per_cent20feb_per_cent202011.pdf

³ <http://www.fsb.org.uk/frontpage/assets/fsb%20-%20nics%20holiday%20scheme%20feb%202011.pdf>



The relief will apply up to the Upper Earnings Limit of £844 a week per employee, or about £44,000 a year. Three new employees, on an average weekly salary of £489 (ONS Annual Survey of Hours and Earnings 2009⁴) would save a small business £7,567.86 in one financial year under this proposal.

The Treasury will continue to benefit from the creation of new jobs through income tax and employees national insurance contribution. For example, one employee at an average weekly salary of £489 will still contribute £5,958.48 per annum to the Treasury. This, for three employees would generate £17,875.41.

The second condition for avoiding a jobless recovery is to make it easier for small businesses to employ people – in particular focussing on apprenticeships and graduate internships. With unemployment for young people running above 20 per cent, the Government needs do more. Small businesses have a good record of accomplishment in the area of employment; between 2002 and 2007, small businesses created over 84 per cent of new jobs in the private sector.

Apprenticeships are valued by small businesses. As many as 82 per cent of FSB members say that they are prepared to or do pay more than the minimum wage of £95 for an apprentice. The Government needs to recognise that small businesses are prepared to pay more for apprentices but that the burden of employment law combined with a lack of information and guidance is stopping small businesses from taking apprentices on.

The FSB believes that allocated funding for apprenticeships be used to benefit micro businesses who struggle to employ. Financial contributions (from existing funds) must be used by Government to stimulate micro-businesses to take on an apprentice.

Since February 2010, the Graduate Internship Programme has supported paid internships in small businesses for 8,500 graduates. However, this scheme will be scrapped in March 2011. The FSB believes that this is a mistake. The benefits are clear:

- 25 per cent of the graduates undertaking internships in small businesses are offered full-time employment at the end of their placement⁵.

⁴ <http://www.statistics.gov.uk/pdfdir/ashe1109.pdf>

⁵ An Evaluation of East Midlands development agency funded student placement activity and its impact on the region's businesses 2005 – 2007. Step enterprises.



- Young people who gain experience of working in small businesses are more likely to set up their own business.
- Over half of young people (52 per cent) have considered setting up their own business, but less than one in ten (7 per cent) have done so⁶.

Extending the Graduate Internship Scheme, under the FSB proposals, would cost £8 million. The scheme could be extended further and a small amount of the additional £800 million to be paid by the banks would be well spent offering internships to more graduates. This might sound like a lot of money for short-term placements, but the returns on investment are significant. If the scheme was extended to a further 5,000 graduates (25 per cent of whom were offered full-time work):

- Benefits payments would be reduced by at least £1.5 million instantly and by a further £3.37 million over the course of a year
- Revenue to the Treasury would increase by over £5.4 million⁷
- A new generation of entrepreneurs would be created.

Better use of the tax system

Taxation is a key foundation of the business environment. Three fifths of small businesses report that the UK taxation system has a negative impact on their ability to take on more staff. A third of small businesses say this is detrimental to their capacity to make capital investment in the business. Furthermore, three quarters believe simplifying the tax system would have a positive impact on their ability to grow their business⁸.

The FSB welcomes the work of the Office of Tax Simplification (OTS) and look forward to their recommendations. The FSB would like to see a tax system that is both simple and competitive, but understands that competitiveness is difficult to fund in the current climate. For example, the reduction in the Annual Investment Allowance from the current £100,000 to £25,000 will affect businesses that require

⁶ Research commissioned by Virgin Media

⁷ Currently a graduate on Job Seekers Allowance would receive £51.85 a week. Over the course of a six week placement this would be a cost of £311.10. If 5,000 extra placements were created in small businesses (as with the last Graduate internship scheme), it would mean a saving of over £1.5million in benefits alone. Based on 25 per cent of graduates being offered a full-time position. by creating 1,250 extra jobs the Government would also save £3.37million on job seekers allowance payments in the first year of employment without taking into consideration other benefits

⁸ http://www.fsb.org.uk/policy/assets/fsb-icm%20panel%20january%202010%20survey_report.pdf



capital investments. The FSB opposes this change in June 2012, as it will stifle growth when we need to be encouraging commercial investment. The FSB believes that the Government should look again at this policy.

