FSB SUBMISSION SCOTTISH GOVERNMENT DRAFT BUDGET 2017-18

DECEMBER 2016

Introduction

This submission sets out FSB Scotland's priorities for the forthcoming Scottish Budget.

Economic forecasts for Scotland's economy suggest serious challenges lie ahead; at a time when the importance of devolved tax revenues makes our economic performance crucially important. The Scottish Government's future spending plans must therefore focus on measures which grow the economy and encourage the creation, sustainability and growth of businesses.

While recent figures suggest a slow-down in the post-devolution growth of businesses in Scotland, nevertheless small firms remain key. SMEs now account for 99% of all firms in Scotland, employing 1.2 million people, while registered businesses have increased by 2% in the last year alone.[1]

Unsurprisingly, given the fragile nature of Scotland's economy in 2016, our own evidence suggests small business confidence is at a five year low.[2] Prior to the European Union referendum, confidence had already been on a downward trajectory for a number of quarters, with problems in the domestic economy cited as a barrier to growth. Many small businesses have also been absorbing a range of cost increases, including changes to the minimum wage and compliance with pensions auto-enrolment. In addition, we expect that our Small Business Index data for the final quarter of 2016, set to be published in January, will show a further fall in Scottish small business confidence.

While there are a number of areas of spending where small businesses would welcome additional investment, *how* money is spent, how the wider public sector behaves and the leadership role of the Scottish Government, are important factors in creating the right conditions for businesses to grow.

For example, we recently highlighted the problems that late payment of invoices cause to small businesses. Our report revealed that average outstanding payment to Scottish small businesses is £5,718. If payment practices matched Norwegian standards, over 2,000 firms a year could be saved in Scotland.[3] The Scottish Government should use its influence to pressure our large firms to change their behaviour.

While most late payment in Scotland arises from business to business payments, the public sector can help by continually aiming to improve its own payment practices. As spending plans are announced, we would strongly **urge the Scottish Government to make it clear to public bodies that delaying payment to suppliers is not an acceptable budget management practice.**

We have also regularly highlighted the importance of getting the maximum economic impact from public spending, particularly capital investment. Whether on transport projects

[1] "Businesses in Scotland 2016", Scottish Government, November 2016
[2] FSB Small Business Index, Scotland Q3 2016
[3] See our press release from November 2016

or energy efficiency, breaking contracts down into smaller projects will enable more local businesses, their employees and suppliers, to benefit directly from this investment and, in turn, generate additional investment for their local economy.[4]

Lastly, we recognise that difficult choices lie ahead. We have therefore suggested three key priorities for the Scottish Government. The next budget should:

- Maintain a stable tax regime by keeping income tax rates unchanged while expanding the Small Business Bonus Scheme (SBBS).
- Get the most out of public spending by ensuring a more efficient, joined-up system of business support and fast-tracking progress on digital public services.
- Focus investment on digital infrastructure and local transport infrastructure projects.

Tax Stability

Given the scale of economic uncertainty, we believe it is important to avoid any additional (and unexpected) tax burdens on small businesses, whilst working towards a less-complex tax system that enables businesses to grow.

In Scotland, a number of devolved taxes affect small businesses; the two most significant of these being income tax[5] and non-domestic rates (NDR).

Non-Domestic Rates

We have frequently called for meaningful reform of NDR: arguing that small businesses need a system that is simpler to understand and navigate; encourages investment and improvement; and doesn't unfairly advantage one part of the economy over another. We recognise the challenges therein and have set out our views in a response to the current Barclay review. In particular, if the current NDR system is retained, we hope a number of reforms can be brought forward at the earliest opportunity, including a move to more frequent revaluations and removing the disincentive to invest by delaying post-improvement revaluations.

In our view a tax based on property, without a link to sales or profit, is always likely to be a larger overhead for smaller firms and start-ups, relative to large firms. Accordingly, the case for some form of discount or relief for smaller businesses is well established and a rates relief scheme has now existed in Scotland for over 13 years.[6] Indeed, other parts of the UK have, over time, moved to replicate the relief offered in Scotland.

