BRIEFING PAPER

Unburdening Enterprise

Reducing regulation for small & medium businesses

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Summary

Small and medium-sized businesses are a crucially important part of the private sector, accounting for 99% of all private sector enterprises and 59.1% of private sector employment. Economic recovery depends on them to create jobs and replace lost public sector jobs. But we cannot expect them to flourish under current regulatory and tax conditions. The focus of this report is to identify the most cumbersome and harmful regulations, taxes and other barriers to growth and to work out how to disentangle them. The report examines a broad set of policies needed to restore confidence in the UK economy and charts the reforms needed to reduce the burden of small business regulation. It examines what is needed, at the level of individual enterprises, to get businesses investing and hiring again.

The first part of the report explains why is it important to increase growth from the supply side – reducing taxes, removing excess and costly regulation, and reducing uncertainty and increasing confidence with a credible and sustainable growth path. The second part focuses on the most troubling problems facing small and medium-sized businesses. After identifying the main burdens, the third part of the report outlines the policy recommendations needed to overcome these obstacles and encourage business growth.

Summary of recommendations and their effects

Our main proposals are:

- Abolishing employers' NIC. This proposal has a potential of creating a minimum of 500,000 jobs by relaxing the tax burden on employment.
- Reversing the 5.6% increase in business rates from April 2012 to free up funds for businesses.
- Substantially reducing costs for the SMEs by removing all unnecessary administrational burdens. The government should continue with its deregulatory agenda demanding higher efficiency from all departments.
- Simplifying the regulatory system for SMEs in order to remove the necessity of hiring lawyers and accountants to help them comply with regulatory standards. Simplification should benefit all UK SMEs.
- Putting a stop to all new regulation coming in from EU that targets SMEs. This could save up to £100bn per year (£23,000 per business) – enough to hire an additional employee or invest into new capital creation and production.
- Making it easier for employers to fire employees for misconduct. This will make it more attractive for employers to hire, and will increase labour market flexibility.
- Encouraging businesses to take more temporary, zero-hour and fixed term employees. Introduce the option of self-employment for SMEs. It saves money, increases job creation and channels resources into profit-making opportunities.
- Removing the minimum wage to create youth jobs.
- Encouraging private sector solutions to help businesses chase late payments and increase their availability to credit.

Introduction

Regulations are often counter-productive. In a desire to create a safer working environment, for example, regulations are imposed that stifle enterprise and divert resources away from productive activities. This is particularly harmful for small and medium-sized enterprises (SMEs), considered to be the drivers of economic growth in an economy.

To see how important SMEs are, consider the statistics. According to the UK Department for Business, Innovation and Skills, in 2010 SMEs accounted for 99% of all private sector enterprises, 59.1% of private sector employment and 48.6% of private sector turnover.[1]

Almost all of these enterprises (99.2%) were at the small end of the spectrum (0 to 49 employees). Of those, 73.4%

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were sole proprietorships, 22.1% were micro businesses (less than 10 employees) and 3.8% were small businesses (10 to 49 employees).[2] The picture is very similar across the EU, where 99.8% of enterprises were small or medium-sized (less than 250 employees), and 92% were micro businesses (less than 10 employees), accounting for two-thirds of jobs and almost 60% of value added in the economy.[3]

The importance of these businesses for growth is enormous. The fact that many SMEs go on to become large and successful companies that end up hiring thousands of workers suggests we would do well to create every possible condition for them to grow and expand. To do this, they need a regulatory and tax environment that makes it easy to do business.

Many small businesses shut down within a year of start-up. The entrepreneurial process is one of experimentation and learning from mistakes. For the economy to prosper, we need the rate of business creation to be higher than the rate of closure (or a marginal rate of success that is higher than the marginal rate of failure). Historically, periods of successful start-ups and a dynamic SME environment have gone along with a prosperous, expanding economy.
This is why regulatory and tax burdens that prevent small businesses from expanding must be removed. It is especially necessary in times of crises where a boost of confidence can only come from more employment and investment incentives for private sector businesses.

The positive feedback loop

The UK economy faces a long recession. Growth forecasts have been downgraded.[4] Eurozone troubles, low levels of confidence, and banks that are much less willing to make potentially risky loans are all holding back expansion. SMEs are experiencing most difficulties in obtaining credit, as they are by their nature essentially risky.[5] Despite the efforts to spur lending through various lending schemes and targets, the banks are unwilling to do so due to uncertainty (part of it regulatory) and risk aversion. Meanwhile, investors are in a lock-down, investing in safe assets with low (or even negative) yields, which is a typical sign of uncertainty.

