



Arbenigwyr mewn Busnes
Experts in Business

FSB Wales response to the Finance Committee

Welsh Government's Budget 2019/20

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About FSB Wales

FSB Wales is the authoritative voice of businesses in Wales, with around 10,000 members. It campaigns for a better social, political and economic environment in which to work and do business. With a strong grassroots structure, a Wales Policy Unit and dedicated Welsh staff to deal with Welsh institutions, media and politicians, FSB Wales makes its members' voices heard at the heart of the decision-making process.

Introduction

The Welsh Government's budget for 2019/20 marks a turning point in the nation's history. Building on the devolution and creation of the Land Transaction Tax and the Landfill Disposal Tax, Welsh Government will for the first time set its own rate of income tax. This decision, worth around £2.1bn to Welsh Government's budget, reflects a move towards greater financial flexibility and accountability for the Welsh Government and National Assembly for Wales.

For the first time, decisions made in the budget will have a direct impact on the fortunes of the Welsh economy and Wales' public finances. It is therefore more important than ever before that the decisions Welsh Government takes are able to ensure a sustainable, growing economy to support its tax and spending ambitions.

FSB Wales believes this can only be achieved if Wales' 250,000 micro, small and medium-sized businesses are able to prosper. We therefore set out a number of priorities for Welsh Government in developing its budget for 2019/20.

Summary

Taxation:

- Within the budget, Welsh Government should set an explicit ambition around closing the employment gap and maintaining wage growth at 0.5 per cent above UK levels.
- Funding for the Economic Action Plan and associated programmes should be maintained or increased to help deliver improvements to the tax base.
- Welsh Government should set its income tax rate at 10p across all bands, maintaining the current arrangement on rates.
- Welsh Government should maintain its 1 per cent lower band for the Land Transaction Tax between £150,000 and £250,000.
- Welsh Government should consider aligning more closely the process of revaluation of rates with economic conditions. There are a number of ways this could be achieved, including three a three-yearly cycle as is happening in Scotland and England.



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- The 2019/20 budget should provide a timeline for consideration of longer-term reforms to business rates, including the scope of issues under examination and any opportunities for consultation with the business sector
- Further detail on the proposed Vacant Land Tax should be delivered through the budget, including the process and timescales involved in policy development.
- FSB Wales does not believe now is the time to introduce a tourism tax in Wales. We would suggest the Welsh Government consults with the sector to better understand the impact of VAT on tourism businesses, learning from the review in Northern Ireland.
- FSB Wales reiterates its call for the devolution of APD to Wales.

Expenditure

- The 2019/20 budget should refocus its headings to align with the Economic Action Plan.
- The Economic Action Plan should include targets for the economy. This would allow us to measure performance of the policy.
- The new headings should be clear and unambiguous and align with the priorities identified within the plan.
- Funding for the foundational sectors should be clearly articulated and a timeline produced for the development of action plans in these areas.
- The Welsh Government should implement the findings of the Reid Review, in particular around the creation of the St David's Investment Fund.
- Welsh Government should introduce a Rural Challenge Fund, to help rural economies to innovate.
- Welsh Government should review finance issues such as patient capital and succession finance through the Development Bank's new research unit.
- Welsh Government should ensure funding for apprenticeships with SMEs is secured and not diverted towards demand amongst large firms and the public sector.
- There should be clear support for Business Wales and the Development Bank for Wales in the budget with commitments going beyond 2020.



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Taxation

Growing the Welsh Tax Base

Welsh Government is now accountable for the performance of the Welsh tax base through its receipts from income tax. Recent research by the Wales Centre for Public Policy (WCPP) has identified the pressures Welsh Government will face in this regard.¹ In short, the Welsh Government will gain or lose revenue depending on its performance relative to the UK in terms of employment levels, wages (in particular in the private sector) and the nature of the Welsh population.

