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Action and Research Centre

The Entrepreneurial Audit

Twenty policy ideas to strengthen self-employment and micro businesses in the UK

by Benedict Dellot and Fabian Wallace-Stephens

February 2017

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Traditional laissez-faire approaches to enterprise support – epitomised by corporation tax cuts and deregulation drives – have reached the limit of their effectiveness. If the government is serious about improving the productivity, resilience and long-term financial success of the self-employed, then it must be more willing to intervene to set problems right – and to do so with a package of reforms stretching from taxation to welfare, through to pensions and late payments.

In this report, we put forward 20 ideas for how the self-employed could be better supported, such as by reforming National Insurance contributions, ironing out the problems of Universal Credit, overhauling business rates, and creating new rights for home-based workers. In doing so we have sought to be pragmatic and realistic, conscious that we live in straitened times and aware that every extra expense must be budgeted for.

The package of measures we present may not be easy wins, nor are they likely to enjoy universal support. But each proposal is presented with the long-term interests of the self-employed in mind, not least those who live in more precarious circumstances. Our fundamental goal – as ever – is to ensure that more people, regardless of their background, have the opportunity to enjoy the benefits of meaningful self-employment, which at its best can offer economic security married with flexibility and a deep sense of purpose.

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The RSA (Royal Society for the encouragement of Arts, Manufactures and Commerce) believes that everyone should have the freedom and power to turn their ideas into reality – we call this the Power to Create. Through our ideas, research and 28,000-strong Fellowship, we seek to realise a society where creative power is distributed, where concentrations of power are confronted, and where creative values are nurtured. The RSA Action and Research Centre combines practical experimentation with rigorous research to achieve these goals.

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Acknowledgements

The authors are grateful to Crunch for their generous support, and in particular to Jason Kitcat for his advice and expertise. Thanks must also go to RSA colleagues for their feedback, including Tony Greenham, Anthony Painter, Matthew Taylor, Janet Hawken, Paul Duffy and Kenny McCarthy. Many external stakeholders have fed into the report, and we are especially grateful to the business support representatives who attended our project roundtable in November 2016, as well as to Alice Johnson and Vicki Hughes at Fugu.

Introduction

A labour market in flux

Self-employment is once again in the media spotlight – and for good reason. The number of people who work for themselves has grown by 46 percent since the turn of the century and today stands at 4.8 million, or 1 in 7 of the workforce (see Figure 1).[1] This compares with just a 12 percent growth in the number of employees over the same period. Since 2008, self-employment has been responsible for nearly half (44 percent) of all jobs growth in the UK.

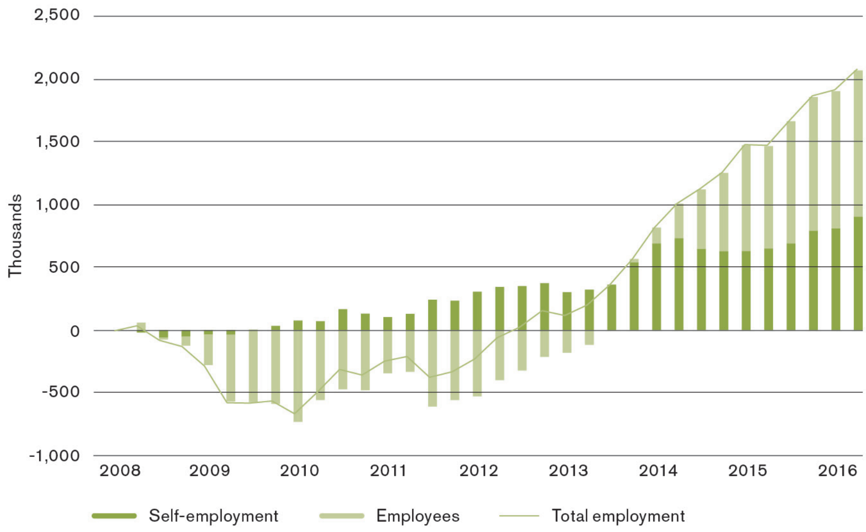
Equally impressive has been the growth in the number of micro businesses, defined as firms with zero to nine employees. In 2000 there were 3.5m micro businesses in the UK. Today there are closer to 5.2m.[2] While much of the expansion has been driven by one-person firms, the number of micro businesses with employees has also increased. 8.5 million people in the UK now own or are employed in a micro business.

But are these welcome developments? Recent media coverage depicts the self-employed as one more legion in a growing army of precariat workers. Bleak headlines such as '*80% of self-employed people in Britain live in poverty*', and '*Self-employment used to be the dream. Now it's a nightmare*' are increasingly common.[3] The overall picture is one of a reluctant band of unhappy workers that would rather be in steady employment. Micro businesses, meanwhile, are painted as lightweight and an overall drain on our economy.[4]

While there is a degree of truth to these claims, many appear to be overstated. For example, the assertion that most of the self-employed have little option but to work for themselves does not bear out in government data or independent surveys. Previous polling by the RSA found that just 19 percent of the self-employed started up in business to escape unemployment – a finding that is repeated across multiple studies.[5] This is reinforced by the Bank of England's analysis, which revealed that few of the newly self-employed (those who started up after 2008) are in search of other work.[6]

1. RSA analysis of UK Labour Force Survey 2000-2016 (with 2016 being an average of January to September).
2. RSA analysis of Business Population Estimates (2010-2015) and BEIS SME Statistics (2000-2009).
3. Fleming, P. (2016) Self-employment used to be the dream. Now it's a nightmare [article]. *The Guardian*, 19 October.
4. See for example: Nightingale, P. and Coad, A. (2014) 'Muppets and Gazelles: political and methodological biases in entrepreneurship research' in *Industrial and Corporate Change*. Vol 23 (1).
5. See Dellot, B. (2014) *Salvation in a Start up? The origins and nature of the self-employment boom*. London: RSA.
6. Tatomir, S. (2015) Self-employment: what can we learn from recent developments? *Quarterly bulletin, Q1* Bank of England.

Figure 1 - Change in the number of employees and self-employed workers since Q1 2008



Source: RSA analysis of Labour Force Survey

Another claim is that a large proportion of the self-employed are in dire financial straits. A recent study by the Resolution Foundation found that the average pay packet of the self-employed has barely moved in 20 years, while research by the Social Market Foundation shows that half the self-employed now earn below the National Living Wage.[7] The Family Resources Survey appears to corroborate these findings, showing that the median full-time self-employed worker earns a third less than the typical employee, and that this gap has widened (albeit marginally) over the last decade.[8]

As before, however, these findings should be treated with a note of caution. According to the Understanding Society Survey, the self-employed are nearly just as likely as employees to say they are satisfied with their income (see Figure 2). This may be explained by them having a greater reliance on wealth over earned income. Over a third of households with only self-employed workers own their homes outright, meaning they have no outgoings in the form of a mortgage.[9] A related point is that a greater proportion of the self-employed are retired, and many of these will have made a conscious decision to trade in a higher wage for more flexibility.[10]

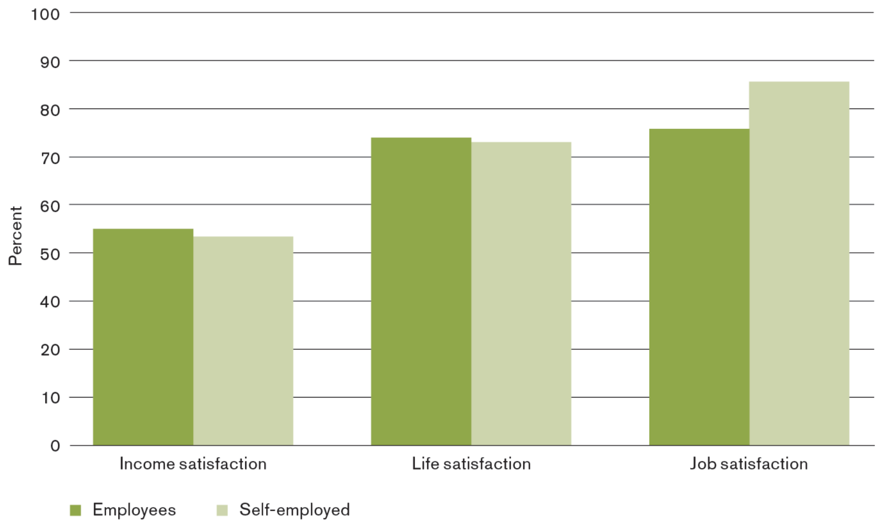
7. Resolution Foundation (2016) Typical earnings of the self-employed lower than 20 years ago [Press notice] RF; and Broughton, N. and Richards, B. (2016) *Tough Gig: Tackling low paid self-employment and the UK*. Social Market Foundation.

8. Median weekly gross earnings among the full-time self-employed were £310 in 2014/15, versus £467 among employees.

9. Dellot, B and Reed, H. (2015) *Boosting the Living Standards of the Self-employed*. London: RSA.

10. Labour Force Survey data (2015) shows that over 2,006,000 people aged over 50 are self-employed.

Figure 2 - Satisfaction with life and aspects of work by employment status



Source: RSA Analysis of Understanding Society Survey (Wave 5)

Precarious if not precariats

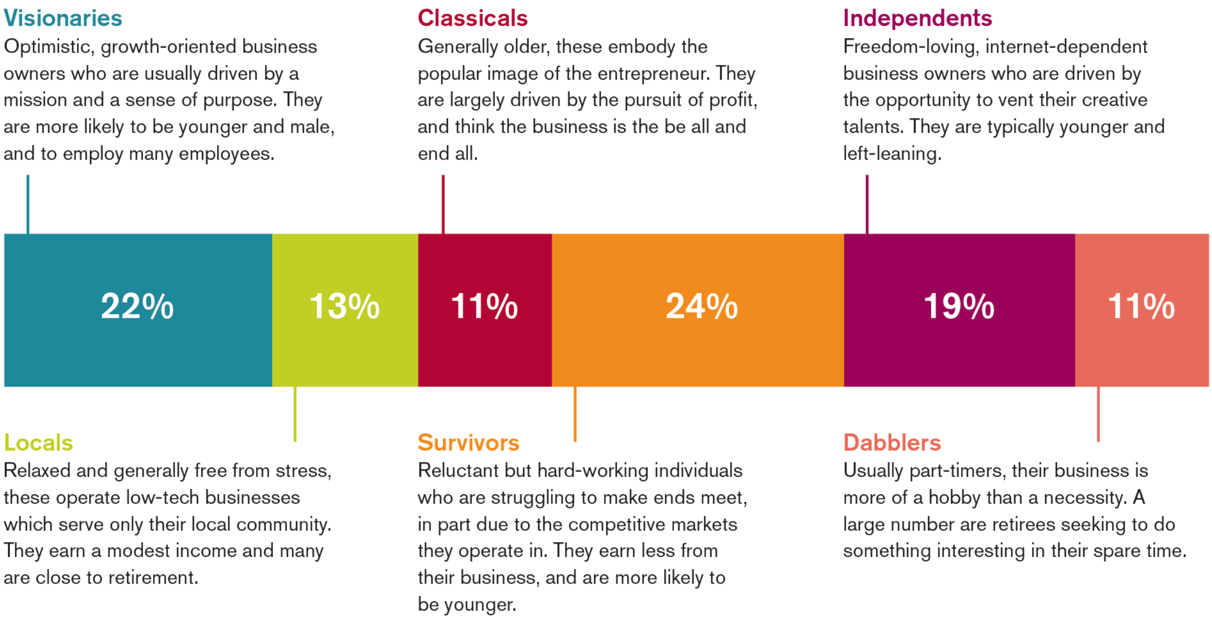
Misperceptions about the self-employed arise in part because they are often treated as one homogenous group. The typology below, drawn from earlier RSA research on self-employment, denotes six 'tribes' of self-employed worker, each varying in their ambition, intensity and style (see Figure 3).[11] While some groups are keen to expand their business, take on employees and bring transformative products to market, others treat their venture more as a part-time hobby – one that bides their time during old age. It is unwise to measure each tribe against the same yardstick of success, or to always cry foul when they have different experiences to conventional employees.

In the same vein, we should be wary of conflating workers that use on-demand 'gig' platforms with the self-employed community as a whole. The stratospheric rise of Uber and Deliveroo is as unsettling as it is impressive, and unions are correct to question whether workers using these platforms have been denied rights by being misclassified as self-employed. However, their experience speaks to only one part of a 4.8 million strong self-employed workforce. The RSA will shortly publish a report on the experience of workers in the on-demand economy, part of which will delve into definitional dilemmas.