So what can be done? Only if the business environment, including the tax and regulatory environment, justifies greater confidence and less uncertainty will banks and investors step forward again to release money into the system and encourage firms to invest and hire. This initiates a confidence spiral: falling unemployment will help increase consumer confidence and boost household incomes. At first, nervous consumers will continue to deleverage, paying off their mortgages and other debts; only then will they go out and spend. Recovery is a slow process and one needs to be patient.

A short-run public spending stimulus, on the other hand, will create unwanted effects. The idea is that government money will boost aggregate demand, since investors will now have more to invest, firms will have more to hire workers and increase production, and consumers will have more to spend – all of which will boost growth. However, it is unlikely that creating temporary jobs in this way will encourage anyone – families or businesses – to spend more, rather than paying off their overhang of debt. The stimulus will be nothing more than a transfer from hard-pressed taxpayers (both individuals and businesses, again) to politically favoured sectors. An employment subsidy, likewise, will create only a temporary effect, since expectations of temporary income offer a much lower psychological incentive to spend than the expectations of permanent income. Meanwhile the general uncertainty and lack of confidence continues.

This is why any solution must come from a different direction – from the direction of cutting taxes and regulatory impediments to businesses. That reduces business costs directly and allows them to invest more into production and spend less on red tape, and consequently gradually increase employment. Instead of politically-directed, skewed and jobless growth, this is a general policy that allows all firms to use their resources efficiently and respond to the demands of consumers.

Accordingly, this report focuses on ways to reduce the burden to businesses and improve their confidence, investment and spending. It aims to show how reducing costs for businesses is a much cheaper and more efficient policy than subsidies and public spending schemes, as it creates economically healthier incentives for businesses – a healthy, competitive, market environment where firms compete for customers, rather than a crony capitalism built on political or bureaucratic favours.

Issues facing small and medium-sized enterprises

Small and medium-sized businesses suffer from several issues. Surveys conducted by the British Chambers of Commerce (BCC), the Federation of Small Businesses (FSB), the Taxpayers' Alliance, and the Institute for Family Business (IFB) identify the following main concerns:

- National Insurance Contributions are too high

(particularly to micro businesses)
• Cash flow problems, illiquidity and late payments (access to finance)
• Regulatory obstacles to hiring people (health and safety, compliance costs, etc.)
• Cost of external experts to comply with regulatory standards
• Fear of Employment Tribunal claims and consequent labour market inflexibility
• Low confidence, few incentives to invest into new production (fear of recession)

Most SMEs, particularly micro-businesses, see **National Income Contributions** as the biggest obstacle to taking on new employees. It is a wage cost that imposes a 13.8% burden on employers (in addition to the 12% rate taken from employees) thus raising substantially the cost of hiring new workers. But it raises £54bn[6] for the Treasury, making it the third most important source of government revenue after income tax and VAT.[7]

According to the FSB's survey of its members in 2010, "44.1% of businesses would take on more employees if the government cut Employers' National Contribution".[8] The same survey found that 41.2% would hire an additional employee if the government would reduce corporate taxes and business rates, 35.4% would like tax breaks to encourage hiring, while 33.1% call for at least 2 years before an unfair dismissal applies.[9] Some 60% of SMEs surveyed by the Chambers of Commerce in 2011 say they want to take on more employees but find it difficult to do so.[10] NICs are a tax on employment. In a situation where unemployment is alarmingly high, a tax on jobs is the last thing the economy needs.

The Taxpayers' Alliance argues that the cost of employers' NICs is actually paid by the employees. They are forced to accept "lower wages, higher prices and higher unemployment".[11] Administration alone imposes a £146 million compliance cost on businesses, placing a particularly hard burden on small businesses who need to hire accountants to help them cope with the system. Ending the NIC system altogether and replacing it with much sounder, privately offered insurance and unemployment packages would reduce a huge burden off the businesses. The 2012 budget placed an additional cost burden on SMEs by increasing business rates, the tax for occupying non-domestic property, by 5.6% in April 2012. This seems to be a substitute of local government revenue lost from freezing the council tax, which seems an unfair and illogical way of trying to prop up local budgets at the expense of business growth.