In summary, the WCPP report suggested the following opportunities:

- **Employment** - If employment rates converge in 2029-30, the Welsh Government budget would be more than £100 million better off each year compared with a scenario of no income tax devolution.
- **Wages** – Maintaining 0.5 per cent faster wage growth than the UK as a whole would increase Welsh Government's budget by around £175m annually by 2029/30.

By contrast, the same report estimates that raising the basic rate by 1p would net Welsh Government around £180m accounting for behavioural responses. It is therefore clear that delivering positive economic outcomes on employment and wages can lead to more prosperous public finances.

We know that there are a number of reasons for the employment and wages gap in Wales. For instance, most recent labour market statistics suggest employment rates among women lag men by around 8 per cent, whilst the employment rate for those with a disability is reported to be 43 per cent UK-wide. Furthermore, economic inactivity remains high in Wales at 22.5 per cent.² Our own research on self-employment has suggested women are less likely to start a business, something which the Welsh Government can address.

As such we would recommend the Welsh Government sets an ambition of closing the employment gap and maintaining the 0.5 per cent faster wage growth within the budget narrative. This would form the medium or longer-term ambition of Welsh Government's fiscal policy.

Welsh Government should commit resources within the budget process to enable both of these factors to be achieved. For instance, priorities aligned to the Economic Action Plan should be properly resourced with an increase in overall funding in order to deliver the

¹ Poole, E and Ifan, G. 2018. *The Welsh Tax Base: Risks and Opportunities after Fiscal Devolution* [Online]. Available at: <https://www.wcpp.org.uk/wp-content/uploads/2018/07/The-Welsh-Tax-Base- WCPP-Final-180627.pdf> (accessed 11th September 2018).

² Welsh Government. 2018. *Key Economics Statistics: July 2018* [Online]. Available at: <https://gov.wales/docs/statistics/2018/180719-key-economic-statistics-july-2018-en.pdf> (accessed 11th September 2018).



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employment and wage growth needed. Likewise, schemes such as Working Wales must be allowed to bed in and should be properly targeted to ensure Wales is reducing its proportion of economic inactivity.

Within the budget, Welsh Government should set an explicit ambition around closing the employment gap and maintaining wage growth at 0.5 per cent above UK levels.

Funding for the Economic Action Plan and associated programmes should be maintained or increased to help deliver improvements to the tax base.

Income Tax

The 2019/20 budget marks the first opportunity for Welsh Government to vary the rate of income tax across the three bands in Wales. The extent of the direct impact on SMEs will depend on the nature and structure of the business concerned, in particular whether they are incorporated or not. Evidence from our sister organisation FSB Scotland suggests that FSB members are more likely to be paying the basic rate, than the additional or higher rates.³

FSB Wales notes that the Welsh Labour manifesto for the 2016 elections to the National Assembly provided a guarantee not to increase income tax during this Assembly term. We believe this is the correct policy at present for a number of reasons:

- It provides consistency in the short-term between trading conditions in Wales and the rest of the UK.
- It allows Welsh Government to further ascertain the impact of Welsh tax policy on SMEs across all devolved taxes.
- Welsh Government has already committed to significant reforms to Council Tax and in the medium-term Non-Domestic Rates.
- It provides stability during a time of unprecedented change through the UK's exit from the European Union.

Welsh Government should set its income tax rate at 10p across all bands, maintaining the current arrangement on rates.

Land Transaction Tax

The Welsh Government budget for 2018/19 set out the first rates and bands for the Land Transaction Tax. In relation to non-residential transactions the Welsh Government reduced the rate between £150,000 and £250,000 from 2 per cent (as currently applies

³ FSB Scotland. 2017. *Income Tax and Small Businesses in Scotland* [Online]. Available at:

https://www.fsb.org.uk/docs/default-source/fsb-org-uk/incometaxreport_dec17_formatted.pdf?sfvrsn=0 (accessed 11th September 2018).



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in England) to 1 per cent.⁴ This essentially halves the cost of tax on transactions between these values.

