Experts in Business

Derek Mackay MSP
Cabinet Secretary for Finance, Economy and Fair Work
Scottish Government
St Andrews House
Regent Road
Edinburgh EH1 3DG

23 November 2018

Dear Derek,

Scottish Government Budget 2019 / 2020

On behalf of the Federation of Small Businesses (FSB), I write to outline our priorities ahead of the publication of the Scottish Government's draft Budget next month.

Since becoming FSB's Scotland Policy Chair in May, I've had the pleasure of meeting many of your ministerial colleagues. During our conversations, I've been impressed with the universal acknowledgement that the health of our local economies is not simply a matter for those in business or economy related briefs, but rather the responsibility of all key decisions makers in government.

I know that you are promoting this approach across government and I look forward to it remaining at the centre of your team's thinking as you draw up the nation's spending plans.

In terms of specific policies, we would urge consideration of the following.

1. **Brexit**

   Nobody needs reminded that, with only a matter of weeks until the UK is due to leave the EU, the terms of our withdrawal are (at the time of writing, at least) still uncertain. While smaller businesses have been clear about the need for a substantial transition period, the prospect of leaving without agreement remains a possibility.

   We have discussed with you previously the need for Scotland's business support network to react nimbly and flexibly to what small firms will need in the post-Brexit trading environment. We have welcomed the opportunity to contribute to the current information and support campaign aimed at businesses in Scotland and look forward to continuing this dialogue.

However, as we move from preparation to post-Brexit adaptation, we believe that additional support will be required. In particular, smaller firms may need financial assistance to enable them to make necessary adjustments, whether accessing technical or expert information on trading, dealing with increased or different bureaucracy, or addressing skills or staffing issues. We therefore submit that the Scottish Government should establish a Brexit resilience fund, similar to that introduced in Wales.

2. Business Rates

a) **Barclay implementation –** FSB has been pleased to support the reform programme associated with the Barclay review of business rates. However, we have reservations that the vision of a modern rates system outlined by Barclay looks some distance away. Therefore, at this budget we would ask you to allocate funding to facilitate modernising the administration of the Scottish rates system – and specifically develop a national rates interface to allow ratepayers across the country to carry out all of their interactions with the system in a single place. We would argue that such a system must be in place at least a year ahead of the next revaluation.

b) **Rates and Reliefs** – The Scottish Government's Small Business Bonus Scheme (SBBS) continues to provide vital help for smaller firms, while maintaining a much-needed degree of progressiveness and fairness in the system. The importance of retaining this relief in 2019/20 cannot be overstated. While we look forward to engaging fully with the upcoming review into the best way to support smaller operators in the rates system, we would like to suggest two minor adjustments to the relief in the year ahead:

- **Additional tapering** – FSB has long argued that non-business recipients of this relief should be excluded from the scheme, and we accept the Barclay recommendation that empty properties should not be eligible. These changes are likely to result in cash savings, which we would like to see reinvested in help for smaller firms (see below for some suggestions of how this may manifest itself).

  To reduce appeal volumes and to help those that may have fallen out of full relief as a consequence of the recent revaluation, we would suggest the reinstatement of a middle tier relief band. While we would be pleased to work with your officials to help design this change, we would suggest a 50 per cent relief band on properties with rateable values of between £15,001 and £16,500. We estimate this change would benefit around 3,500 business with a cost of less than £5 million.

- **High street help –** While the SBBS provides vital support for tens of thousands of Scottish shops and other businesses on the high street, the thresholds will, by definition, mean that certain town centre properties do not qualify for the relief. Of course reforms around tapering, such as those outlined above, could offset some of the impacts. However, in light of moves to apply a one third discount to "retail" properties with RVs of under £51,000 in England, we would ask you to consider whether an expansion of rates relief focused on help for properties that deliver goods or services of most importance to the local community would be appropriate.

3. Town Centre Diversification Fund

Important as they are, business rates are not, of course, the only issue facing our town centres and the businesses who trade there. The challenges are many and varied. Accordingly, building on the Scottish Government's Town Centre Regeneration Fund, we contend that Ministers should establish a new Town Centre Diversification Fund. This would facilitate the adaptation of empty high street retail units for non-retail operators. The fund could also be used to boost housing volume in our town centres and help local businesses adapt to regulatory changes, especially those related to waste and recycling. We would suggest an initial fund of at least £100 million, which could in large part be funded by the Barnett consequentials from the similar initiatives introduced at the UK Budget.

4. Income tax

It is worth reiterating that, based on the pre-2018 income tax rates, more than two thirds of our members are basic rate taxpayers, with less than a quarter paying a higher rate. So, their concerns about rising taxes aren't so much about their own pockets, as their customers' and the effects on the wider economy.

On the question of the behavioural impact of the divergence in bands and rates north and south of the border, we know that small business owners take decisions for a whole variety of reasons – some of it is purely business; some of it depends on what's best for their family, their staff or their community. While it might be easier to predict how the corporate sector will react, we are not aware of any real analysis of how smaller firms are responding to the different tax regimes. Thus, we would argue that we need a better handle on the real-world effects of the changes to date, before we see any greater divergence.

We also need to remember that, in a complex and interlinked tax system like ours, changing one aspect in one area can have many and varied knock-on effects elsewhere.

The oft-cited example is that, if the gap between the higher rate income tax thresholds widens, but the upper earnings limit for National Insurance Contributions remains pegged to the higher UK threshold, more Scottish taxpayers will have an effective tax rate of 53 per cent on a larger slice of their income. And obviously, the larger that slice becomes, the more it will be noticed.