The second problem of **cash flow and illiquidity** has been worsened by the recent banking and Eurozone crises. An increasing number of businesses tend to blame lack of confidence and the fear of another recession for their reluctance to invest and hire more. Illiquidy is spreading further as unemployment rises and the economy shrinks. Healthy companies are handicapped by other, less healthy companies who are slow to pay their bills. Cash flow problems affect 73% of SMEs according to the FSB.[12] The same report finds that two-thirds of respondents have written off invoices, with over a fifth writing off more than £5,000. FSB's 2012 Member Survey found that 47% of SMEs are experiencing late payments, reporting an increase of late payments in dealing with the public sector.[13]

According to research done by BACS in 2011, large corporations are responsible for the most of the £24bn of late payments to the SMEs.[14] Some 41% of the SMEs experiencing late payments blame big companies for overdue invoices. They report payments being late for 39 days on average. SMEs spend on average half a day a week chasing their late payments which is driving additional costs to these businesses, not to mention depletion of resources. BACS calculates that this resulted in 158 million hours lost to the economy. Around half of all firms have outstanding invoices worth £5,000, while a fifth are owed more than

Basel III and SMEs

Further regulatory constrains for SMEs arise from the new banking reform and the implementation of Basel III. Even though the full implementation of these regulatory standards won't happen until 2019 at the latest, the impact on banks can be immediate due to an anticipated regulatory burden that will lower the availability of credit to smaller, and hence, more riskier borrowers. The ASI report on "How Basel III threatens small businesses" in 2011 by Tim Ambler recognized that "large customers will not be affected, but the SMEs and the more volatile businesses will bear the brunt of both a lower availability of loans and higher rates of interest." The report further concludes that the final effect will provide an unnecessary burden to the SMEs which could hamper economic growth in the UK (Ambler, 2011). This additional regulation aimed at the banks will indirectly harm SMEs and will increase their lack of funding. Instead of enabling more loans to the private sector, the banking regulation will lower the total amount of loans designated towards SMEs.

£20,000, according to the FSB. BACS reports an average of £27,000 owned per company. Rising illiquidity and the lack of credit availability hurts the entire private sector, directly or indirectly. Without being certain when or whether their invoices will be paid, businesses cannot make clear plans on future investments and employment. Without the safety net of bank credit, many firms may fall into bankruptcy, which passes losses on to others. One way to solve this problem, and the lack of confidence it produces, is to ensure that small firms have a greater prospect of holding on to the revenues that they do generate – which means lowering direct costs in the form of taxes and business rates.

The **dismissal process and tribunal claims** add further to small business problems. The process is long and costly for employers, which scares firms off from hiring new workers and reduces labour market flexibility. The BCC (2011a) found that one-third of firms who needed to downsize were threatened with a tribunal claim in the last three years.[15] Although most of the claims were settled or the employee gave up on pursuing the threat, 35% of cases ended up at a tribunal, diverting the firms' productive resources into legal disputations. Some 37% of cases were settled – generally on legal advice that this would be much cheaper than going to a tribunal. Firms that contested cases lost money even when they won a tribunal. The BCC found that 61% of SMEs feel that the dismissal rules are weighed against the employer.[16]

The BCC (2010) employment law report found evidence of decreasing UK competitiveness as a result of employment regulations and tribunal claims.[17] Unreasonable health and safety regulations, time-off provisions and an average waiting time of 20 weeks for a hearing at an employment tribunal were found to be substantial costs for SMEs. The BCC points in particular to the irrationality of imposing the same health and safety standards for home workers and staff in the work place. They also call for a relaxed system of hiring and firing, where an "employer's reasonable belief that an employee committed misconduct should be enough for dismissal."[18]

Though the law is intended to protect workers, it actually encourages disputes and thus discourages employers from hiring more workers, making the labour market worse off. Taking on a new worker – especially one who has been unemployed for a long time – is risky, and this law only adds to that risk. Tribunal claims should aim to be less weighed against employers.

Regulatory burdens add more costs on SMEs. The BCC's survey on small businesses showed that firms are postponing hiring even when 60% do express the need for more employees.[19] The biggest barriers are seen to be the dismissal and health and safety rules – 54% of employers see them as "mostly or extremely burdensome", while 25% report them as "slightly burdensome".[20]

The BCC also published an estimate on the cost effects of new regulation on SMEs. Even though some policies, such as the removal of the default retirement age and legal dispute reforms were cutting costs for businesses, UK and EU regulations still generate much greater costs than benefits for SMEs. The BCC's estimate is a total of £22bn over the next 4 years.[21] The highest cost burden will come from the announced minimum wage increases (more than £40m for every announced increase up until 2015). This policy will strike youth unemployment in particular, as younger people are mostly less qualified and experienced, and are generally willing to accept lower wages to gain experience and a "first foot on the ladder". Employment law also discourages the businesses to take on temporary workers and interns due to an uncertain tax status of such workers. Removing the minimum wage would not only substantially decrease the costs for the small business sector; it would be the single best policy aimed at lowering youth unemployment.