Furthermore, the knock-on impact of the cut in this band leads to a reduction in tax liable for property purchases up to a value of £1.1m. This has led to the tax becoming more progressive when compared to its UK counterpart, Stamp Duty Land Tax. FSB Wales believes a significant proportion of our members would have benefited from this change. We therefore believe it should be maintained in the short-term and the impact reviewed at a later date to ascertain the impact on the number of transactions.

Welsh Government should maintain its 1 per cent lower band for the Land Transaction Tax between £150,000 and £250,000.

Non-Domestic Rates

In the run up to the National Assembly elections in 2016, we called for a number of reforms to the Non-Domestic Rates (Business Rates) system to improve its fairness. We are pleased that Welsh Government has implemented a number of these proposals, including; making the small business relief scheme permanent, uprating the multiplier by CPI instead of RPI and introducing reliefs for the childcare sector.

The Cabinet Secretary for Finance recently announced the next revaluation of business rates will be in 2021, in line with England. We welcome this announcement as it ensures the tax base reflects more closely current economic conditions. The Cabinet Secretary further committed to review longer-term changes including a potential three year cycle amongst other things. Ultimately, the aim in this area is to ensure the tax base adequately reflects property prices.

Welsh Government should consider aligning more closely the process of revaluation of rates with economic conditions. There are a number of ways this could be achieved, including three a three-yearly cycle as is happening in Scotland and England.

In his most recent statement, the Cabinet Secretary also confirmed that work is being undertaken to look at broader reforms to the system including whether there are different approaches to valuation that would be fairer and better improve economic outcomes. The statement also refers to Land Value Tax as a potential alternative tax for Wales. Additionally, the Barclay review in Scotland has proposed a number of other potential reforms such as providing a 12 month delay on rates accruing to investment in new plant, buildings and machinery.

⁴ Welsh Government. 2018. *Welsh Tax Policy Report* [Online]. Available at: <https://beta.gov.wales/sites/default/files/publications/2018-06/welsh-tax-policy-report.pdf> (accessed 11th September 2018). P.51



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FSB Wales welcomes the Welsh Government's ambition to undertake longer-term reform of business rates. We also agree that fairness and economic outcomes are the correct guiding principles for reform.

The 2019/20 budget should provide a timeline for consideration of longer-term reforms, including the scope of issues under examination and any opportunities for consultation with the business sector.

Tax Administration

FSB Wales has welcomed the introduction of the Welsh Revenue Authority. Since the two devolved taxes went live in April we have had a good degree of interaction with the WRA and there appears to be a willingness to focus on helping small firms to comply with tax legislation introduced in Wales. As tax devolution and reform gathers pace, we can envisage the WRA being given a larger role in administering taxes and would suggest this play a role in any longer-term review of non-domestic rates.

In order to inform our understanding of tax administration amongst SMEs in Wales, we have partnered with Bangor University to carry out research into tax policy in Wales. We hope this research will be able to inform both the WRA and the Welsh Government in due course.

New Taxes

In October 2017 the Welsh Government announced four new tax ideas to take forward as part of the new power to introduce taxes in devolved areas.

Vacant Land Tax

Of the four taxes proposed, the Vacant Land Tax has since been chosen as the first of these to be implemented. We recognise the six stage process between identification and implementation of any new tax will inevitably lead to a long period of policy development.⁵ Despite this, we believe more detail is needed on the Vacant Land Tax proposals to allow us to make an assessment of its impact on SMEs in Wales.

Further detail on the proposed Vacant Land Tax should be delivered through the budget, including the process and timescales involved in policy development.

Tourism Tax

Along with the Vacant Land Tax, Welsh Government has also suggested it will implement a Tourism Tax in Wales. In the past FSB has campaigned for a reduction of VAT on tourism to 5 per cent to bring the UK into line with many other European countries. Many of these countries combine locally administered tourism taxes with low rates on

⁵Welsh Government. 2018. *The process of developing a new tax for Wales* [Online]. Available at: <https://gov.wales/docs/caecd/publications/180213-developing-infographic-en.pdf> (accessed 11th September 2018).