A recent survey[7] of almost 1,000 FSB members in Scotland revealed that 74 per cent are receiving some form of discount as a result of the SBBS, with 57 per cent now paying no rates at all. With savings of up to £4,000 per annum, businesses reported that they were most likely to have used the saving to invest in their business (reported by 37% of recipients), while 35 per cent use the lower bill to offset other cost increases and 19 per cent have invested in their staff.

FSB is in no doubt that the SBBS has been a key support mechanism to tens of thousands of smaller businesses during recent turbulent economic times. Furthermore, it has supported investment by small firms and incentivises business growth, with 57 per cent of businesses currently operating at home or without premises reporting that the SBBS makes them more likely to consider expanding into commercial premises. Were the SBBS to be

[4] "Local Procurement: Making the best of small business, one year on: Scotland Report", CLES-FSB, July 2013
[5] We recognise that income tax is not fully devolved to the Scottish Parliament
[6] Evaluation and Effectiveness of the SBRRS, DTZ Pieda, 2004
[7] Online survey of FSB Scotland members conducted in August-September 2016 with 960 responses.

removed, a fifth of small firms report they would close the business, whilst almost a fifth would cancel investment.

While recognising the increasing complexity of reliefs, we believe that small business rates relief must be a permanent element of any business rates system and **we therefore urge the Scottish Government to continue to support the Small Business Bonus Scheme and warmly support plans to give full relief to 100,000 firms.**

Further, while understanding various complicating factors, we would urge the Scottish Government to at least match England's poundage rates wherever possible.

Lastly, we urge the Scottish Government to ensure all relevant information about the forthcoming Revaluation is issued as soon as possible to enable businesses to factor their new bills into their financial plans.

Income Tax

While Scotland has seen an increase in the number of companies since devolution, many small businesses remain unincorporated[8] and are subject to the income tax system rather than corporation tax. Accordingly, the devolution of most aspects of income tax to Scotland is of great interest to small businesses.

While there may be economic benefits to creating a more competitive tax regime in Scotland, we recognise current funding constraints make this a difficult prospect. Equally, changing tax rates in Scotland could lead to anomalies with other parts of the tax system (such as National Insurance Contributions). Moreover, the impact of changes to income tax rates on Scotland's small businesses is unclear. In particular, more modelling to understand the likely outcome of, for example, changes to the 'additional' rate of income tax would be helpful. More generally, any alterations to tax rates should be assessed for their impact on businesses.

On balance, given current economic uncertainty it would be advisable to avoid any extra administrative commitments to Scottish firms. **The Scottish Government should therefore maintain an income tax system unchanged and aligned with the UK system for 2017-18.**

Delivering Services to Business More Efficiently

In our submission[9] to the Scottish Government's Enterprise and Skills Review, we highlighted how the delivery of services to support business has become inefficient and, ultimately, less effective. Too many organisations are competing, not collaborating, to sell their initiative to businesses. This issue was highlighted in Audit Scotland's recent review which stated that economic development agencies and councils were unable to:

"…identify the public sector support that was available for businesses to pinpoint any duplications or gaps…due to the complexity of all the bodies and initiatives involved."[10]

The next phase of the Enterprise and Skills Review offers an opportunity to focus minds on how business support can improved. In the interim, we have previously suggested that the Scottish Government should make a start on reducing clutter by introducing a moratorium on any new publicly funded business-facing websites.

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[8] Our evidence suggests that only 47% of our members are incorporated. "The FSB 'Voice of Small Business' Member Survey 2014–Scotland"
[9] "Enterprise and Skills Review", FSB, August 2016.
[10] "Supporting Scotland's economic growth: The role of the Scottish Government and its economic development agencies", Audit Scotland, July 2016.

FSB has also argued for some time that businesses should be able to conduct more transactions with government online: for example, finding out sector or geographic-specific business advice, as well as paying bills or applying for licences. We agree with the Scottish Government that "digital technology provides a foundation for innovative, integrated public services that cross organisational boundaries."[11] However, progress to improve e-government in Scotland has been painfully slow. We firmly believe that legislation will be necessary to drive forward the whole-public sector approach needed to make better digital public services a reality.