Nevertheless, we should not be blind to the real insecurities that face people who work alone. Not every self-employed person is a 'precariat' – in the sense of being unhappy and forced into a situation not of their choosing – but most do operate precariously. Life in self-employment is characterised by peaks and troughs, with business that ebbs and flows in line with the markets people operate in. According to polling by Bright Blue, 55 percent of the self-employed on a low income said that income volatility is one of the biggest challenges they face.[12]

11. For more information see Dellot, B. (2014) Op cit.
12. Kirkby, D. (2016) *Standing Alone? Self-employment for those on low income*. Bright Blue.

Figure 3 - The six tribes of self-employment



**Percentages refer to the proportion of the self-employed community who fall into these tribes*

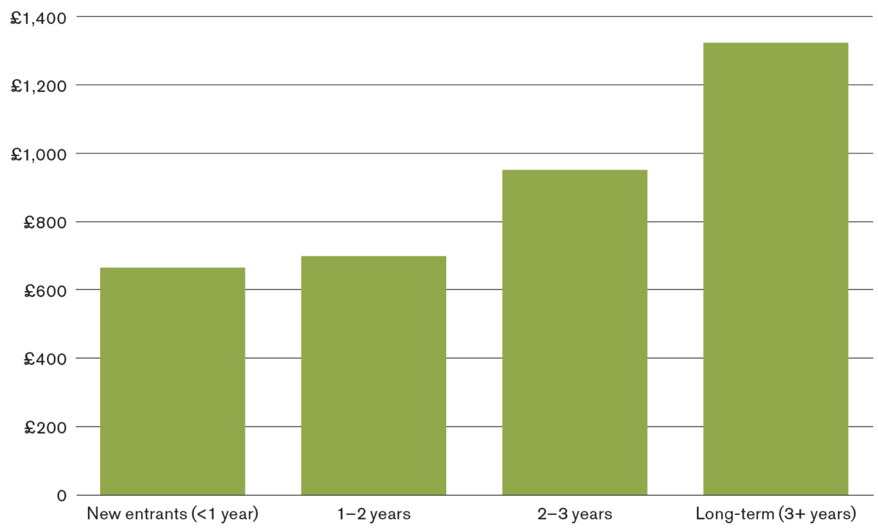
People who strike out alone also forgo protections they may have taken for granted as an employee. There is no access to Statutory Maternity Pay should they become pregnant, nor is there recourse to Statutory Sick Pay should they fall ill at work. Recent government moves to establish a National Living Wage and to auto-enrol workers onto a private pension scheme have passed them by. Insecurity is inherent across all the above tribes and is as much a problem for the high-skilled as it is for the low-skilled.

Left unchecked, the risk is that such precariousness will lock out the least affluent from secure self-employment. It is already the case that people with wealth to their name, assets to fall back on and valuable connections to tap are most likely to thrive in business. Previous RSA analysis shows that people who have received an endowment of £10,000 or more are twice as likely to move into self-employment as those who have received no inheritance.[13] Entrepreneurship is treated as one of the most meritocratic arenas, but the data tells a different story.

Our belief is that self-employment, at its best, can be the route to a better life – one that allows people to make their mark on the world and find a better work-life balance. We also know that it can be financially viable in time, and that people who move into self-employment are far from destined to be destitute. New insights are emerging that show self-employed earnings can grow significantly in the right conditions. Our analysis of longitudinal survey data reveals that people who have been self-employed for 3+ years earn twice as much on average as those who have worked for themselves for less than a year (see Figure 4).[14]

13. Dellot, B. (2015) *Why entrepreneurship is still the preserve of the privileged* [Blog] RSA.
14. See also Reuschke, D. (forthcoming) *City economies and microbusiness growth*.

Figure 4 - Monthly earnings from self-employment by duration in self-employment



Source: RSA analysis of Understanding Society Survey (Waves 3-6)

The question as we see it is therefore not: "How do we save people from self-employment?" But rather: "How do we enable more people to take part in *meaningful* self-employment?" That is, the kind that can offer economic security married with flexibility and a deep sense of purpose. The prize is not just a workforce that is healthier and happier, but also a nation that is more prosperous and diverse. Although the narrative of the heroic entrepreneur may be misplaced and oversold, a society that is more *entrepreneurial* in the round is something we should inherently value.

Moving the dial on self-employment policy

How, then, should policymakers respond? The growth of self-employment has not been lost on the new government, nor on its predecessors. Both Cameron and Osborne were vocal champions of entrepreneurship and enacted various initiatives in the name of supporting the self-employed. Under their tenure, the higher rate of Corporation Tax was reduced from 28 to 20 percent, regulation was culled through programmes like the Red Tape Challenge, and access to finance was expanded through schemes such as Start Up Loans (SUL). The last government also launched two specific inquiries into self-employment: the Deane and Mone Reviews.

Yet while some of these moves have been welcome, others are hard to justify. The cut in Corporation Tax, for example, mainly benefited larger corporations and does little for start-ups that are usually loss-making in the first few years. The 'one-in, two-out' rule on red tape, meanwhile, seemed more of a ploy to grab the headlines than an attempt to resolve a real barrier facing the average business owner. It is also clear that in some cases, business initiatives have been chronically underfunded. The Local Enterprise Partnerships were stymied from the outset due to a lack of resources.

While these issues are a reflection of shallow policymaking, equally concerning has been the narrowness of government agendas. Seldom have policymakers strayed from the traditional policy levers of regulation, tax and finance to look at the personal issues facing the self-employed, for example their access to pensions or mortgages. The Julie Deane Review, which had a remit to look at these topics, was a step in the right direction, but its final policy recommendations were disappointingly timid.[15] Policymakers have been particularly reticent to look at welfare coverage, possibly seeing it as anathema to an entrepreneurial society.

It is against this backdrop that the RSA and Crunch have chosen to explore and critique recent policy affecting the self-employed. With a change of government and May's succession to the office of prime minister, we have a window of opportunity to look afresh at how the self-employed are treated. The rest of this paper details the findings from our research and lays out a number of recommendations across four policy domains: taxation; welfare and pensions; business support and employment services; and regulation and late payments. We will return to other issues such as enterprise education and procurement in future work.

Underpinning each of our proposals is a broader call for policymakers to be more interventionist. Past governments have sought to do right by the self-employed by leaving them to their own devices. But this laissez-faire approach – epitomised by ill-targeted tax cuts and broad brush deregulation drives – has reached the limit of its effectiveness. The time is ripe for the government to move from a low-road to a high-road policy approach in its treatment of the self-employed, and show a greater willingness to invest in business support, strengthen welfare coverage, and boost productivity and earnings potential of small businesses. The launch of the Taylor Review into Modern Employment Practices and the creation of a new Industrial Strategy indicate that the incoming government may be more open to such a hands-on approach.

In crafting our policy ideas, we have sought to follow six core principles, and would urge policymakers to do likewise as they seek to support the self-employed in future:

1. **Seek equality of rights and responsibilities** – Wherever possible, the self-employed should receive the same rights and protections as employees, however this comes with added responsibilities and may require the levelling of taxation. A broader shift towards neutral treatment is desirable.
2. **Recognise the diversity in 4.8 million individuals** – Policy must be built on a recognition that not all the self-employed share the same experiences or have the same needs. Few live up to the stereotype of the all-or-nothing, heroic entrepreneur.
3. **Consider the individual, not just the business** – Policy must not only strive to make businesses profitable. It must also help to make self-employed lives more liveable, for example by opening up access to pensions, insurance and mortgages.
4. **Avoid self-employment for self-employment's sake** – Too often we champion any rise in self-employment, regardless of the underlying drivers. Policy must not be driven by numbers but by the quality of people's experiences in self-employment.

15. Deane, J. (2016) *Self-employment Review: An independent report*. London: BEIS.

5. **Be guided by evidence, not what appears common sense** – Too many initiatives are based on guess work and underpinned by outdated business stereotypes. Policymakers should dedicate resources to gathering and evaluating evidence, including direct consultation with the self-employed.
6. **Aim for continuity and avoid reinventing the wheel** – Notwithstanding the ideas put forward in this report, the government should aim for policy continuity. Unnecessary change can create confusion and disruption.

With these broad principles in mind, we begin our report by looking at tax policy – an area that has received more attention than most, but which, paradoxically, is arguably in the greatest need of reform.

Recommendations

Recommendation #1 – Equalise the treatment of employees and the self-employed for National Insurance contributions

The government should seek to close the gap in National Insurance contributions (NICs) paid by employees and the self-employed, noting that this is a driver of bogus self-employment and delays progress in extending more rights to business owners.

Recommendation #2 – Undertake more regular property revaluations to ensure the business rates system is fit for purpose

The government should commit to undertaking regular revaluations of properties, which would make levies more accurate, reduce the number of appeals and allow businesses to absorb smaller tax hikes over time.

Recommendation #3 – Explore the scope for transitioning from a business rates to a revenue rates system

The government and the Office of Tax Simplification should consider whether business rates could be replaced with a levy based on firm turnover, or looking to the future, a levy based on the value of land (a Land Value Tax).

Recommendation #4 – Consider extending the use of cash accounting to the smallest of companies

HMRC and the Treasury should reflect on the findings of the Office of Tax Simplification's small business tax review, and in particular consider whether there is a strong case for allowing the smallest companies to use cash accounting methods.

Recommendation #5 – Lessen the fixation on Corporation Tax and concentrate future efforts on more burdensome levies

The new government should reconsider its commitment to reducing Corporation Tax to a new low of 17 percent, and instead aim cuts at more burdensome taxes such as business rates and VAT.

Recommendation #6 – Establish a Paternity Allowance and an Adoption Allowance for self-employed parents

The government should use proceeds from an increase in Class 4 NICs to create a Paternity Allowance for self-employed fathers and an Adoption Allowance for the self-employed who adopt children.

Recommendation #7 – Reform Universal Credit to ensure it responds to the realities of starting and growing a business

The Department for Work and Pensions (DWP) should iron out the flaws in Universal Credit (UC) to ensure it is fair in its treatment of the self-employed and employees, and that it does not hinder potentially viable businesses:

- Extend the 'start up period' from 12 to 24 months
- Move from monthly to annual or quarterly reporting
- Give New Enterprise Allowance (NEA) advisers responsibility for undertaking the Gateway Interview
- Align information and accounting requirements for the tax and UC systems

Recommendation #8 – Protect the self-employed against dips in income caused by illness and injury

In the absence of Statutory Sick Pay, the government should explore alternative ways of protecting the incomes of the self-employed at times of ill health. More specifically:

- Consider the scope for a collective income protection insurance scheme, in the same mould as Nest
- Open up all elements of the new Fit for Work service to the self-employed

Recommendation #9 – Boost pension enrolment among the self-employed through an opt-in / opt-out question

The government should present the self-employed with a 'forced choice' question asking whether they would like to opt in or out of a private pension scheme. This could be presented when the self-employed complete their tax self-assessment.

Recommendation #10 – Transform the Lifetime ISA (LISA) into a suitable savings gateway for the self-employed

The government should make adjustments to the Lifetime ISA to ensure it runs with the grain of self-employed lifestyles. More specifically:

- Raise the age limit for opening an account from 40 to 50
- Scrap the 5 percent penalty for early withdrawals
- Allow account holders to freely draw down on their savings on the condition they promptly repay the funds

Recommendation #11 – Establish a What Works Hub for Business Support Evaluation

The government should fund the creation of a permanent evaluation centre to monitor, coordinate and disseminate the results of evaluations of business support schemes. In addition, the government should commit to underpinning all new major business support schemes with a randomised control trial.

Recommendation #12 – Expand and raise awareness of the business coaching role of accountants

The Institute of Chartered Accountants in England and Wales (ICAEW), the Association of Chartered Certified Accountants (ACCA) and other accountancy trade bodies should look at how accountants might deepen their business advice and mentoring role, while ensuring that more of the self-employed are aware of these opportunities.

Recommendation #13 – Consult businesses on the creation of a UK equivalent to the Small Business Administration in the US

The government should open a public consultation on the merits of creating a UK Small Business Administration that would co-ordinate state-led business support and provide a forum for shared learning across the public, private and third sectors.

Recommendation #14 – Promote co-operatives as a form of mutual assistance for the self-employed

The government, Co-operatives UK and trade associations should work together to champion co-operatives among the self-employed, and consider whether there need to be legislative changes to remove barriers in their way.

Recommendation #15 – Ensure the Jobcentre Plus is match fit to support the self-employed post Work Programme, with a specialist in every branch

In preparation for the end of the Work Programme, the DWP should undertake an audit of staff skills in the Jobcentre Plus network, and ensure there is at least one work coach in every branch that can be a named self-employment specialist.