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VAT on tourism, providing a greater degree of flexibility to accommodate local conditions.

For instance, VAT in one of Wales' major competitors for tourists - the Republic of Ireland - is currently 9 per cent across a broad section of the tourism sector. We are also aware of UK Government's recent consultation on the impact of VAT on tourism in Northern Ireland. Our sister organisation FSB NI submitted evidence to the review suggesting a cut on tourism VAT to 10 per cent or less.

Furthermore, a significant proportion of those who visit Wales for overnight stays come from our largest neighbour, England. Many of these tourists will have other options for holidays within a similar distance to Wales and we currently do not understand their sensitivity to price.

FSB Wales has recently begun consulting with members on this issue. Initial results from members in Gwynedd suggest a high degree of opposition to the proposal, particularly if the funding is not hypothecated to the sector.

FSB Wales does not believe now is the time to introduce a tourism tax in Wales. We would suggest the Welsh Government consults with the sector to better understand the impact of VAT on tourism business, learning from the review in Northern Ireland.

Air Passenger Duty

FSB Wales has long supported Welsh Government's calls for air passenger duty to be devolved to the National Assembly for Wales. The recent creation of the Cardiff – Doha link by Qatar airways shows there is an appetite for long-haul flights to Wales and we believe APD, if properly used, could lead to increase connectivity with the rest of the world. Furthermore, we note that the UK Government has recently consulted on this issue in relation to Northern Ireland.

FSB Wales reiterates its call for the devolution of APD to Wales.

Spending Priorities

Economic Action Plan

FSB Wales has welcomed the introduction of the Economic Action Plan. The EAP reflects a broad shift in policy away from the sectors approach towards four main themes; the Economic Contract, a regional approach to economic development, foundational sectors and new national 'thematic' sectors.

Previous Welsh Government budgets have been difficult to analyse in relation to activity undertaken under the sectors banner with titles such as 'Business Development' and 'Business Solutions'. In order to reflect the Economic Action Plan, FSB Wales believes these headings should be refocused to align directly with the four priorities mentioned



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above. These should be clear and unambiguous to allow for proper analysis and debate around the levels of resource needed under each priority.

The 2019/20 budget should refocus its headings to align with the Economic Action Plan. The new headings should be clear and unambiguous and align with the priorities identified within the plan.

At present, the Economic Action Plan doesn't include targets to measure performance. FSB Wales would like to see targets introduced to set out a clear ambition for the longer term and a means of measuring that ambition.

The Economic Action Plan should include targets for the economy. This would allow us to measure performance of the policy.

Foundational Sectors

The EAP provided the first formal recognition of the foundational economy in an economic strategy document, which FSB Wales has welcomed. Taking the foundational sectors forward, the Welsh Government has previously signalled its intent to deliver action plans in each of the areas concerned. Furthermore, in its previous budget process £1.5m was committed to projects in the foundational economy.

We would like to see funding for the foundational sectors clearly articulated within the budget to support the action plans. As part of this, a timeline for the creation of the action plans should be published, as well as an update on the use of the £1.5m to date.

Funding for the foundational sectors should be clearly articulated and a timeline produced for the development of action plans in these areas.

Reid Review

The Welsh Government recently published the Reid Review of research and innovation in Wales. The review makes the case for the creation of a St David's Investment Fund in order to better resource and project the innovation agenda in Wales. In particular, we feel that further funding should be targeted at the point where businesses and universities interact, through funds similar to Higher Education Innovation Funding (HEIF).

The Reid review identifies this funding as ceasing to exist in Wales from around 2014 onwards with European funding largely filling the gaps.⁶ Given the uncertainty around European funding going forward, Welsh Government should act in this area as a priority and seek to develop the St David's Investment Fund as per the Reid recommendations.

⁶ Reid Review. 2018. Available at: <https://gov.wales/docs/det/publications/reid-review-en.pdf> (accessed September 11th 2018). P.43



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The Welsh Government should implement the findings of the Reid Review, in particular around the creation of the St David's Investment Fund.