5. Public procurement

Despite ongoing reform, FSB remains concerned that endeavours to improve the number and value of public contracts won by Scottish smaller businesses do not appear to be bearing fruit. Moreover, there is far more scope to use procurement as an inclusive growth tool in local and regional economies across Scotland.

According to recent research by the Improvement Service, the number of local suppliers to Scotland's councils has declined by 42 per cent since the reform programme began ten years ago, while local authorities' average spend with local suppliers has also gone down (by 3%) over the same period. While we have more detailed information about the spending of local authorities, they are only responsible for around half of public procurement; there is little information about the progress of other public bodies. Similarly, there has been little progress on the Scottish Government's 2017 Programme for Government commitment to using procurement between 'anchor' institutions as a community wealth building tool.

Key to a more progressive procurement policy, we have consistently argued, is proper analysis of spend and robust targets in those areas where improvement is most needed or would deliver most value. To that end, we would urge the Scottish Government to set annual targets in its procurement strategy to improve spend with micro and small businesses across Scotland. We have previously suggested to local authorities that they increase their spend with micro businesses by a modest 1 per cent per annum – and this, we submit, would be a realistic target for the Scottish Government to consider for both its own, and wider public sector, spending.

Providing small businesses with the right advice and training on bidding for public contracts has been central to the Scottish Government's efforts to support SMEs. While the Supplier Development Programme (SDP) continues to expand its activities, it is now time to ensure a more consistent approach to support smaller businesses across the public sector. Accordingly, the Scottish Government should consider how the SDP can be adequately resourced to work across the public sector, not just with local government. Similarly, high-spending sectors such as the NHS and further and higher education should be directed to work more closely with the SDP.

6. Tourism

FSB is aware that Ministers plan several discussion events regarding proposals for a tourism tax in Scotland. Given the strength of feeling in a growth sector which employs 207,000 people, we would be concerned if these events replace the formal consultation to which the First Minister earlier committed.

FSB research has consistently demonstrated that tourism businesses and the wider business community are opposed to a tourism tax – with some three quarters (77%) coming out against. Therefore we would urge you to continue to reject calls for its introduction and maintain focus on growing, not taxing, the visitor economy.

Nevertheless, the success of the tourism industry has created challenges in rural communities in particular, as evidenced by the deterioration in local infrastructure. As such, and given the budgetary pressures facing local authorities, we would advocate the continuation and expansion of the Rural Tourism Infrastructure Fund – funded by the considerable contribution that this £6 billion industry already makes to Scotland's finances.

7. Smarter regulation

As you are aware from discussions with FSB, one of the recurring frustrations of our members is the unintended negative impacts on their business from concurrent but separate new initiatives and regulations from departments across governments. Current examples include new waste and public health measures.

Not only is the cumulative impact of these changes not measured, the isolated impact of individual policies is not adequately assessed because Business and Regulatory Impact Assessments (BRIAs) are carried out by individual departments with no oversight by Scottish Government regulatory policy officials. Therefore, we would urge that sufficient resources be made available to create:

- An independent, specialist central unit to provide direction and scrutiny on regulatory processes, such as BRIAs, with the required level of rigour; and

- An annual study, akin to the FSB and CEBR Impact of Government Policy Index, to assess and track the costs and benefits for businesses of Scottish Government policies.

8. **Business facing digital services**
For a number of years, FSB has highlighted that there is much work to be done to improve the digital footprint of the public sector bodies that interact with the business community – including councils, regulators and tax authorities. We have been disappointed that progress in this area has been slow, despite FSB repeatedly raising this issue with officials and Ministers.

At this budget, we'd urge you to commit to action on this front – including an immediate moratorium on funding for new business-facing websites and, if required, direct Ministerial intervention to break any impasse between government departments, their agencies and local authorities.

9. **Brexit-proofing the skills system**
One of the most notable implications for the Scottish economy of our departure from the EU is likely to be around the end of free movement. Indeed, employers are already experiencing what the CIPD has referred to as a "labour supply shock" due to the decline in EU workers arriving in the UK.

As a result, we would urge you to begin constructing a responsive skills system fit for the post-Brexit future and, in so doing, take action by:

- Supporting and incentivising small businesses to invest in their workforce by opening up the Flexible Workforce Development Fund to non-levy payers; and

- Providing greater support for smaller Scottish firms – in the shape of higher contribution rates – to recruit adult apprentices (aged 25 and over) across all frameworks, thereby allowing older workers to switch careers using the Modern Apprenticeship system.

10. **Low carbon and the environment**
Last year, the Scottish Government committed to introducing Low Emission Zones into our four biggest cities by 2020, phasing out the need for new petrol and diesel cars and vans by 2032, and introducing a deposit and return scheme for drinks containers.

While FSB welcomes measures to decarbonise the transport network and boost recycling rates, the small business community will require help and support to adapt to new ways of working. Therefore, we would ask you to allocate £15m for a Low Emission Zones Support Fund to enable small businesses to invest in cleaner fleets; and commit to an ambitious roll-out of fast charging points in our cities, towns and villages.

On a deposit and return scheme, in order to minimise the economic impact of any such scheme, we would urge the Scottish Government to introduce a fund to support smaller businesses to adapt and comply. Given the practical challenges involved, we would also urge the exemption of the very smallest businesses from mandatory participation in the scheme.

I trust that the foregoing is helpful and we would, of course, be happy to expand on any point with you or your officials.

Yours sincerely,

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