Administrative and compliance costs bother 80% of SMEs. A staggering 83% and 82% of SMEs needed to hire external experts for tax and employment regulation compliance, respectively. Some 60% needed to use these services "often" and 43% " very often".[22]

The data provided by SMEs shows how the burden of regulatory compliance is responsible for layoffs, stalled investments and lower profits. The FSB's survey from 2008 shows that 27% of businesses seeking expansion see increasing regulation as the most important difficulty in doing so.[23] Some 50.7% of businesses that were planning to downsize or close cite the regulatory burden as the reason why, while 42.6% blame the burden of employment law. Another survey in 2009, examining businesses that had stopped hiring, found that 34.3% of them blamed employment legislation and paperwork. The FSB notes that "unfortunately many businesses perceive that government cuts regulations with one hand and introduces new burdens with the other."[24] The BCC's cost estimates for new regulation confirms these findings: although some regulation is being cut, yet more is coming onstream, driving up costs for businesses, raising uncertainty and reducing investment incentives. The FSB cites this as one reason why, according to the World Economic Forum's Global competitiveness report, the UK ranks 83 out of 142 countries in its burden of government regulation.[25] Other worrying international comparisons are the extent and effect of taxation (rank 94), general government debt (rank 120) and government budget balance (rank 138).

The conclusion of all this is that the burden of government regulation is one of the most severe constraints to UK competitiveness, which should be addressed as urgently and as seriously as the budget deficit and public debt.

Recommendations

In summary, we recommend the following:

- Abolish employers' NIC first for small and micro businesses then for medium-sized businesses.
- Reverse the 5.6% hike in business rates for all SMEs.
- Remove excessive regulatory standards and administrational burdens that increase costs for businesses and make it difficult to employ more workers.
- Exempt SMEs from new UK regulation, and impose a moratorium on future EU regulation.
- Reduce the number of employment tribunals by making it easier to fire employees who commit misconduct.
- Create incentives for zero-hour, temporary and fixed term contracts, and introduce self-employment to reduce hiring costs for SMEs
- Act as an enforcer of contracts – public sector agencies should pay their invoices more promptly.
- Encourage the creation of a private secondary bond market in order to ease the availability of funding to the SMEs.

Abolishing employers' NICs

The UK tax system places a huge burden on SMEs. Reforming it would free up funds and increase liquidity. By reducing the tax burden the government directly lowers costs and increases profits for SMEs.

The proposal is to remove the employers' contribution on all micro and small businesses immediately, while extending it to the medium-sized businesses in one year's time. By phasing out NICs, the Treasury would create a positive signal to small business owners and change their expectations, encouraging them to expand and hire again. Meanwhile the gradual nature of the policy implementation will help the Treasury to bear the revenue losses.

The NIC holiday, introduced last year by the Chancellor, did not yield the expected results. The reason is the same as why a fiscal stimulus cannot work and why an employment subsidy cannot work – future expectations under uncertainty mean that temporary effects do not change people's long-term plans. The anticipation of higher taxes in the year after the holiday is over will continue to discourage firms from investing and hiring. Similar was the effect of anticipation of a 5.6% hike in business rates, to which the businesses responded by saving money rather than investing it. It is clear how this increase is highly regressive on business growth, and that it should be scrapped immediately.[26]

According to the Office for National Statistics the median gross weekly earnings in the UK were £498 per week or £2,158 per month (a decrease of 0.5% from 2011).[27] In Table 1 the average employer's NIC per employee, per year is calculated to be £2,540.30 a year.[28] For a micro business operating with 5 employees, abolishing the employer's NIC would save the business a total of £12,701.5 per year on average. For a small business owner with 10 employees this will yield a saving of £25,403 per year on average, which is enough to employ an additional worker at almost

Wage	Week	Monthly	Yearly
Gross pay	£469.00	£2,158.00	£25,896.00
Tax-free allowances	£155.87	£675.42	£8,105.00
Total taxable	£342.13	£1,482.58	£17,791.00
Tax due	£68.43	£296.52	£3,558.20
Employee NICs	£42.24	£183.04	£2,196.48
Total deductions	£110.67	£479.56	£5,754.68
Net wage	£387.33	£1,678.44	£20,141.32
Employers' NICs	£48.85	£211.69	£2,540.30