Recommendation #16 – Reform the payment structure of the New Enterprise Allowance to avoid unnecessary drop outs

The government should adjust the NEA payment structure to ensure it is both fair and practical. More specifically:

- Raise the NEA payment to the level of the Jobseeker's Allowance (JSA)
- Taper away the payment after three months rather than halve it abruptly

Recommendation #17 – Remove the 'one in, two out' rule for regulation and shift the emphasis to quality over volume

The government should drop its commitment to the 'one in, two out' rule on regulation, acknowledging that quality is more important than volume. It should also preserve the 'green tape' that allows small businesses to attract talent, engage with customers and be protected from unscrupulous competitors.

Recommendation #18 – Clarify how the self-employed are treated under the Health and Safety at Work Act

The government should reverse its confusing amendments to the Health and Safety at Work Act, which could lead many of the self-employed to falsely believe they are exempt from a general duty to protect themselves and others from the risk of harm.

Recommendation #19 – Ease rules and harmonise taxes that constrain home-based businesses

The government should work with local authorities and landlords to remove unnecessary obstacles that prevent the self-employed operating from home. More specifically:

- Consider the merits of a Right to Home Working, whereby the self-employed would not need permission to operate from home so long as they abide by existing nuisance and disturbance clauses in their contracts
- Take steps to harmonise council tax and business rates to ensure home-based business owners are never double taxed

Recommendation #20 – Strengthen protection against late payments, including through a Right to a Written Contract

The government should beef up regulation against late payments by focusing on deterrence, disclosure and prevention. More specifically:

- Increase the interest rate that can be charged on late payments
- Extend the new 'duty to disclose' payment terms and procedures to medium-sized companies
- Create a Right to a Written Contract for any supplier engaging in a transaction above a given size

Tax and National Insurance

The NICs dilemma

Few matters are more contentious or thorny than taxation. Yet most people can agree on what a good tax system should aspire to: it should be clear and straightforward, fair in the way it treats citizens, resilient to abuse, and free of loopholes to be exploited. We would also add that taxes should be progressive, such that those with the greatest capacity bear the greatest burden. These qualities hold as much for small business taxation as they do for any other domain.

Our foremost concern with the current system is that people doing the same work but under different guises can face widely different tax treatments. Nowhere is this more apparent than in the amount of National Insurance contributions (NICs) paid by employees and the self-employed. The present system breaks down as follows:

- **The self-employed pay two forms of NICs**
  - Class 2 NICs - £2.80 a week above earnings of £6,000 a year (although Class 2 is soon to be terminated)
  - Class 4 NICs – 9 percent above earnings of £8,060 and a further 2 percent above earnings of £43,000
- **Employees pay one form of NICs and their employer another**
  - Class 1 NICs – 12 percent above earnings of £8,060 and a further 2 percent above earnings of £43,000
  - Employer NICs – 13.8 percent of employee earnings above £8,112 a year

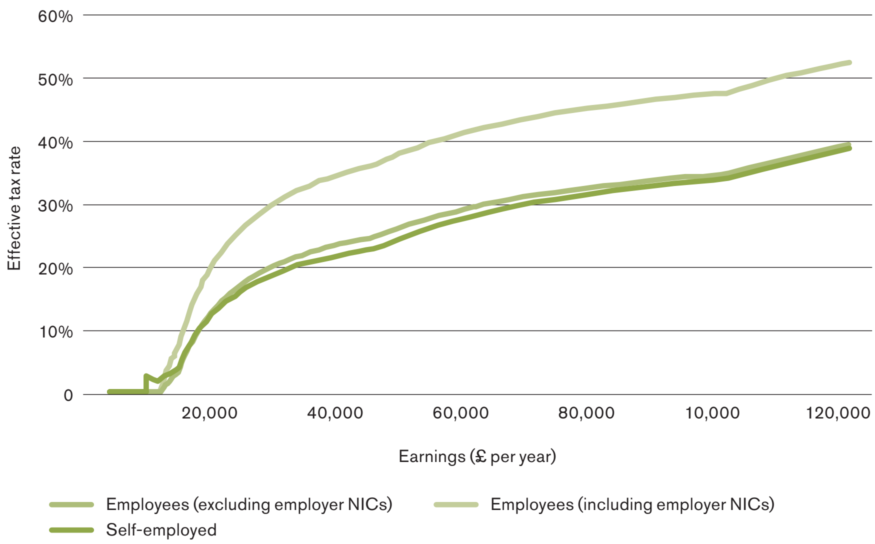
The self-employed therefore pay a lower proportion of their own income in contributions (9 percent instead of 12 percent), while having no equivalent of employer NICs paid on their behalf. To illustrate this with an example, a self-employed person earning £15,000 a year would pay £770 in NICs, whereas an employee doing the same job would see £833 deducted from their pay packet, with their employer adding a further £951 in NICs (see Figure 5). On top of this, the self-employed have the advantage of being able to deduct some expenses from both their NICs and Income Tax liabilities.

The size of this NICs differential causes three core problems. The first is the incentive it creates for false self-employment. Employers who treat individuals as self-employed contractors when they should be engaged as standard employees face considerable savings by not paying employer NICs. For a worker paid the median wage of £27,000, this equates to a windfall of over £2,600 every year. While workers who are misclassified as self-employed may themselves gain by paying a marginally lower NICs rate, they also lose valuable worker rights – such as access to holiday pay and employer pension contributions.

The second problem is that the NICs differential makes it difficult, if not impossible, to argue that the self-employed should have access to greater welfare protections, including Statutory Maternity Pay and Statutory Paternity Pay (see the next chapter for more detail on welfare matters). Many economists and tax experts already believe the self-employed receive more in social security benefits than the size of their contributions merit.[16]

And third, the exchequer loses out on a large sum of money that could be channelled into public services. Indeed, there is increasing concern in the Treasury that the rise in self-employment, and in particular the growth of gig work enabled by platforms like Uber and Deliveroo, may serve to worsen the state of the public finances.[17] According to HMRC, the Exchequer relinquished £2.85bn in the last financial year (2015/16) as a result of the self-employed paying lower NICs levies than employees.[18]

Figure 5 - Effective tax rates paid according to employment status (Income tax + NICs)



Towards equal treatment

The argument that the self-employed should face a lower NICs burden usually rests on the claim that they take more risks, engage in entrepreneurial endeavours and bring new products and services to market. This will be true of some business owners, particularly those in the 'Visionary' tribe of our aforementioned typology. But not every self-employed person will fit these traits. Think of self-employed tradesmen and women in

16. Houlder, V. (2014) Calls to end national insurance tax subsidy for self-employed [article] **Financial Times**, 21 September.
17. Houlder, V. (2016) UK taxman warned over the 'gig economy' revenue gap [article] *Financial Times*, 2 December.
18. O'Connor, S. (2016) Tax and the dilemma of the self-employed [article] *Financial Times*, 25 October.

carpentry, plumbing and electrical work, whose job is a predictable, if highly-skilled, vocation.

A better case for the self-employed receiving special treatment is that they face higher tax compliance costs as a proportion of their turnover than large businesses. Another credible argument is that self-employment as a flexible form of work is critical to a dynamic labour market that can respond with agility to economic downturns. Yet both these claims, however true, are not enough to explain the extent of the tax advantage open to people who work for themselves.

To those who would argue a NICs rise would punish the self-employed, consider that the real winners from the discrepancy are the highest earners. While the self-employed hairdresser on £15,000 a year gains £63 in NICs savings, a self-employed IT consultant on £60,000 stands to benefit from £903, not including the £7,160 foregone in employer NICs. Although it may be uncomfortable, it is time for business advocacy groups to get behind the idea of NICs reform, and to put the long-term interests of their members ahead of minor short-term gains.

We see a number of options for how the NICs system could be restructured, all of which aim to level the treatment of employees and the self-employed:

- **Option #1, Soft levelling** – The self-employed begin paying the same personal NICs rate as employees (ie 12 percent rather than 9 percent), but employer NICs remain unchanged.
- **Option #2, NICs merger** – All forms of NICs including the employers levy are folded into a universal NICs, with the self-employing paying the same rate as employees.
- **Option #3, Transaction tax** – The same as soft levelling, but employer NICs are turned into a 'transaction tax' to be paid by any household or business using the services of any worker, self-employed or employee.
- **Option #4, Payroll tax plus** – The same as soft levelling, but employer NICs are reconstructed as a 'payroll tax plus', with employers paying a levy for all workers they employ including independent contractors.[19]

Each of these proposals has merits and limitations, and clearly some do not solve all the problems of the current NICs discrepancy. The 'soft levelling' approach leaves employer NICs intact, which is the biggest headache for the Treasury and arguably the key driver of bogus self-employment. The NICs merger, meanwhile, would end most of the incentives to engage in false self-employment, while bringing in extra revenue for the exchequer, yet the immediate costs for the self-employed are almost certain to be too great to bear. There is also another, more fundamental, option to consider: merging NICs and Income Tax altogether.

We recommend that the government and the Office of Tax Simplification explores each of these options in more detail, and arrives at a suitable proposal for removing the inconsistency between how the

19. Idea raised by Andrew Harrop, General Secretary of the Fabian Society. See: https://twitter.com/andrew_harrop/status/791019364631842820?lang=en

self-employed and employees are treated under National Insurance. In doing so, we should be mindful of causing ripple effects in the tax system, such as creating further incentives for incorporation. Business owners already stand to make sizeable tax savings by moving from sole trader status to limited company.

Recommendation #1 – Equalise the treatment of employees and the self-employed for National Insurance contributions

The government should seek to close the gap in National Insurance contributions (NICs) paid by employees and the self-employed, noting that this is a driver of bogus self-employment and delays progress in extending more rights to business owners.

Modernising business rates

Alongside NICs, another tax in urgent need of reform is business rates, which is levied on most non-domestic properties including shops, warehouses, factories and offices. The stated purpose of business rates is to cover the cost of council services and the upkeep of infrastructure that local firms depend on.

Rates are calculated by multiplying the 'rateable value' of a property – its open market rental value – with a given 'multiplier' figure set by central government. For example, if a business property has a rateable value of £20,000, and the multiplier set by the government is 0.462, the business will pay £9,240 in rates (before any relief is applied). Local authorities currently keep up to 50 percent of the money raised in their area, but under new plans councils will be able to keep all of the proceeds and some authorities will be able to tweak their multipliers.

In the 2016 budget, the then chancellor George Osborne made several changes to ease the burden of business rates on small firms. Among his reforms were to raise the Small Business Rate Relief threshold from £6,000 to £15,000, and increase the higher rate threshold from £18,000 to £51,000. According to the government's estimates, these measures will result in 600,000 firms being freed from paying business rates, while a further 250,000 businesses will see a reduction in their charges.

But as welcome as these reforms are, the business rates system is still beset with several flaws – some administrative and others more fundamental. Starting with the former, one issue is the infrequency with which revaluations of properties take place. Although a revaluation is set to take place this year, the last audit occurred nearly a decade ago in 2008. Delaying revaluations in this way may save businesses some pain in the short-term, but it stores up bigger tax hikes to be revealed in future years.

Another shortcoming of the system is that it is prone to appeals. Because the 'rateable value' of properties is partly based on the subjective viewpoint of surveyors, many business owners raise doubts about the accuracy of their rate bill. Others complain that the rateable value of their building has depreciated in the period since the last revaluation. A recent Communities and Local Government Committee report described the number of appeals as a 'massive problem' for the system, with estimates that almost 900,000 businesses have challenged their rates bill since 2010.[20] Such appeals can take years to resolve and lead to high administrative costs for councils – a cost that is ultimately borne by the taxpayer.

Of course, revaluations themselves cost time and money. But there is a strong argument for conducting more frequent property surveys to limit the volume of appeals and ensure that businesses can absorb smaller, more frequent, tax changes over time.

Recommendation #2 – Undertake more regular property revaluations to ensure the business rates system is fit for purpose

The government should commit to undertaking regular revaluations of properties, which would make levies more accurate, reduce the number of appeals and allow businesses to absorb smaller tax hikes over time.

The more fundamental problem with business rates is that it takes little account of how much a business can afford to pay, since it is not based on the amount of turnover or profit a firm generates but rather the value of the property in which it resides. This creates severe difficulties during economic downturns, when market conditions worsen yet the amount that firms pay in rates remains unchanged. Consider that business rates raised half the revenue of Corporation Tax in 2007/08, but that this grew to two-thirds by 2012/13 when the economy was reaching a nadir.[21]

Another underlying issue is that business rates struggle to capture the gains from e-commerce activity. The rates system was conceived long before the advent of the internet, at a time when high streets were crucibles of local economic activity and most businesses (at least B2C) needed a physical shopfront to trade goods and services. We now have a perverse situation where a multinational e-commerce trader with an out of town warehouse can pay a similar amount to an independent shop on the high street.