Scotland has a good range of support services for businesses but **there is scope for improvement to make that support more user-friendly and deliver it more efficiently.**

Investment

We recognise that the Scottish Government must balance a range of competing demands for investment when public finances are under severe pressure. We also recognise that it must do this when Scotland's economic performance has become far more directly relevant to Scotland's budget and when the economic outlook has rarely looked less certain. On this basis, creating the foundations for a stable economy must be a central factor in investment decisions in the forthcoming budget. In particular, we have previously argued[12] that Scotland needs to focus on improving the economic resilience of our communities to better withstand economic turbulence.

Accordingly, we believe **that investment should be directed towards digital and local transport infrastructure - key building blocks in creating more successful, productive local economies.**

Local Transport Infrastructure

In recent years the Scottish Government has invested in a number of large-scale infrastructure projects, such as the new Forth crossing. While this investment has been welcome we are concerned that investment in local infrastructure has fallen behind. Most small businesses trade locally,[13] primarily using road transport, while Audit Scotland recently revealed that a third of local roads were in an unacceptable condition.[14] Economists have also argued that greater productivity returns could arise from concentrating investment on improving local transport infrastructure, particularly roads.[15]

We have previously called on the Scottish Government to create a fund to tackle the backlog of repairs to local roads. Further, **the Scottish Government should commit to devoting Scotland's share of Autumn Statement infrastructure spending towards shovel-ready local transport infrastructure.**

Digital Infrastructure

Progress has been made on improving Scotland's digital infrastructure, in particular we welcome the government's commitment to deliver superfast broadband access to all by 2021 and the mobile phone coverage action plan. Yet the evidence suggests we are still far from being a leading digital nation.

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[11] "Scotland's Digital Future: Delivery of Public Services", Scottish Government, September 2012
[12] "Resilient Economies, Resilient Communities. FSB Scottish Parliament Manifesto 2016", FSB, October 2015
[13] FSB survey work conducted ahead of the Scottish independence referendum suggested that 61% conducted most or all of their business within the local or regional area
[14] "Report: Maintaining Scotland's roads: a follow-up report", Audit Scotland, August 2016
[15] See: "The Stanford Marshmallow Experiment and the Scottish Economy", Stephen Boyle, The Herald, January 2016.

As of June 2016, 83 per cent of Scottish premises could access superfast broadband, compared to 89 per cent of English premises. In addition, 58 per cent of Scottish premises had outdoor 4G coverage from all four networks, compared to 75 per cent of English premises.[16] Ofcom's mapping also reveals that large swathes of Scotland lack a 3G or 4G signal.

We know that roll-out of superfast broadband to smaller businesses tends to lag behind roll-out to the wider population. This is due to the high proportion of smaller firms in rural areas and issues with connecting premises in business parks. We would argue that new interventions should target these sorts of premises as an early priority.

We have argued for clearer, more reliable information for businesses and communities about the roll-out of superfast broadband to allow firms to plan ahead. To do this, **the Scottish Government should produce an annual list of infrastructure work necessary to bring about universal next generation access, with estimated costs.** And, to ensure investment in Scotland is no less competitive, the Scottish Government should match the UK's commitment to provide rates relief for new digital infrastructure.

Skills

Finally, we are aware that significant investment opportunities will arise as a result of the proceeds from the Apprenticeship Levy. In 2017-18 alone, Scotland will receive £221m. We have argued that this funding should not be focused solely on supporting additional apprenticeships, but should instead support broader investment in skills through a flexible skills fund that employers can use to address their business's training needs.

We have also argued that levy-paying employers should be able to recoup as much as possible from the Scottish Government; and for better links between industry and education through innovative approaches such as the industry-led, vocational academy model used by CodeClan.[17]

Further information and contact

For further information on any of the points raised in this submission, please contact Susan Love on susan.love@fsb.org.uk or 0141 221 0775.

About the FSB

As experts in business, FSB offers members a wide range of vital business services, including advice, financial expertise, support and a powerful voice in Government. Its aim is to help smaller businesses achieve their ambition.

[16] Communications Market Report: Scotland, Ofcom, 2016
[17] "Scottish Government Response to the UK Apprenticeship Levy", FSB, August 2016.