Table 1: Average UK wages and employers' NICs *(Source: Office for National Statistics (2012) Annual Survey of Hours and Earnings; HM Revenue and Customs (2012) National Insurance Contributions, tax rates and total deductions and allowances for a single, full-time employed individual.)*

no additional cost. In terms of part time employment (gross median weekly earning is £152.9), one part time job can be created by removing the NIC in a micro business with 5 employees, while two part time jobs can be created by removing it in a small business with 10 employees.

According to BIS around 22% of UK private sector businesses are micro businesses, while 4% were small businesses, numbering a total of 1.16 million.[29] According to the surveys done by FSB and the BCC, between 44% and 60% of all small businesses would take on additional employees if the government ended employers' NICs. Taking only the lower figure (44%) and discounting sole proprietorships, this would open up room for more than 500,000 jobs.[30]

Compliance costs, which the Taxpayers' Alliance calculates at around £146 million, and which levy a disproportional burden on SMEs, would generate additional savings.[31] Such savings could be used to take on new workers or to increase production or investment, which would raise confidence and lower uncertainty among SMEs.

By removing employers' NICs the Treasury would experience an immediate decrease of revenues on 7.08 million jobs in micro or small businesses. On average, the Treasury would lose £18.5bn a year (3.1% of the 2012 budget). Accounting for the medium-sized businesses in the following year, the loss would be an additional £7bn (1.2% of the 2012 budget). On the other hand, despite the immediate loss, the Treasury would see an increase in income taxes from newly employed persons, an increase of revenues from corporate taxes paid by growing companies, greater VAT revenues on expanding production and consumption, and a decrease of expenditures on unemployment benefits. The budget gap of the initial 3.1% would quickly be filled up by new incoming revenue (within three years, we estimate), as would the 1.2% created in the following year by the exemption of medium-sized businesses.

Remove excess regulation and reform employment law

According to the surveys, regulatory standards impose the highest costs on SMEs. Removing and relaxing most of these will free up funds and allow the SMEs to reorient their resources towards productive and growth enhancing strategies. There is a strong need to level the playing field for SMEs and big companies, since it is unreasonable to impose the same rules on both big multinational corporations and small retail businesses with few employees. The government should review all existing regulations aimed at small businesses, and remove and simplify most of them immediately in order to reduce the huge cost burden they impose. In addition, SMEs should be exempt from any new regulations. Setting up simple regulatory standards and one-stop shops will significantly reduce costs for SMEs. This means minimising administrative burdens, reducing compliance costs, paperwork and so on. All this will help SMEs avoid having to hire external consultants to help them comply with the rules. **Simplification of the process and lowering costs** should be the aim.

The government has already started this process with a commendable deregulatory agenda. They have initiated the One-In, One-Out (OIOO) system where a regulation cannot be introduced without removing one of equal costs, and have launched a Red Tape Challenge website asking for public cooperation and feedback to reduce unnecessary burdens and improve the regulatory system.[32] In the new Enterprise and Regulatory Reform Bill, the government has already announced scrapping 50% of the 1,500 regulations recognized as burdensome through the Red Tape Challenge, and plans to reduce inspection burdens and put time-limits on new regulation via 'sunset' clauses.[33] They have also continued using the Regulatory Policy Committee (RPC) set up in 2009 as an independent body of experts with an aim to scrutinise each department's deregulatory efforts. Any new regulation, before it can be implemented has to be given a passing grade by the RPC and has to comply with its recommendations.

These are laudable efforts, but there is more that can be done. According to the BCC's (2012) Red Tape Challenged? report, 50% of new regulations were out of scope of the OIOO system, imposing a cost of more than £30 million to UK SMEs annually.[34] Many of these out of scope regulations come from the EU, meaning that domestic departments have no choice but to implement them. The report has also found that many government departments still lack transparency and are failing to comply with their own deregulatory agenda. Some departments (BIS and the Cabinet Office in particular) fail to implement RPC recommendations and carry on with the regulation even when the RPC hasn't given it a passing grade. The Enterprise and Regulatory Reform Bill is still in its Parliamentary scrutiny process and isn't likely to take full effect until 2013. Continuation of such efforts is necessary, but it needs to be done with greater efficiency.