This points to the need for a more fundamental rethink of property tax for businesses.[22] One option would be to transition to a 'revenue rates' system where tax liabilities are calculated according to turnover, or some other indicator of business performance. This would have the advantage of rising and falling in line with economic cycles, while capturing all businesses in a given area including online traders. It would also be more objective and therefore less prone to appeals, and would eradicate the peculiar incentive that business rates create to leave properties undeveloped.

However, this proposal comes with several technical challenges, not least the question of how the location of sale would be determined for companies engaging in internet trading. There may also be value in

20. Communities and Local Government Select Committee (2016) 100 percent retention of business rates: issues for consideration; and Sharman, L. (2016) *Council leaders call for urgent reform of business rates appeal system* [article] LocalGov, 19th May 2016.

21. Miller, H. (2014) *IFS Green Budget*, Chapter 11: Business Rates. Institute for Fiscal Studies.

22. Crerar, P. (2016) Outgoing Westminster council leader claims business rates 'unfit for purpose' [article] *Evening Standard*, 22 December 2016.

alternative proposals, such as for a Land Value Tax (LVT) that would be a levy on land rather than property, or a 'point of exchange' tax that would charge taxes at the point of delivery or purchase. The government and the Office of Tax Simplification should investigate different options for a root and branch reform of the business rates system, with any change designed to be revenue neutral for local authorities and the Treasury.

Recommendation #3 – Explore the scope for transitioning from a business rates to a revenue rates system

The government and the Office of Tax Simplification should consider whether business rates could be replaced with a levy based on firm turnover, or looking to the future, a levy based on the value of land (a Land Value Tax).

Streamlining tax administration

For most of the self-employed, it is not just the amount of tax they pay that is a burden but also the time required to comply with the rules. According to the Small Business Survey, of the non-employing SMEs who said tax was an obstacle to the success of their business, 60 percent pointed to the effort required in compliance, while 56 percent said the overall level was a problem.[23] Although the UK's tax system is one of the most robust in the world, it is arguably more complex than it needs to be as a result of myriad reliefs, exemptions and options open to tax payers.

The Office of Tax Simplification recently explored how small business taxation could be streamlined.[24] Among their recommendations were to align filing and payment dates for different taxes like PAYE and VAT, to ensure that companies only have to provide information to one government department rather than many as is currently the case, and to have HMRC provide more support on evenings and weekends. They have also explored and critiqued tax models such as 'look through' taxation, which would tax business owners directly on company income (and therefore replace Corporation Tax).[25]

Another tax change they have considered in detail is the concept of a SEPA, otherwise known as a Sole Enterprise with Protected Assets.[26] This new tax form would give sole traders a degree of limited liability protection for their assets, removing the need to incorporate their business and take on added administrative burdens. In polling undertaken by Ipsos MORI, 78 percent of company owners agreed that gaining protection through limited liability was an important consideration in their decision to incorporate, with 60 percent pointing to tax savings.[27] We believe the government should take seriously the idea of establishing a SEPA, however would urge that the limited liability protects the pension of business owners as well as their primary residence.

23. BEIS (2016) *Small Business Survey 2015: Businesses with no employees.*
24. Office of Tax Simplification (2016) *Small company taxation review.*
25. See Office of Tax Simplification (2016) *Lookthrough taxation: A discussion paper.* The OTS concluded that lookthrough would not amount to a general simplification of the tax system.
26. Office of Tax Simplification (2016) *SEPA: Sole Enterprise with Protected Assets.*
27. HMRC and Ipsos Mori (2014) *Reasons behind incorporation: HMRC research report 317.*

Another way to reduce tax compliance burdens for the self-employed would be to allow the smallest of companies to use cash accounting methods over accruals accounting. Cash accounting allows for the recording of income and expenses as and when money enters and leaves a business. In contrast, accruals accounting requires that income and expenses are recorded at the point they are incurred, regardless of whether the cash moves later. Accruals accounting can create cash flow headaches for small businesses as it may require them to pay tax on money they have yet to receive.

Not everyone is in agreement about the relative merits of cash accounting over accruals accounting. Some believe that accruals is less prone to abuse and gives shareholders a better picture of how a business is performing. The Office of Tax Simplification, however, notes that cash accounting gives sufficient detail for most small companies, particularly those with just one owner-director.[28] Moreover, conceptually, most owner-directors tend to think about their businesses in cash terms rather than accruals terms. HMRC and the Treasury should further explore the scope and appetite for accounting practice reform.

Recommendation #4 – Consider extending the use of cash accounting to the smallest of companies

HMRC and the Treasury should reflect on the findings of the Office of Tax Simplification's small business tax review, and in particular consider whether there is a strong case for allowing the smallest companies to use cash accounting methods.

Calling time on Corporation Tax cuts

A final consideration for the government is where the relative burden of taxes should fall. How much should be raised through VAT and how much through Corporation Tax? How much through National Insurance and how much through business rates? These questions become increasingly open as we see the waning of hypothecated taxes designated to fund particular services. Business rates, for example, ostensibly exists to cover the cost of the local amenities that firms use in their area. Yet many doubt they will see the full benefit of their contributions.

The last government under Cameron and Osborne committed to a clear and consistent strategy of cutting Corporation Tax, which they saw as the surest way to support entrepreneurship and attract businesses to operate in the UK. The main rate fell from 28 percent to 20 percent between 2010 and 2015, and is set to fall to 17 percent by the end of the decade. Last year saw calls to reduce the rate of Corporation Tax even further to 15 percent, with the ex-chancellor saying at the time that such a move would show the world that the UK is "still open for business".

But is the government right to focus so heavily on Corporation Tax? First, it only affects incorporated businesses making a profit. Second, the UK already had one of the lowest Corporation Tax rates in the OECD. And third, government surveys show that just 20 percent of

28. Office of Tax Simplification (2016) *Small company taxation review.*

Box 1: What about Making Tax Digital?

By 2020, HMRC plans to have transitioned to a fully digital tax system. The aim is to create a 'real time' service that allows taxpayers to submit information on an ad hoc basis, and which gives them a more accurate and up to date assessment of their tax liabilities. Sole traders will no longer have to complete an annual self-assessment, but will be required to update HMRC at least quarterly with their details. This change has caused concern among some business and accountancy groups who believe it will create an added burden for the self-employed, particularly those lacking digital skills. While these fears are understandable, over the long run Making Tax Digital promises to make tax reporting more seamless for businesses, with fewer unexpected tax bills and more help in calculating liabilities (eg through a new service that pre-populates digital accounts with information provided by banks and pension providers). HMRC should continue to liaise with business groups to ensure the upcoming digital system fully accommodates the self-employed.

small businesses who say that tax is an obstacle point specifically to Corporation Tax.[29] As Table 1 shows, more important to most of the self-employed are VAT, business rates and National Insurance. Moreover, it is possible that the government recouped the funds lost in the Corporation Tax cut through its subsequent uplifting of the dividend tax and changes to the VAT Flat Rate Scheme.

If the government is to cut business taxes in future, we would urge them to focus less on Corporation Tax and more on relieving the levies that most of the self-employed find truly burdensome. An immediate step could be to shelve the proposed reduction in Corporation Tax from 20 to 17 percent, and use the funds instead to reduce the Business Rates multiplier.

Recommendation #5 – Lessen the fixation on Corporation Tax and concentrate future efforts on more burdensome levies

The new government should reconsider its commitment to reducing Corporation Tax to a new low of 17 percent, and instead aim cuts at more burdensome taxes such as business rates and VAT.

Zooming out to look at all forms of taxation – business and otherwise – there may also be a credible argument for rebalancing the overall tax burden away from earned income (ie from employment and entrepreneurial activity) towards unearned income (ie inheritances and capital gains such as property appreciation). Here the rationale is not technical but moral: earned income is the result of individual effort and ingenuity, whereas unearned income is typically born (although not always) from good fortune.

29. Worley, W. (2016) George Osborne to slash corporation tax to show UK is 'still open for business' after Brexit vote. *The Independent*, 3 July 2016.

The tax blogger and barrister Jolyon Maugham speculates that a 2.5 percent annual charge on aggregate wealth of £1.3tn could yield enough to bring the top rate of Income Tax down from 40 to 30 percent, while achieving a revenue neutral outcome.[30] In reality, a wealth tax is a political non-starter and, in any case, would be enormously difficult to implement in practice. However, there is merit in exploring, for example, whether a radical reduction in Income Tax or NICs could be paid for through a rise in Inheritance Tax or Capital Gains Tax. We plan to consider options for wealth tax reform in future research.

Table 1: Types of taxation considered to be obstacles to business success

	All businesses with no employees	All SME employers
VAT	52%	56%
Income tax	20%	18%
Business rates	18%	31%
NICs	13%	22%
PAYE	12%	23%
Corporation tax	12%	20%
Vehicle tax/fuel duty	12%	9%

Source: Small Business Survey 2015 (BEIS, 2016)

30. Maugham, J. (2015) *Fiscal Black Socks* [blog] Waiting for Godot, 13 September 2015.

Welfare and pensions

Welfare entitlements, past and present

The self-employed have had a complex and ill-defined relationship with the welfare system ever since its founding. People 'working on their own account' were originally excluded when the first elements of social security were introduced in 1911, and were treated as an anomaly when William Beveridge drew up his plans for the welfare state as we know it today.

Over time, the self-employed have become eligible for more protections, including the Maternity Allowance, Childcare Vouchers and the new Single Tier State Pension. However, they are still excluded from several benefits that are open to employees (see Table 2). This includes Statutory Maternity Pay, Statutory Paternity Pay, Statutory Sick Pay, holiday pay, and employer pension contributions. Of the benefits paid by employers, some are partly reimbursed by the state while others are wholly paid for by the employer.

Table 2: Welfare protections not currently open to the self-employed

State-led	Mixed responsibility	Employer-led
Jobseeker's Allowance (contribution-based) Industrial Injuries Disablement Benefit	Statutory Maternity Pay Statutory Paternity Pay Statutory Adoption Pay (employers can claim a large percentage of the costs from SMP, SPP and SAP)	Employer pension contributions Statutory Sick Pay (prior to 2014, employers could claim back most of the cost) Holiday pay

Business advocacy groups and politicians alike have urged the government to close the gap in benefit entitlements between employees and the self-employed. The Deane Review reported there was "a clear desire for equal treatment and recognition" and that "discrepancies should be reviewed".[31] Labour leader Jeremy Corbyn has likewise called for the self-employed to have the same "safety net" as employees, echoing his predecessor Ed Miliband's pledge to give "equal rights" to people who work for themselves.[32] Most business lobby groups have made similar calls, including the Federation of Small Businesses, Ipse and Enterprise Nation. So too has the RSA.

31. Deane, J. (2016) *Self-employment Review: An independent report*. London: BEIS.
32. Caldwell, S. (2016) *Labour Party promises stronger safety net for self-employed workers* [article] Business Advice, 14 November 2016.

But how might an extension in welfare coverage be paid for? Some believe the self-employed already receive more protections than their National Insurance contributions merit, and in an austere fiscal climate the government is unlikely to make a move without an equivalent increase in taxation.

One option is to create a top-up system, whereby the self-employed would voluntarily choose to pay more in National Insurance in return for extra protections. However, this idea has two significant shortcomings: first, it could lead to a two-tier welfare state that would lock out the poorest from protections which should arguably be universal; and second, it would depend on people having considerable foresight about the risks they may face and how their lives are likely to pan out. In the countries where such a voluntary top-up system is in operation – including Hungary and the Czech Republic – take up of extra benefits tends to be low.[33]

An alternative option – and our preferred approach – is to finance the extension of extra protections by raising the rate of Class 4 NICs from 9 percent to 12 percent of earnings above the low tax threshold, as proposed in the last chapter. We are unware of any public polling or focus groups where this idea has been mooted to the self-employed. However, a number of the business support representatives who attended our roundtable on this research project in November 2016 were confident that many business owners would not feel aggrieved at such an increase, so long as it was clearly linked to new entitlements (even if they were not to benefit directly and immediately themselves).