We additionally hope that the OTS will make recommendations to you that ease the burden of IR35 and tangible simplification of the tax system. As mentioned above, many small businesses already find the tax system difficult to understand and use. A third of small businesses find using taxable allowances difficult to understand or use and progress needs to be made in this area.

A major concern for small businesses is the continual increase in fuel prices. This has had major implications on inflation and has been a key upward driver. The arguments in favour of introducing a stabiliser mechanism and delaying the planned fuel duty increase are overwhelming. The International Energy Agency estimates that current fuel prices are taking 0.5 per cent off GDP. Furthermore, over 60 per cent of businesses are unable to absorb the rises.

The unpredictable increases in fuel prices are damaging growth. 62 per cent of businesses have increased prices, one in ten small businesses will lay off staff, a quarter will freeze wages and 36 per cent will have to reduce investment in new products and services.

The arguments against introducing a fuel duty stabiliser are less conclusive. The fuel duty stabiliser is relatively simple to calculate and administer. When oil prices rise, fuel duty is lowered (and vice versa). The majority of fuel sold in the UK has duty paid by oil companies rather than fuel retailers, with only 20 businesses covering more than 99 per cent of fuel sales (making administration simple). Furthermore, a fuel duty stabiliser is a green tax and, as argued by the Stern Review, the quality of the environmental signal sent by carbon taxes is undermined by price volatility.

The FSB believes that the Government should be ambitious and look at measured fiscal incentives. The Government should look at how best to use certain fiscal tools to drive not only growth, but also job creation and therefore tax revenues. Many groups have discussed reducing VAT on construction to 5 per cent but it does not seem as if HMT have carried out a proper review into this area. The French economy benefited from the creation of over 50,000 new jobs and a 7 per cent increase in turnover (amounting to €2 billion).



It is clear that economies are most likely to grow and generate increased revenues for the Treasury, when taxes are low. In the United States, the Joint Economic Committee found that reducing excessive tax rates in the 1980s stimulated growth, reduced tax avoidance, and increased the amount and share of tax payments generated by the rich. Higher tax rates in the 1990s on the other hand suppressed revenues. The income generated by the top one percent of income earners actually declined in 1993.

The Green economy

The global industry in low carbon and environmental goods and services is worth £3 trillion a year, and will be over £4 trillion by the middle of the next decade.⁹ However, we are already lagging behind many of our European counterparts and it is essential that we put in place the long-term policy drivers to allow our small business sector to capitalise on their potential competitive advantages in the low carbon sector.

Small businesses have a competitive advantage over bigger companies in the green industries because of their ability to respond quickly to emerging markets. It is essential that they be allowed to develop these competitive advantages. The Government must ensure public support for green innovation is reflective of the needs of small businesses.

The move to a green economy will not only necessitate the need to develop new green technologies but also the need to look at how we can make existing products more sustainable. Remanufacturing/modifying existing products and services is just as important to the low carbon economy as developing new technologies and the R&D system needs to reflect that.

The definition of research and development for the small and medium enterprise scheme needs to reflect the need to green existing products and services. There is also a real need to improve and expand the SME research and development tax credit system to allow small businesses to access it more easily and to give them the financial incentive to innovate and meet the demands of a low carbon economy.

While the FSB supports the tax credit scheme, which helps some 4,500 small businesses at a net worth of £250 million per year, we do believe that the Government must reform it to ensure it meets the needs of our innovative small businesses.

⁹ BIS Low Carbon Transition Plan 2009



The FSB believes that the Government should look at extending the tax reduction rate for SME credits for green innovation. Given the crucial role green innovation will play in keeping our economy competitive in the global economy we believe the tax deduction rate should be extended from 75 per cent to 100 per cent.

The current SME research and development tax credit system is seen as a windfall that is received at the end of the innovation process rather than a financing tool that can help a firm during the course of the process and actually help it achieve its innovation objective. The Government must look at methods of changing the delivery process and timeline of relief for those eligible.

Yours sincerely,

John Walker
Federation of Small Businesses
National Chairman