Over the next four years, there should be no new regulation on SMEs. This includes anticipated national minimum wage increases, pension reforms, paternity leave, the equality bill, immigration caps, and a moratorium on any new EU regulation impacting SMEs. Even though it seems hard to avoid EU regulation, a general exemption for micro and small businesses from new incoming EU regulation would be something worth fighting for.

It is hard to calculate the exact cost-benefit of lighter regulation, but given the estimated £22bn of regulatory compliance costs by the BCC in 2011, reducing this burden would be a big boost for every small business.[35] In addition, removing the annual cost of EU regulation, estimated by the FSB at €124bn (£100bn) per year,[36] would amount to a windfall of £23,000 a year for every business – almost enough for every business to take on one new employee at the average wage.[37] Adding to this the unaccounted costs for having to hire external help, it is easy to see that the annual regulatory burden in the UK well exceeds the annual average gross salary.

The plea for less regulation doesn't imply removing all regulation since SMEs need a sense of reliability and guarantee in order to be considered a credible borrower. Deregulation is a call for reducing and removing all those regulative, administrative, and legal burdens that exemplify adverse use of resources and constrain a business in its growth and development.

Temporary contracts and self-employment

Another revealing fact in surveys done by the BCC and the FSB shows that there has been an "increase of atypical contracts for firms that reach 10 employees".[38] These are zero-hour, temporary or fixed term contracts, which are designed to reduce hiring costs. The government should recognize and support this movement by adjusting the regulatory standards. At a time when SMEs face such large uncertainties, these contracts allow them to employ people on a partial basis – which is better than them not employing anyone at all. It should be possible to extend such contracts to all new staff.

The self-employment option is another potentially effective policy to reduce costs for SMEs. In his research paper Dr Madsen Pirie (2012) argues that encouraging self-employed would bring huge relief to SMEs, in terms of a reduced tax burden on employee wages.[39] He recognizes that a significant burden to SMEs comes from employment legislation and protection whose costs of compliance are regressive on SMEs. Things like maternity leave, holiday pay, or threats of tribunal are all causing small businesses to decrease their hiring. It is a policy aimed at lowering costs of job creation for SMEs, "without affecting the relationship that large firms have with their employees."Taking on temporary or self-employed workers allows businesses to be more flexible and responsive to consumers. They can more easily adjust their size to match demand. If they are successful they will increase their staff and offer the current staff better and/or full time contracts. If they are less successful they have an easier way to reduce staff levels and cut costs. Employers will be more inclined to take business risks, knowing they can adjust quickly to potential adverse effects. That in turn opens up new investment and even more employment opportunities.

The 'youth contract'

Youth unemployment is a particularly sensitive issue during any financial crisis. Due to a high number of lost jobs in the public and private sector, new hiring is limited to those with more experience. In order to address this issue a wide range of policies has been advocated in order to encourage employers to hire more young people and recent graduates. The results so far are disappointing. The government has tried to push employers into hiring more young people by offering monetary stimuli to employers and by deciding on a threshold of youth unemployed to be hired. It is trying to create an artificial demand for young people, and is doing so by providing wrong incentives to employers. The final outcome will be a distortion of the labour market against older workers (over 24) and a formation of a political market for employers to compete on.

A policy of reducing the income tax for the young could result in a slightly better effect but would still leave the problem of discrimination and favourism towards one social group at the expense of another.

One policy in particular harms youth unemployment – the minimum wage, and its announced increases in the next three years (minimum wage legislation accounts for the majority of the £22bn of regulatory costs estimated by the BCC, 2011b). Not only is it costly for employers who need to increase the mass of wages they pay out now, but it also imposes restrictions for youth hires. The young are more willing than the rest of the workforce to work for a rate lower than the market rate in order to get experience. They engage into unpaid internships and volunteering hoping to get more experience and be more competitive on the market. Removing the minimum wage is the single best policy for young workers who lack experience, as it will make it much more affordable for the private sector to offer them temporary jobs and work placements.

Tribunal claims

Businesses too often cite tribunals as the top priority in employment law reform. They should be done much faster, and should not be weighed against employers, as they are now. But even changing the timing won't yield any substantial change unless the conditions of making the claim are changed. It should be easier to fire a member of staff if the employer feels the employee is not contributing to the company.

Businesses already have the powers to reduce head count when cost pressures are high, and they use it as the final option to fight insolvency. Reforms to the employment law are not about being able to fire people; they are needed to initiate a boost in confidence for taking on more risk. Making it easier to fire implies a credible threat available to the employer, not an incentive to fulfil it. This is not a policy aimed against workers. It is a policy aimed at helping businesses to feel safer in hiring new employees, which will actually boost employment.