On the question of which benefits should be extended to the self-employed, most commentators talk of Statutory Maternity Pay. The RSA backs this call, however believes there may be a stronger case for prioritising the creation of a paternity pay model for self-employed fathers, given the complete absence of support for them at present. Such a 'Paternity Allowance' could mirror the structure of the Maternity Allowance in relation to SMP, meaning it would be paid at a rate of £139.58 a week or 90 percent of average earnings (whichever is lower) for two weeks. We estimate a Paternity Allowance would cost around £20m to introduce in England and Wales.[34]

The self-employed should also be able to share their parental leave in the same way as employees, and have access to an Adoption Allowance that would assist self-employed parents of adopted children.[35] As the RSA has argued in previous studies, there is a strong justification for extending parental benefits to the self-employed since these are not just protections for workers but also for children, who should be entitled to the same degree of support regardless of the occupation of their parents.[36]

33. European Employment Observatory Review (2010) *Self-employment in Europe*. Social Europe.

34. The number of self-employed fathers in each age group was estimated from: the number of total paternities in each age group (ONS Births), and the proportion of men in each age group that are self-employed (Annual Population Survey). Using data from the FRS we calculated what proportion of self-employed fathers would be entitled to the maximum benefit of £139.58 a week, for two weeks. This was around 70 percent for all age groups. All other workers were assigned an entitlement based on 90 percent of the average earnings for workers in their age group that earn less than £155 (90 percent of which is the maximum entitlement).

35. As recommended by Julie Deane in her review of the self-employed.

36. Op Cit.

Recommendation #6 – Establish a Paternity Allowance and an Adoption Allowance for self-employed parents

The government should use proceeds from an increase in Class 4 NICs to create a Paternity Allowance for self-employed fathers and an Adoption Allowance for the self-employed who adopt children.

Smoothing the transition to Universal Credit

The one area of welfare where the self-employed have enjoyed near parity of treatment with employees is means-tested benefits, where eligibility is determined by income rather than built up through National Insurance contributions. Two of the most important of these are Working Tax Credits and Child Tax Credits, which serve to top up the incomes of low paid workers. Approximately 18.8 percent of the self-employed are in receipt of tax credits, versus 10.6 percent of employees.[37]

While tax credits are a vital lifeline of support, one particular issue facing self-employed claimants is that of over and under payments. The entitlements of the self-employed are calculated at the beginning of the tax year based on what they earned the year previously. However, this is only an estimate and their real earnings can deviate from the prediction, sometimes significantly. Those who subsequently earn less than expected may struggle with insufficient tax credit, while those who earn more could find themselves having to reimburse money to the tax authorities. HMRC recently secured powers to settle unpaid tax bills by accessing people's bank accounts directly.

The government expects that this problem will be resolved with the introduction of Universal Credit, which will affect both employees and the self-employed. The flagship welfare programme will roll six means-tested benefits into one, including Tax Credits, Housing Benefit and Jobseeker's Allowance. The hope is that this will streamline what is a convoluted and bureaucratic welfare system, and ensure that there is always an incentive for people to increase their working hours. DWP estimate that it will save £38bn over 12 years from its inception and result in 300,000 more households moving into work.

The self-employed will be treated significantly differently than under the legacy Tax Credits regime. Before being able to claim Universal Credit, they will first need to attend a Gateway Interview with a Jobcentre Plus work coach, who will determine whether or not they are 'gainfully self-employed' – that is, running a business with a reasonable expectation of profit. Those who pass this test will then be exempt from having to search for other work. Alongside this, the self-employed will have to start reporting their earnings on a monthly basis rather than annually, and do so through an online account.

However, unlike claimants looking for conventional work as an employee, the self-employed will have their Universal Credit entitlement pegged to a 'Minimum Income Floor' (MIF). This is an assumed level of earnings that, for most workers, will be the equivalent to the National Living Wage. Anyone earning beneath the MIF will not have the difference

37. RSA analysis of the Family Resources Survey (2014/15).

made up by a larger Universal Credit payment. So, assuming the MIF is set at £1,100, a self-employed worker would receive the same UC entitlement whether they earn £300, £500 or £900 – a stark contrast to the Tax Credits system where benefits generally rise as earnings fall.

The rationale for the MIF is twofold: first to minimise the incentives for the underreporting of income; and second, to ensure the welfare system does not subsidise loss-making businesses indefinitely. While the RSA agrees with these objectives, the current design of Universal Credit appears to be out of kilter with the realities of how businesses function. For example, the government has established a 'start up period' that will exempt the newly self-employed from the MIF during their first 12 months in business. Yet only a small proportion of the self-employed will be able to reach the equivalent of the National Living Wage in the space of a year.

Combined with the monthly reporting requirement, the MIF is also likely to be detrimental to claimants with volatile income. Someone paid in large lump sums throughout the year may in one month earn so much that they are entitled to zero Universal Credit, while in another earn very little but see no increase in their UC entitlement due to the MIF. As Table 3 shows, two people can earn the same amount over the course of the year yet end up with widely different UC payments because one has lumpier income patterns than the other. The MIF may also be triggered when claimants have large expenses in one month, such as investments in tools or a sizeable utility bill.

Other challenges relate to administration and compliance. A study undertaken by the University of York into the potential impact of UC found that many of the self-employed were comfortable with the idea of reporting their income on a monthly basis.[38] However, it remains to be seen whether claimants will always be able to meet the strict seven day reporting deadline. As we understand it, claimants will also have to provide a different set of information through the UC online portal to that required from HMRC for their Making Tax Digital updates and self-assessment forms, possibly necessitating two sets of books.[39]

Table 3: The impact of fluctuating incomes on UC entitlements

Person	Mary	Jill
Circumstances	Mary earns £15,000 per year in regular monthly payments. She is in a single person household with no children and her rent is £150 per week.	Jill earns £15,000 per year in irregular monthly payments, alternating between £1,650 one month and £850 the next. She is in the same circumstances as Mary.
Annual UC entitlement	£3,153 (averaging £263 per month)	£2,504 (averaging £209 per month)

38. Sainsbury, R. and Corden. A. (2013) S*elf-employment, tax credits and the move to Universal Credit*. Social Policy Research Unit.

39. It is regrettable that it is the lowest earning self-employed that will be required to report on two separate timetables into two different online government systems.

Together, these problems not only serve to leave the self-employed materially worse off, they also risk sinking businesses that could in time be self-sufficient and net contributors to the exchequer. We propose several reforms to put Universal Credit back on the right tracks:

1. First, the start up period where the self-employed are exempt from the MIF should be extended from 12 months to 24 months, in recognition of the time it can take for businesses to become viable. During this extended period, the self-employed would still be required to report to the Jobcentre Plus to show that progress is being made.
2. Second, the reporting period for Universal Credit should either revert to an annualised system (as under tax credits), or work on a quarterly basis (which would align with the new tax reporting period). Shifting from monthly to annual or quarterly reporting would help to mollify the impact of lumpy incomes on people's UC entitlements.
3. Third, the information and accounting requirements for the Universal Credit and tax self-assessment systems should be aligned as far as possible. DWP should also consider whether to give the self-employed greater leeway on the seven day reporting deadline in extenuating circumstances.
4. Fourth, the responsibility for undertaking the initial Gateway Interview should pass to New Enterprise Allowance business advisers. These will be better placed than JCP work coaches to determine whether claimants have a credible business and be classed as gainfully self-employed.

Recommendation #7 – Reform Universal Credit to ensure it responds to the realities of starting and growing a business

The Department for Work and Pensions (DWP) should iron out the flaws in Universal Credit (UC) to ensure it is fair in its treatment of the self-employed and employees, and that it does not hinder potentially viable businesses:

- Extend the 'start up period' from 12 to 24 months
- Move from monthly to annual or quarterly reporting
- Give New Enterprise Allowance (NEA) advisers responsibility for undertaking the Gateway Interview
- Align information and accounting requirements for the tax and UC systems

Protecting income during periods of ill health

So far we have discussed how the self-employed might be able to access contributory benefits and means-tested benefits on a par with employees. However, there is one important entitlement we have yet to address: sick pay. Unlike employees, the self-employed have no right to Statutory Sick Pay and must for the moment fall back on Employment Support Allowance (ESA). This is paid to most people at a rate of £102.15 a week, and becomes means-tested after a year. It can also come with a requirement to take part in training and attend job interviews if the claimant is deemed partially fit for work.

The Association of British Insurers estimates that 80,000 self-employed people move onto ESA every year.[40] Worryingly, however, most of the self-employed appear to favour ploughing through an illness rather than seeking support. Recent polling undertaken by the Department for Business, Energy & Industrial Strategy (BEIS) found that more than 80 percent said they would try not to take time off work should they become sick or injured, while 15 percent said they had no recourse to any support, be it savings or a spouse's extra income.[41] Those who find themselves in the position of having to work through an illness may end up causing greater harm to themselves over the long run.

In the absence of state help, some have advocated that the self-employed turn to Income Protection (IP) insurance, which can help to maintain people's incomes for long periods should they fall ill. According to the Federation of Small Businesses (FSB), however, only 9 percent of the self-employed are signed up for an IP product.[42] This may reflect the high cost of premiums, which can be prohibitively expensive for older people working in more hazardous industries. Quotes given to us by a leading price comparison website suggests that the cost of income protection insurance for a 49-year-old electrician would be almost twice as much as that for a 29-year-old graphic designer.[43]

Costly premiums may be an inevitable feature of the insurance landscape. But they may equally reflect a private insurance market that is struggling to generate the economies of scale needed to bring down costs. If this is the case, there may be a role for the government to play in pooling risk among the self-employed at a grand scale, for example by creating a collective insurance protection scheme. The aim would be to do what Nest has done for the pensions sector: open up cost-effective financial products to those who would otherwise be excluded from the market, and to do so in a way that minimises any crowding-out of existing private sector activity.

Alongside orchestrating wider insurance coverage, the government could take the step of fully opening up the new Fit for Work service to the self-employed. The aim of this new programme is to provide speedy health support to people who have fallen out of work, with the intention of nipping in the bud any long-term issues. The Fit for Work service has two elements: first, an advice service (delivered online and over the phone) that provides informed guidance, for example on how to manage musculo-skeletal problems or deal with stress; and second, an assessment service with a trained healthcare professional that results in a detailed Return to Work Plan. While the self-employed are able to access the advice line, they are currently excluded from the more comprehensive assessment. Locking out the self-employed from a service that could get them back into work is a false economy for the government.

40. Association of British Insurers (2014) *Welfare reform for the 21st century.* ABI.

41. BEIS (2016) *Understanding Self-employment: BIS Enterprise Analysis research report*.

42. Federation of Small Businesses (2016) Going it Alone, Moving on Up: Supporting self-employment in the UK.

43. The quote for income protection insurance was £11.83 a month for the 29-year-old graphic designer, versus £19.88 for the 49-year-old carpenter. These quotes were based on an income of £27,000, with an expectation that the policy would pay out £1,000 a month for up to 12 months.

Recommendation #8 – Protect the self-employed against dips in income caused by illness and injury

In the absence of Statutory Sick Pay, the government should explore alternative ways of protecting the incomes of the self-employed at times of ill health. More specifically:

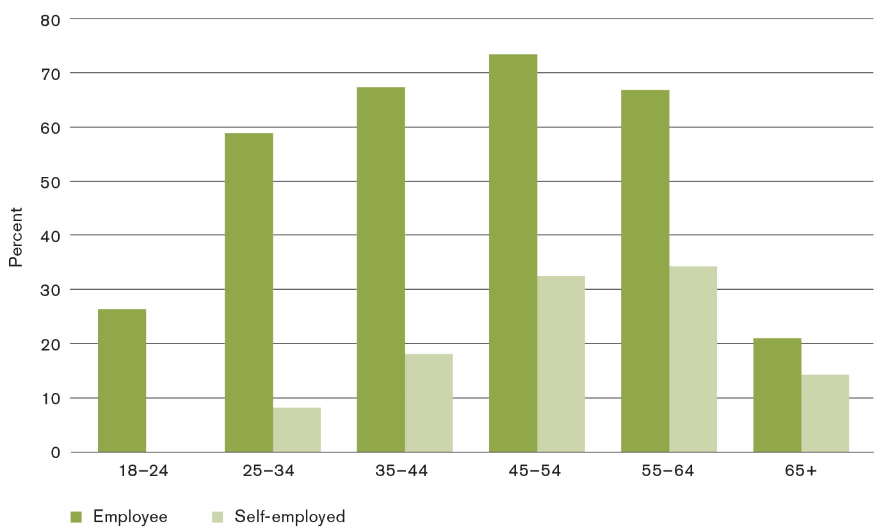
- Consider the scope for a collective income protection insurance scheme, in the same mould as Nest
- Open up all elements of the new Fit for Work service to the self-employed

The future of pensions and retirement security

The final aspect of welfare policy in need of review is pension coverage. The self-employed were recently granted eligibility for the new Single Tier State Pension worth £155.65 per week, however this is not a cure-all and in most cases people will still need other sources of income in retirement. A private pension is one of the best savings vehicles available, yet few of the self-employed are currently signed up to a scheme, and those who are tend to save little and save late:

- Only 23 percent of the self-employed are enrolled onto a private pension, versus 61 percent of employees
- The self-employed closest to retirement (55-64 year-olds) have £85,500 saved on average, compared with £162,250 for employees – nearly a twofold difference
- Just 8 percent of self-employed 25-34-year-olds are enrolled onto a pension, with late savers depriving themselves of the benefits of compound interest (see Figure 6)

Figure 6 - Proportion of workers paying into pension by age group and employment status



Source: RSA analysis of Family Resources Survey 2014/15

Several factors lie behind these low numbers. The self-employed have no equivalent of auto enrolment, which has been a key driver in boosting pension coverage among employees. Nor do they benefit from employer pension contributions, estimated to be worth an average of £91,500 over the course of a savers' lifetime.[44] Research by Citizens Advice also reveals widespread misperceptions about the value of pensions – such as the false belief that ISAs deliver better returns – as well as broader fears about the stability of pension funds.[45] Half of the self-employed surveyed by Citizens Advice said they do not trust pensions as a safe place to store their money.