Rural Economies

In our report, *A Taskforce for Rural Economies* we highlighted the pressures currently facing small firms in rural areas from the developing 'city region' agenda and uncertainties around Brexit. In particular, policies such as LEADER and the broader RDP have built up momentum over time that risks being lost through the transition period.⁷ Our proposal was to convene as taskforce to examine the role of rural economies in the Welsh Government's broader economic strategy and to institute a 'rural challenge fund' that would continue and enhance programmes such as LEADER post-brexit.

This would be an open fund designed to attract new ideas and new thinking for economic development in rural areas. The emphasis would be on allowing rural areas to design their own projects and interventions in a number of areas in order to further economic development

Welsh Government should introduce a Rural Challenge Fund, to help rural economies to innovate.

Wales' Missing Middle

Recent research by FSB Wales has shown a significant gap in the number of medium-sized firms in Wales. Our report, *Wales' Missing Middle* examined the factors behind this and called for an economic development policy that focused on developing Wales' small firms to become local anchored but globally competitive medium-sized companies.⁸ One of the core issues around this has been access to finance, and in particular finance that is 'patient' – i.e. it is over a longer term. With the Development Bank now in place, the Welsh Government should review this issue, as well as the issue of finance for succession planning, to ensure Wales' small firms are able to grow sustainably.

Welsh Government should review finance issues such as patient capital and succession finance through the Development Bank's new research unit.

Apprenticeships

FSB Wales recently responded to the Welsh Government's proposals for a tertiary education commission for Wales. Within the consultation, a number of issues were raised around apprenticeship reform – including around the impact of the apprenticeship levy. Apprenticeships are a vital route in to many industries. Despite this, in areas such as construction there continues to be a lack of diversity in the nature of apprentices, with few women entering the sector.

⁷ FSB Wales. 2017. *A Taskforce for Rural Economies* [Online]. Available at: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb_taskforce_for_rural_economy.pdf?sfvrsn=0

⁸ FSB Wales. 2017. *Wales' Missing Middle* [Online]. Available at: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb_missing_middle_eng.pdf?sfvrsn=0



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We know from previous data that 56 per cent of Wales' apprentices were placed with an SME during 2016/17, showing how SMEs are committed to the apprenticeship pathway to employment. Unfortunately, this figure has declined by 2 per cent per year over the last three years. The introduction of the levy has significantly increased demand amongst both large employers and the public sector, where previously there was less interest in apprenticeships.

While funding has increased slightly following the introduction of the levy, there is a real danger that to accommodate this new demand small firms, who have always been engaged in apprenticeships, will lose out as funding is squeezed.

Welsh Government should ensure funding for apprenticeships with SMEs is secured and not diverted towards demand amongst large firms and the public sector.

EU Funding

There is a significant degree of uncertainty surrounding the future of EU funding, and specifically whether Wales will receive the same amount of funding under any new UK regime. In our most recent report *Support Success: Business Support Beyond 2020* we analyse the cost of various business support interventions.⁹ The report concludes that both Business Wales and the Development Bank for Wales provide good value for money, in particular when compared to direct investment to large companies through the Business Finance Scheme.

With this in mind, we've called on the Welsh Government to ensure funding for business support services continues post-2020. This should be clearly reflected in the budget, particularly in relation to projections for indicative budgets post-2020.

There should be clear support for Business Wales and the Development Bank for Wales in the budget with commitments going beyond 2020.

⁹ FSB Wales. 2018. *Supporting Success Business Support Beyond 2020* [Online]. Available at: [https://www.fsb.org.uk/docs/default-source/fsb-org-uk/final-business-support-beyond-2020-\(english\).pdf?sfvrsn=0](https://www.fsb.org.uk/docs/default-source/fsb-org-uk/final-business-support-beyond-2020-(english).pdf?sfvrsn=0) (accessed 2nd August 2018).