The government has made efforts in tribunal reforms and has introduced them in the Enterprise and Regulatory Reform Bill.[40] They have extended the qualifying period for a dismissal from one to two years and have encouraged dispute resolution without requiring a tribunal. However, they have rejected the proposals of the Beecroft report on no-fault dismissals for small businesses that would have made it easier for them to attract more staff, in addition to exempting them from various employment laws.[41] They have also introduced a possibility of a financial penalty on employers in a tribunal, attempting to discourage employers to undergo tribunals and opt for an early settlement. The government is in these cases showing a lack of courage to truly reform the labour market. Half-baked policies will only produce half-baked solutions.

After seeing deteriorating UK productivity, keeping on inefficient workers subject to employment law protection is a policy that will keep productivity low for quite some time.[42] Low productivity is a sign of a bad economy. Domestic competitiveness is deteriorating, making domestic businesses inflexible in adapting to market conditions. This will only make them more prone to failure.

Cash flow problems

The illiquidity arising from big corporations and the public sector not paying their bills on time is a problem for every business that supplies them. Here is where the government should fulfil one of its elementary roles in a society and act as an enforcer of contracts.

By setting a deadline in which all invoices from public organisations must be paid (the FSB proposes 10 days), and making its sub-contractors do the same, it will set an example and create incentives for the private sector to follow its lead.[43] Even though this might not solve the problem immediately, it would create a new standard that would most likely become the norm in all contracts. Solutions such as these based on reputation and credibility already exist in the form of the Prompt Payment Code that presents the private sector's effort to end late payments.

Creating a "secondary" bond market for SMEs is another positive idea, however only if done by the private sector. Governments are notoriously bad at picking industry winners. A secondary bond market would be particularly helpful to family businesses, perceived to be much less open to risk. It would give them an alternative source of financing, reducing the high dependency that UK businesses have on bank loans – a double benefit in times where bank lending is hard to come by. The UK has excellent capital markets and a highly developed financial system, and it is time to use them to help smaller companies.

Another way of increasing performance and competitiveness is by promoting clusters where small firms can acquire the benefits and advantages of working alongside others. The role of government here is to reduce the obstacles against clusters forming, such as planning restrictions. Decentralization can also help: a local community will have a better idea of what kinds of clusters can work in its area than can distant government officials.

Conclusion: Britain on the wrong track

The UK has dropped in measures of economic freedom over the past few years, according to the Heritage Foundation's freedom index.[44] It has fallen out of the top 10 "free" nations and now holds 14th place among "mostly free" nations with a score of 74.1 (down from 76.5 in 2010). Its drop was mostly down to high income and corporate taxes and government spending. In these categories the UK ranks as "mostly unfree".

Two other areas that saw the UK slipping are labour freedom and financial freedom. Once characterized by market freedom, the UK financial sector is beset by regulations, most emanating from the EU. Another reason is the nationalization of Northern Rock and RBS during the crisis. Despite all this the level of financial freedom is still high (80) and labour freedom (71) reasonably so. But there is still much room for improvement, particularly on labour market law and regulation.

The Fraser Institute's Economic Freedom of the World also reports disturbing signs whereby the UK has dropped significantly as a result of deeper regulation of credit, labour and business.[45] Its worst performance is in administrative burdens and bureaucracy costs, both substantially deteriorating in the last decade. Hiring and firing regulations are also ranked low, while the worst indicator is private sector credit availability, dropping down significantly since 2008. The problems facing all these areas were recognized in the surveys of UK businesses analyzed in this report: removing them would create a substantial boost to economic growth in the UK, raising its rankings in economic freedom once again.

The Heritage and Fraser Institute indexes have a highly positive correlation with economic growth and the favourability of the business environment.[46] Even though the UK's business environment is still rated largely free, its decline on tax, regulatory and labour-market freedoms sounds a warning for its long-term growth and prosperity.

The most direct way to help SMEs' cash flow is to reduce their outgoings. By removing employer NICs, lowering tax and business rates, and stripping away some of the most costly regulation that affects businesses and workers, the government would allow more funds to be used for production and employment, who are likely to have a much clearer vision of how to generate wealth than any number of Whitehall planners.