How might pension coverage among the self-employed be improved? The solution favoured by the Deane Review is for the government to work with private pension providers to offer more flexible products for the self-employed – a move the RSA would back. However, history tells us we cannot leave it to the market alone to rise to the challenge. Nor is the government likely to be willing to create additional financial incentives, such as extra tax relief for contributions made by the self-employed. In any case, the Pensions Commissions reported over 10 years ago that financial incentives had failed to boost enrolment numbers among the wider workforce.

There is, however, a compelling and cost-effective alternative in the form of nudging techniques that are underpinned by behavioural science. One idea is for the government to present the self-employed with what is called a 'forced choice' question, possibly at the point when they complete their tax returns. This would ask them to opt in or out of a pension scheme, such as those offered by Nest, the government-backed pension provider. An evaluation undertaken by Harvard University of a similar initiative applied in a US workplace found that enrolment rates increased from 9 percent to 34 percent in the first four months of implementation.[46]

Recommendation #9 – Boost pension enrolment among the self-employed through an opt-in / opt-out question

The government should present the self-employed with a 'forced choice' question asking whether they would like to opt in or out of a private pension scheme. This could be presented when the self-employed complete their tax self-assessment.

The virtues of the LISA

Alongside pension reform, it is also worth considering how ISAs might be used to complement or top-up retirement savings. Research undertaken by Nest found that the self-employed often prefer to use ISAs because they are simpler to understand, involve fewer intermediaries, and allow savers to access their money more easily – an important feature for business owners managing volatile incomes.[47]

In this regard, the new Lifetime ISA (LISA) may prove to be an ideal

44. Prudential (2013) *Self-employed miss out on £91,500 in retirement, Pru reveals.*
45. Citizens Advice (2016) *Shy of retiring: addressing under-saving among self-employed people.*
46. Carroll, G. (2005) *Optimal defaults and active decisions* [NBER Working Paper].
47. Nest (2014) *Improving consumer confidence in saving for retirement*. London: Nest.

savings vehicle for the self-employed. For every £4 that savers invest in a LISA, the government will add an extra £1 bonus, with an annual savings limit of £4000. Legal and General estimate that if a 25 year old took out a LISA and saved the full amount of £4000 every year, with an estimated annual growth rate of 5 percent they could expect a tax-free sum of £416,000 by age 60.[48] The LISA is only intended to be drawn down during retirement, or used for purchasing a property.

For all its promise, however, the Lifetime ISA has a number of limitations, the first being that it is only open to people below the age of 40. It is unclear why the government has chosen to insert a low age clause, and it seems unjust to lock out older self-employed people who lack the same access to adequate savings products as their younger counterparts. A second issue is that savers must pay a 5 percent penalty if they withdraw their money before the age of 60, or for another reason than to purchase a property. Given that savers would also lose their bonus in the process, this penalty seems unnecessary.

If the government intends the LISA to be used as a savings gateway for the self-employed, they should consider raising the age barrier, possibly by another 10 years, and scrapping the penalty on LISA withdrawals. We would also urge the government to consider allowing the self-employed to freely draw down on their LISA while keeping their bonus, on the condition they repay the funds within a short period of time. This extra liquidity would be attractive to the self-employed with fluctuating incomes, and would help people to manage in extenuating circumstances, such as during a time of illness or business expansion.

Recommendation #10 – Transform the Lifetime ISA (LISA) into a suitable savings gateway for the self-employed

The government should make adjustments to the Lifetime ISA to ensure it runs with the grain of self-employed lifestyles. More specifically:

- Raise the age limit for opening an account from 40 to 50
- Scrap the 5 percent penalty for early withdrawals
- Allow account holders to freely draw down on their savings on the condition they promptly repay the funds

48. Jeffries, T. (2016) *Pensions versus Lifetime ISAs: How does new savings offer stack up and does it portend the beginning of the end for pension tax relief?* [article] This Is Money.

Business support and employment services

From breadth to depth

If welfare is the safety cushion for the self-employed, then business support is the springboard. The term itself – 'business support' – is fittingly vague, and tells us something about the array of options open to people who want to start, maintain or grow a business. From advice and mentoring through to coaching and voucher schemes, there are hundreds of initiatives operating in the UK, delivered from across the public, private and third sectors.

But what works best? And how many of these schemes are really helping the self-employed to survive and thrive? Our review of the literature – mostly evaluations of government or quasi-government initiatives – shows there are few simple answers. For example, the What Works Centre's appraisal of business support programmes found inconclusive evidence regarding whether private-led schemes are better than public-led ones, and whether locally-led solutions are more effective than centrally-managed ones.[49] This runs counter to what we might expect, and shows that common sense is not always the best guide to follow.

Where there is more consensus is in the relative merits of programmes that prioritise depth over breadth. An evaluation of the old Business Link service shows that those offices that used so-called 'managed brokerage' schemes – which involved homing in on fewer clients with more intensive support – tended to be more successful in improving at least one business outcome than offices which ran on a lighter touch model, delivering simple "MOTs for businesses".[50] The ability to foster a close relationship between clients and advisers, and to hold robust early assessments of client needs, appear to be particularly important features of successful programmes.

This raises questions about the government's recent move to axe the Business Growth Service (BGS) and replace it with Local Growth Hubs (LGHs). While the former channelled intense support to businesses with growth potential, the latter is more akin to a 'one stop shop', and is delivered locally rather than administered centrally. As the business support expert Kevin Mole argues, whereas the BGS was built on evidence that intense managed brokerage works, the same cannot be said for the

49. What Works Centre (2016) *Evidence Review 2: Business Advice.*
50. Mole, K. F. et al. (2009) *Broader or Deeper? Exploring the most effective intervention profile for public small business support* [working paper no. 105].

light touch model of LGHs.[51] He also reiterates that there is "no evidence" that support is best provided at a local level.

Mole and other critics may turn out to be wrong about Local Growth Hubs. But how will we know? The planned evaluation of LGHs scores only 1 out of a possible 5 on BEIS's own impact evaluation measurements. Rather than be based on a randomised control trial, it is likely that LGHs will be assessed predominantly using self-reporting and general key performance indicators (KPIs).[52]

This speaks to a broader issue of limited or low quality evaluations across the business support world. A study by the Enterprise Research Centre found that there are "very few robust studies of the long-term impact of non-financial support", while the What Works Centre noted in their analysis that of the evaluations that do exist, few consider cost-effectiveness (hence their difficulty in reaching firm conclusions).[53] A government intervention that bucked the trend was the recent Growth Vouchers scheme, which was underpinned by a randomised control trial and shows promising results.[54]

It is not for this report to try and spell out the individual features of successful schemes. However, we would recommend that the government create an ongoing What Works Hub for Business Support that is tasked with this responsibility. Such a Hub would analyse patterns in independent evaluations, champion and help to coordinate new evaluations in the public, private and third sectors, and disseminate the findings throughout the expansive business support network. Alongside this, the government would be wise to undertake randomised control trials on any business support initiative with a budget above a given threshold. BEIS is steadily making progress in the area of impact assessments, but could benefit from a more systematic approach.

Recommendation #11 – Establish a What Works Hub for Business Support Evaluation

The government should fund the creation of a permanent evaluation centre to monitor, coordinate and disseminate the results of evaluations of business support schemes. In addition, the government should commit to underpinning all new major business support schemes with a randomised control trial.

Breaking through the awareness barrier

It is one thing to have an effective support ecosystem in place, but it is another for the self-employed to then use it. According to the Small Business Survey, just 19 percent of non-employing businesses sought advice or information in the prior 12 months to questioning.[55] Although some will refrain simply because they feel no need for assistance, others

51. Mole, K. (2015) My research helped build Growth Accelerator – axing it is a mistake [article] *The Guardian*, 9December 2015.
52. BEIS (2016) *Evaluation Plan 2016: Accountability and learning at the heart of BIS.*
53. Drews, C. and Hart, M. (2015) *Feasibility Study – Exploring the Long-term Impact of Business Improvement Services*. Enterprise Research Centre.
54. BEIS (2016) *Growth Vouchers Programme Evaluation, Cohort 1: Impact at Six Months.*
55. BEIS (2016) *Small Business Survey 2015: Businesses with no employees.*

may be unaware of what is on offer. The same survey found that only 17 percent of non-employing business owners had heard of Tools for Business (on the Gov.Uk website) and just 11 percent were aware of Local Growth Hubs.

The solution is not necessarily to crank up the noise and increase the amount of information channelled to the self-employed (although every robust scheme needs a proper marketing budget). Rather, it may be more effective to think about how existing support is framed. There is evidence that structures for government provision that cover the whole country, and which use 'simple and single branding', can be better at capturing people's attention and managing expectations.[56] The Business is Great campaign exemplifies this approach with consistent branding and simple messaging.

As well as reframing messages, it is also worth thinking about the appropriate *messenger*. While both state and non-state schemes can struggle to win over an audience, there is one group to which the self-employed turn on a regular basis: accountants. Of the non-employing businesses who sought advice in the last year, 25 percent approached accountants, versus 19 percent a general business adviser, 9 percent internet search and 5 percent a family member.[57] This raises the question of whether accountants could expand the existing role they play in advising clients on business matters, such as on marketing and exporting. Accompanying this could be a broader communications exercise, possibly led by ICAEW and ACCA, to raise awareness of these opportunities.

Recommendation #12 – Expand and raise awareness of the business coaching role of accountants

The Institute of Chartered Accountants in England and Wales (ICAEW), the Association of Chartered Certified Accountants (ACCA) and other accountancy trade bodies should look at how accountants might deepen their business advice and mentoring role, while ensuring that more of the self-employed are aware of these opportunities.

Coordination in the service of clarity

Another potential reason for the limited take-up of support is the degree of churn in government initiatives. The Business Growth Service barely lasted four years before it was disbanded for the Local Growth Hubs, while the Growth Vouchers scheme came and went within the space of two years. Such 'big bang' changes – as the ex-political adviser Tom Gash puts it – take time to bed in and become noticed by would-be clients. They also create uncertainty for providers in the supply chain. It is telling that in Scotland, which has not experienced the same degree of flux as England and Wales, awareness of support schemes is very high.[58]

As the FSB has highlighted, the picture is markedly different in the United States where there is a Small Business Administration (SBA) orchestrating government initiatives. Part of the reason for its success is that

56. Greene, F. and Patel, P. (2013) *Enterprise 2050: Getting UK enterprise policy right*. *Federation of Small Businesses.*
57. BEIS (2016) *Small Business Survey 2015: Businesses with no employees.*
58. Ibid.

it has been in operation since 1953, giving the support ecosystem years of stability and continuity.[59] The UK set up a similar body called the Small Business Service in the early 2000s; however it was disbanded shortly after its inauguration – reportedly because it had limited power across central government and its objectives were too broad and nebulous.

Is there an argument for creating a UK version of the SBA? One might argue that the localisation of government support through the Local Growth Hubs, and before that through Local Enterprise Partnerships, makes this a redundant question. Yet central government is still an important provider and funder of business support, with activities spanning Business is Great, UKTI and Innovate UK, to name a few. Moreover, with the recent and rather curious termination of the Enterprise Directorate in BEIS, there is a gaping void of leadership and vision for business support in central government.