Endnotes

1. SMEs are defined as having between 0 and 249 employees according to the BIS (2011) statistical release.
2. BIS (2011) "Business Population Estimates for the UK and regions 2010", pp 1-3.
3. Eurostat (2011) "Key figures on European business with a special feature on SMEs." pp 10-12.
4. Office for Budget Responsibility (2012) "Economic and Fiscal Outlook – March 2012", pp 5-6.
5. Bank of England (2012) "Credit Conditions Survey" Survey Results, 2012 Q2, pp 2.
6. Meakin (2011) "Abolish National Insurance." Taxpayers' Alliance, pp.12
7. HM Treasury, Budget 2012, pp 8. Combined NIC is the second biggest source of revenue (£108bn)
8. Federation of Small Businesses (2011b) "The job centre is not working", pp 7.
9. Ibid. pp 7-8.
10. British Chambers of Commerce (2011a) "The workforce survey", pp 4.
11. Meakin (2011) "Abolish National Insurance." Taxpayers' Alliance, pp 14.
12. Federation of Small Businesses (2011c) "Solving late payment and helping cash flow"
13. FSB (2012) "The FSB 'Voice of Small Business' Member Survey". pp 35.
14. Bacs (2011) "British corporates are worst offenders in £24 billion late payments." Press release.
15. British Chambers of Commerce (2011a) "The workforce survey. Small Business." pp 15-16.
16. Ibid. pp 17.
17. British Chambers of Commerce (2010) "Employment regulation: Up to the job?"
18. British Chambers of Commerce (2010) "Employment regulation: Up to the job?" pp 18.
19. British Chambers of Commerce (2011a) "The workforce survey. Small Business." pp 4.
20. Ibid. pp 11.
21. British Chambers of Commerce (2011b) "Employment Legislation: Holding back growth and jobs."
22. British Chambers of Commerce (2011a) "The workforce survey. Small Business." pp 18-19.
23. Federation of Small Businesses (2011d) "Better Regulation"
24. Federation of Small Businesses (2011a) "The Burden of Regulation" pp 2.
25. Ibid. pp 1. and World Economic Forum (2011) Global Competitiveness Report 2011-2012, pp. 360-361.
26. Even though small businesses pay a lower rate, the lowest increase for 2012/2013 was still a high 3.9%.
27. Office for National Statistics (2012) "2011 Annual Survey of Hours and Earnings", pp 1-2.
28. According to the rates available from HM Revenue and Customs (2012).
29. BIS (2011) "Business Population Estimates for the UK and regions 2010" Table 1, pp 2.
30. The calculation is based on the assumption of opening only one job for the 44% of businesses who expressed concern with the NIC over hiring. Also, the reason sole proprietorships aren't taken into account is simply because they wouldn't experience any savings from an abolished NIC since they don't hire any employees. However, abolishing the NIC could open room for them to hire an additional employee where they weren't able to do so before. The figure of 500,000 is therefore an underestimation of the total possible jobs created by abolishing the NIC.
31. Meakin Rory (2011) "Abolish National Insurance." The Taxpayers' Alliance, pp 16.
32. Accessible at: http://www.redtapechallenge.cabinetoffice.gov.uk/home/index/
33. House of Commons (2012) "Enterprise and Regulatory Reform Bill" pp 42-46.
34. British Chambers of Commerce (2012) "Red Tape Challenged?" pp 4-5.
35. British Chambers of Commerce (2011b) "Employment Legislation: Holding back growth and jobs."
36. Federation of Small Businesses (2011a) "The Burden of Regulation" pp 6.
37. Assuming the cost is spread equally.
38. British Chambers of Commerce (2011a) "The workforce survey. Small businesses." pp 9. and Federation of Small Businesses (2012) "The FSB 'Voice of Small Business' Member Survey". pp 43
39. Pirie (2012) "The Growth Agenda: The self-employment option", pp 2-3.
40. House of Commons (2012) "Enterprise and Regulatory Reform Bill", pp 7-10.
41. Beecroft (2012) "Report on Employment Law"
42. ONS (2012) "Labour Market Statistics, July 2012" pp 8.
43. Federation of Small Businesses (2011c) "Solving late payment and helping cash flow"
44. Heritage Foundation (2012) "The 2012 Index of Economic Freedom"
45. Fraser Institute (2011) "Economic Freedom of the World 2011 Annual Report"
46. Papers by Carlsson, Lundstorm (2002), Easton, Walker (1997), Gwartney, Lawson (1999) and Williamson, Mathers (2009) among others, provide evidence to prove this claim.

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