BEIS should conduct a public consultation on the merits of a UK equivalent to the Small Business Administration, including its potential objectives and powers. The FSB previously suggested it focus on access to finance, however this seems less of an issue today than it was at the time of the economic downturn. The self-employed may be better served were the SBA to look at coordinating business support in its various guises. It should not interfere with the delivery of private support, but it could provide a forum for shared learning and priority setting. The aforementioned What Works Centre, for example, could be hosted under the umbrella of a UK SBA.

Recommendation #13 – Consult businesses on the creation of a UK equivalent to the Small Business Administration in the US

The government should open a public consultation on the merits of creating a UK Small Business Administration that would co-ordinate state-led business support and provide a forum for shared learning across the public, private and third sectors.

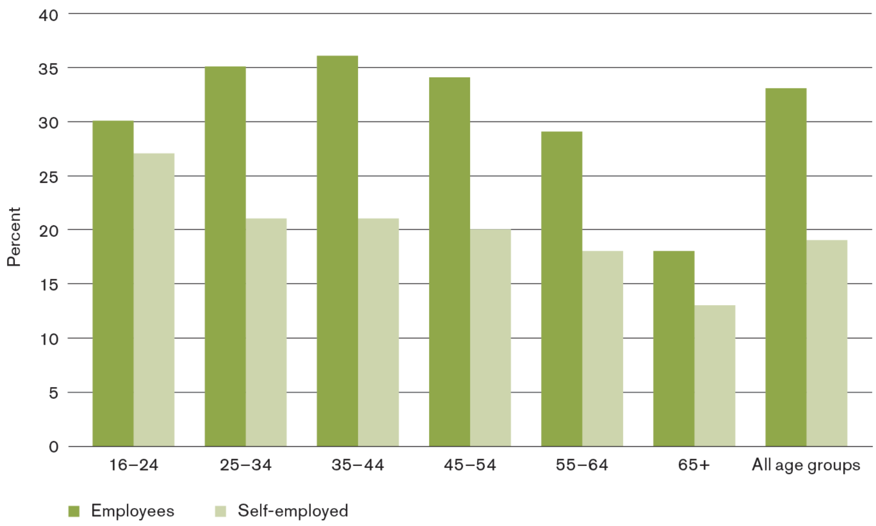
Taking a fresh look at co-operatives and unions

So far we have considered the nature and delivery of generic business support, which aims to develop broad skills such as marketing and cash flow management. But we also need to consider training that upskills people in their particular sector or occupation, whether that be construction, graphic design or personal fitness.

It is concerning that the self-employed are considerably less likely than employees to access training, with 19 percent vs. 33 percent taking part in the past year (see Figure 7). The reasons are likely to be the same as those for why people do not access general support: a lack of time, money and awareness. These might be thought of as demand-side problems. Indeed, one of the biggest issues is a lack of recognition among business owners that they could benefit from training.

59. Greene, F. and Patel, P. (2013) Op cit.

Figure 7 - Access to training in the past year by employment status and age group



Source: RSA analysis of Understanding Society Survey (Wave 5)

However, there are also supply-side issues in the form of limited adult learning opportunities, particularly in further and vocational education, which should be a source of ongoing support for self-employed tradesmen and women and other independent professionals. One solution is for large businesses to open up their employee training programmes to the self-employed in their local area, possibly as part of their corporate social responsibility (CSR) initiatives. Local Growth Hubs could be the broker, connecting their network of business owners with 'anchor institutions' that have the requisite training programmes.

Yet this relies on the generosity of businesses, depends on their timetable, and assumes that their training programme aligns with what the self-employed are seeking. An alternative solution would be for the self-employed in different occupations or sectors to band together for mutual assistance. There is already much to applaud among long-standing unions like Equity and Bectu, which support freelancers in the entertainment and creative industries. As well as undertaking conventional union activity like collective bargaining, Bectu provides low-cost training courses to its members, while Equity offers career development advice.

Co-operatives take mutual support one step further by bringing the self-employed together under one roof, with each member having an equal stake and say in the collective business. In addition to pooling risk, one of the main advantages of co-operatives is that they foster shared learning and development, with members exchanging advice and ideas safe in the knowledge that what is good for one person is good for everyone. A special type of co-operative in France – BEC Co-operatives – runs an incubation pay-back system, whereby long-standing members who have been assisted in the past contribute 10 percent of their profits to help fledging business owners go through the same support journey.

The business community should explore the relative merits of different grassroots initiatives, and work with Co-operatives UK and existing trade bodies like techUK (technology), ICAEW (accountancy) and CIC (construction) to spread word of schemes with the greatest potential.[60] The government should also look at whether regulatory changes need to be made to remove barriers in the way of innovative schemes. The RSA will shortly begin work with the FSB to capture examples of promising practice from around the world, including the BEC co-operatives in France and Bread Funds in Holland.

Recommendation #14 – Promote co-operatives as a form of mutual assistance for the self-employed

The government, Co-operatives UK and trade associations should work together to champion co-operatives among the self-employed, and consider whether there need to be legislative changes to remove barriers in their way.

Moving from unemployment to self-employment

The final area of support worth considering is that for unemployed people who wish to move into self-employment. There are two main gateways of assistance at present: the Work Programme and the New Enterprise Allowance.

The Work Programme focuses on job seekers who have been out of work for more than a year, with support delivered by private providers on a payment-by-results basis. However, this is set to be replaced by the more specialist Work and Health Programme (WHP), which will have a smaller budget and be geared towards people with health problems or who have been out of work for two or more years. The change partly reflects disappointment in some quarters at the results of the Work Programme, although closer analysis of client outcome data reveals that it achieved similar results to previous employment initiatives but at a much lower cost, and the performance of some providers was strong.[61]

If the new Work and Health Programme is to be effective, it will need to offer a clear route for people who wish to start up in business. Indeed, self-employment may be the only form of work that accommodates the health conditions of some WHP clients. Most providers are likely to recognise this from the outset, but the government should consider mandating that they provide a minimum service offer to clients aspiring to self-employment. This would mark a break from the 'black box' approach of the Work Programme, which gave providers the flexibility to run a variety of services of their choosing, but which also resulted in varying levels of support across the country. A 2013 investigation by the All-Party Parliamentary Group (APPG) on Microbusinesses found that only half of Work Programme providers offered specific advice on self-employment to their clients.[62]

60. Co-operatives UK have already produced valuable research on this topic. See Conaty, P., Bird, A. and Ross. P. (2016) *Not Alone: Trade union and co-operative solutions for self-employed workers. Co-operatives UK.*

61. Neville, S. and O'Connor, S. (2016) Long-term unemployed funding to be cut [article] *The Financial Times*, 4 April.

62. All Party Parliamentary Group on Microbusinesses (2013) *Microbusinesses and the Work Programme.*

Because of the narrower remit of the WHP, it is also likely that more jobseekers will need to turn to the Jobcentre Plus for support. This will create an additional burden on an already strained service, and in the words of a Work and Pensions Select Committee report, will "require significant cultural and practical change".[63] We are particularly concerned about the capacity of work coaches to cater to the needs of jobseekers wishing to start up in business. Coaches are primarily recruited and trained as generalists, and it is unclear whether (through no fault of their own) they will be able to provide the right advice, for example around business planning, managing cash flow and dealing with expenses. Recall that they will soon also have to administer the 'gainful self-employment' test under Universal Credit.

As a matter of urgency, the Department for Work and Pensions should undertake an audit of staff skills throughout the Jobcentre Plus network, and ensure that at least one work coach in every branch is a named and trained self-employment specialist. DWP should also ensure that business basics are introduced to work coaches as part of their training programme.

Recommendation #15 – Ensure the Jobcentre Plus is match fit to support the self-employed post Work Programme, with a specialist in every branch

In preparation for the end of the Work Programme, the DWP should undertake an audit of staff skills in the Jobcentre Plus network, and ensure there is at least one work coach in every branch that can be a named self-employment specialist.

The second gateway of support for jobseekers is the New Enterprise Allowance (NEA), which is open to most of the unemployed and offers a £1,274 stipend of financial support over six months, plus support from volunteer mentors. However, this too is coming to an end and will soon be replaced with a new version of the programme, also delivered by private providers. NEA Phase 2 will contain many of the same elements of the original programme, but with an additional pre-assessment stage – 'Link Up, Start Up' – where applicants will hear more about what is required of them in self-employment and the issues they may face in reaching a liveable income.

The refreshed NEA will also run in closer tandem with Universal Credit. This means changing the payment plan for providers, with a new reward for helping clients increase their income to the level of the Minimum Income Floor. It will also mean opening up NEA support to *existing* self-employed claimants on Universal Credit, specifically those struggling to reach the MIF. We welcome this move, however caution that the Department for Work and Pensions may find itself overwhelmed by requests for help given the number of self-employed UC claimants that are likely to have incomes below the MIF. Approximately 41.2 percent of the

63. House of Commons Work and Pensions Committee (2016) *The future of Jobcentre Plus.*

full-time self-employed earn less than the MIF.[64]

It is also a concern that the size and structure of the allowance under the new NEA will remain broadly unchanged. NEA claimants are currently paid £65 a week for the first three months, but this is then cut to £33 a week for the following three months. Rather than have an abrupt cliff edge in payments, a better approach would be to taper this reduction over time. A second problem is that the NEA payment averaged over the course of the full six months is worth a quarter less than what people receive under Job Seeker's Allowance (note that claimants must give up JSA before moving onto NEA).[65] The two payments should be equalised as there appears to be no justification for such a discrepancy.

Recommendation #16 – Reform the payment structure of the New Enterprise Allowance to avoid unnecessary drop outs

The government should adjust the NEA payment structure to ensure it is both fair and practical. More specifically:

- Raise the NEA payment to the level of the Jobseeker's Allowance (JSA)
- Taper away the payment after three months rather than halve it abruptly

64. RSA analysis of Family Resources Survey (2014/15).

65. NEA payments averaged over the six months of eligibility equate to £53 a week, compared to £73.10 a week for Jobseeker's Allowance.

Regulation and late payments

The urge to purge

Of all the tools and levers that policymakers can use to support the self-employed, few have received more attention than deregulation. Successive governments since the late 1970s have been vocal in their ambition to ease the administrative burdens facing small businesses, and have taken aim at rules stretching from employment law and property law, through to product regulations and health and safety procedures.

The zeal for regulatory reform continued apace under Cameron's leadership.[66] In 2010, the coalition introduced a 'one-in, one-out' rule to manage the volume of regulations affecting businesses, and this was soon extended to 'one-in, two-out' in 2013. The then government also legislated for the introduction of 'sunset clauses', which allow for the revision of regulations after a set period of time, and bound itself to publish a target (in pounds) for cutting regulation. This included a requirement for the government to disclose its progress in reaching this target.

Measured against the volume of regulations repealed, policymakers have cleared made progress. The Red Tape Challenge resulted in over 2,400 regulations being scrapped or amended – from reducing the length of fire safety inspections for businesses with good records, to extending presumptive permission for planning on minor property extensions. The Cameron government also worked closely with the European Commission to improve EU regulations, resulting in less onerous rules for environmental impact assessments and food labelling.[67] To say that policymakers have taken deregulation seriously is an understatement.

Distinguishing between good and bad regulation

But how much is too much? It is worth remembering that the UK already has some of the most lightly regulated markets in the developed world. We are seventh on the World Bank's Ease of Doing Business Index, and according to the OECD have the second least regulated economy among developed countries.[68] Evidence also suggests that the perception of regulatory pressures may be greater than the reality. According to the Small Business Survey, approximately 35 percent of non-employing

66. For a comprehensive account of how regulation management has changed in the UK, see Harries, R. and Sawyer, K. (2014) *How to run a country: the burden of regulation*. Reform.
67. Business Taskforce (2014) *Cut EU red tape: One year on*.
68. Koske, I. et al. (2015) 'The 2013 update of the OECD's database on product market regulation: Policy insights for OECD and non-OECD countries' in *OECD Economics Department Working Papers,* no. 1200.

businesses report that 'regulation' is a major obstacle to their business, yet a quarter (24 percent) of these could not point to any specific set of rules or requirements.[69]

One reason for the hype surrounding regulation is that successive governments (and opposition parties) have themselves stoked up fears with anti-'red tape' rhetoric.[70] This in turn has fuelled media commentary, leading to further government posturing in a self-perpetuating cycle. Headlines such as '*Small firms hit by £713 extra red tape bill*' and '*Small businesses are being smothered by red tape*' are indicative of the culture of alarm that surrounds regulation.[71] It does not help that surveys of business owners often deploy leading questions using the pejorative term 'red-tape', which inevitably elicits more negative replies.[72]

Rarely do the business community or policymakers acknowledge that regulation can be advantageous for the self-employed. Rules and procedures fundamentally exist to reduce risks and uncertainties in the market, and without them businesses would be unable to operate. So called 'green tape' can ward off unscrupulous competitors that cut corners, reassure customers of the safety and quality of a product or service, and lead to the creation of new markets (for example the production of safety gear or security equipment). A study involving qualitative interviews with business owners found that regulation can also reduce insurance premiums, with one interviewee (a steel supplier) reporting an £85,000 saving.[73]

Equally important is the impact of regulation on a firm's ability to attract talent. When the Beecroft report suggested in 2012 that small businesses be able to opt out of unfair dismissal procedures, one of the concerns raised by more thoughtful commentators was that this could serve to create a two-tier labour market.[74] Small businesses would be seen as less scrupulous employers and in turn struggle to recruit skilled workers who are more discerning about their workplace. The EU's Stoiber report was met with the same reaction when it suggested that the smallest firms be exempt from nearly all European laws governing business practices.[75]

None of this is to dismiss the real barriers facing people who work for themselves. Vexing paperwork still exists and the time it takes to comply with some rules is excessive. However, sweeping statements about red tape and intermittent calls for a 'bonfire' of regulations are unhelpful. A better approach to managing regulation would be to focus on quality rather than quantity (ie design over volume), and to treat each rule and requirement by its individual merits. As a first step, we recommend the government

69. BEIS (2016) *Small Business Survey 2015: Businesses with no employees.*

70. Kitching, J. (2006) *A burden on business? Reviewing the evidence base on regulation and small-business performance* [online] London: Kingston University.

71. Saunders, J. (2015) *Small businesses are being smothered by red tape* [article] Elitebusiness, 7 January 2015; and Cullen, E. (2014) Small firms hit by £713 extra red tape bill [article] Businesszone, 17 July 2014.

72. Kitching, J. (2006) Op cit.

73. Kitching, J., Hart, M. and Wilson, N. (2015) 'Burden of benefit? Regulation as a dynamic influence on small business performance' in the *International Small Business Journal*, Vol. 33(2).

74. BEIS (2012) *Dealing with dismissal and 'compensated no fault dismissal' for micro businesses.*

75. Traynor, I. and Nelsen, A. (2014) Bonfire of red tape proposed in 'bid to keep Britain in EU' [article], *The Guardian*, 12 October.

remove the 'one in, two out' rule on regulation, as well as the £10bn target for cuts. These goals are crude and risk damaging regulatory safeguards that can help rather than hinder the self-employed.

Recommendation #17 – Remove the 'one in, two out' rule for regulation and shift the emphasis to quality over volume

The government should drop its commitment to the 'one in, two out' rule on regulation, acknowledging that quality is more important than volume. It should also preserve the 'green tape' that allows small businesses to attract talent, engage with customers and be protected from unscrupulous competitors.

Health and home working

It is not for this report to delve into specific types of regulation and make ad hoc suggestions for reform. However, there are two areas where there is a strong argument for regulatory change.

The first relates to the matter of health and safety. Up until 2015, the self-employed were included in the Health and Safety at Work Act (HSWA) in the same vein as employees. The Act imposes a duty upon people and organisations to protect others in the workplace, for example to perform testing and examination of machinery, ensure that potentially hazardous substances are handled and stored correctly, and provide training to anyone who needs to operate a piece of equipment that could cause harm. The duty is clear and the Act is thought to work reasonably well.

In 2011, however, the Lofstedt review into health and safety proposed that the self-employed whose work poses no harm to themselves and others should be exempt from this duty.[76] As the TUC and the Institute of Occupational Safety and Health pointed out at the time, this was a needlessly confusing amendment to the wording of the rules, since the only time the HSWA can be applied is when the self-employed *do* pose the risk of causing harm to themselves or others.[77] Put another way, the self-employed would still need to conduct some form of risk assessment, regardless of Lofstedt's proposal.

In the end, the Deregulation Act of 2015 (which contained the amendments) stipulated that the self-employed would fall under the purview of the HSWA if they are carrying out an "undertaking of a prescribed description", which includes work in agriculture, forestry, construction and health and social care, among other sectors. Yet this has served to create even more confusion than the original proposal, since many of the self-employed will falsely believe they are exempt from the HSWA simply because their sector is not listed. To ensure the self-employed are clear of their obligations, the government should reverse this unnecessary ruling and reinstate the original wording of the Act.

The second area in need of regulatory reform is home-based working. Fifty-nine percent of non-employing business owners operate from home – from hairdressers and child minders through to architects and

76. Lofstedt, R. E. (2011) *Reclaiming health and safety for all: An independent review of health and safety legislation*. DWP.

77. TUC (2013) *Self-employed and the Health and Safety at Work Act* [briefing for affiliates]

Recommendation #18 – Clarify how the self-employed are treated under the Health and Safety at Work Act

The government should reverse its confusing amendments to the Health and Safety at Work Act, which could lead many of the self-employed to falsely believe they are exempt from a general duty to protect themselves and others from the risk of harm.

masseurs.[78] Yet as research by Dr Frances Holliss has shown, it is still seen as an anomaly in our economy, if not a practice to be avoided.[79]

A central issue is that landlords often stipulate in contracts that no work is allowed to take place in a property, regardless of whether it is safe, clean and quiet. The last government took the important step of lifting the ban on social tenants starting a business in their own home; however it is unclear whether this has filtered through into new tenancy agreements (TAs). Many TAs already include a clause prohibiting tenants from causing a nuisance to their neighbours, and this should suffice as a way of preventing disturbing work from taking place in a property. We recommend that the government steps in to ensure workers have a right to operate from the properties they rent, so long as they oblige by existing clauses.

Another issue pointed out by Holliss is that 'dedicated workspace' in homes may be liable for business rates. This is not an issue in itself – although see the points made about business rates in an earlier chapter – however it becomes a problem when the owner of the property is also liable for council tax. Home-based workers who feel they could be unjustly double taxed may choose not to declare their business premises to the local authority. Or they may merge their domestic dwelling with their business quarters, creating unnecessary hazards. The government should take steps to fully harmonise council tax and business rates to ensure that home-based workers do not pay twice for local services.`

Recommendation #19 – Ease rules and harmonise taxes that constrain home-based businesses

The government should work with local authorities and landlords to remove unnecessary obstacles that prevent the self-employed operating from home. More specifically:

- Consider the merits of a Right to Home Working, whereby the self-employed would not need permission to operate from home so long as they abide by existing nuisance and disturbance clauses in their contracts
- Take steps to harmonise council tax and business rates to ensure home-based business owners are never double taxed

78. Small Business Survey (2016) *Op cit*.
79. Holliss, F. (2015) *Beyond Live/Work: The architecture of home-based work*. Routledge.

Calling time on late payments

A good example of where regulation can be an aid to the self-employed is protecting against late payments. According to a recent survey undertaken by the Federation of Small Businesses, 30 percent of its members' bills are paid late, with nearly nine in 10 of these payments delayed by over a month.[80] This in turn leads to cash flow problems, while time is wasted chasing clients for unpaid bills. The emergence of 'invoice factoring' platforms – where banks and other lenders 'buy' invoices in exchange for a proportion of their value – has helped to soften the blow of late payments. However, it is still unjust that the self-employed are not fully compensated for their work.

Governments past and present have sought to regulate against late payments. In 1998, the then Labour government introduced legislation giving businesses the right to charge interest on money owed to them, and in 2002 the act was amended to allow businesses to claim debt recovery costs. In 2013, the coalition government announced that public sector organisations would be required to pay all of their clients within 30 days, while private sector organisations would need to do likewise within 60 days. Cameron's government also introduced the voluntary Prompt Payment Code, whose signatories commit to paying their clients on time with clear and fair procedures.

Looking forward, the government is set to create the new post of Small Business Commissioner, a high profile individual who will be tasked with settling late payment disputes between small firms and large clients. The Australian version of the Commissioner on which the role is based is reported to have solved more than half the cases it took on, at 30 percent the cost of alternative legal action.[81] In addition, the government will shortly launch a new 'duty to report' rule for large firms, which will require them to share information on their payment terms and the average time taken to pay invoices, among other information. The aim is to make "payment behaviour a reputational boardroom issue".[82]

While these moves are promising, the government could and should go further to clamp down on the UK's late payments culture. Some have suggested legislating that private sector businesses must pay within 30 days; however this simplistic reaction overlooks the legitimate reasons for longer payment times, for example payment delays that clients themselves face in their own supply chains (which may extend overseas). A more subtle response is required, which combines the power of social norms (through disclosure), prevention (through formal contracting) and deterrence (through more robust interest charges). We recommend that the government:

- **Increase the interest rate charged on late payments** – Suppliers are currently able to charge 8 percent annually plus the Bank of England's base rate (currently 0.25 percent). However, for

80. Federation of Small Businesses (2016) *Time to Act: The economic impact of poor payment practice*. London: FSB.
81. BBC News (2015) *Small business commissioner to target late payments* [article] BBC, 26 July.
82. BEIS (2016) *Duty to report on payment practices and performance: government response and draft regulations.*

a business owed £2,000, this equates to just £165 spread over a year, or 45p per day. This interest rate should be increased to create a stronger deterrent against payment delays. The government should also consider whether to make interest rate charges compulsory, which would overcome the problem of businesses fearing reprisal for actively taking the decision to charge interest.

- **Extend the 'duty to disclose' payment information to medium-sized businesses** – The new duty to disclose rules will come into force in April 2017, yet will only apply to large UK companies (and large limited liability partnerships - LLPs) that exceed two of the following criteria: have more than 250 employees, annual turnover of £36m, or more than £18m on their balance sheets. Given the reporting requirements are not particularly onerous, there is no reason why these thresholds should not be lowered to companies in the medium-sized bracket.
- **Establish a Right to a Written Contract for transactions over a given size** – Late payments could be prevented early on in the client-supplier relationship by ensuring that both sides have a written contract in place, which clearly spells out deliverables, a timetable for payment and the best point of contact in the client organisation. Last year, the Freelance Isn't Free Act in New York City made such contracts mandatory for any engagement which amounts to more than $800 over a four-month period.[83] This move could be replicated in the UK and would address the problem of suppliers becoming unstuck in talks when no contract is surfaced.

Recommendation #20 – Strengthen protection against late payments, including through a Right to a Written Contract

The government should beef up regulation against late payments by focusing on deterrence, disclosure and prevention. More specifically:

- Increase the interest rate that can be charged on late payments
- Extend the new 'duty to disclose' payment terms and procedures to medium-sized companies
- Create a Right to a Written Contract for any supplier engaging in a transaction above a given size

83. For more information see https://www.freelanceisntfree.org/

Conclusion

The overarching message of this report is that self-employment is here to stay, and that this requires a more serious response from policymakers.

While we applaud the efforts of past and present governments to make the UK a better place to start and grow a business, policies have been lacking in imagination and are too often grounded in outdated business stereotypes. Broad brush deregulation, ill-targeted tax cuts and a general laissez-faire attitude have been the order of the day. Seldom have policymakers given the same degree of attention to matters of welfare, pensions, insurance and business support.

Our central call is for the government to take a more hands-on approach to supporting the self-employed, enabling them to upskill, improve their earnings potential and become net contributors to the UK economy. This is not about issuing special favours. Indeed, one of our core principles is a 'rights and responsibilities' approach, which would see some of the self-employed pay greater National Insurance contributions in return for greater protections. Nor is it a demand for expensive, blockbuster initiatives – a call that would fall on deaf ears in straitened times.

Rather, it is a request for more subtle interventions that are grounded in evidence rather than ideology, and which respond to the changing realities of a modern economy. From reconfiguring business rates and reviewing late payments legislation, through to repairing Universal Credit and deploying nudging techniques to boost pension enrolment, each of the recommendations laid out in this report are intended to improve the lives of the self-employed in a way that is economically feasible and politically palatable.

As we continue to develop our proposals over the coming months, we would be grateful for feedback and ideas for further avenues of exploration.

If you would like to find out more, please email Benedict Dellot at benedict.dellot@rsa.org.uk

Appendix

	1) Soft levelling	2) NICs merger	3) Transaction tax	4) Payroll tax plus	5) Wealth tax filler
Change	The self-employed begin paying the same personal NICs rate as employees (ie 12% instead of 9%), but Employer NICs remains unchanged.	All forms of NICs are folded into a universal levy, with the self-employed paying the same as employees. The burden of Employer NICs is shifted from employer to worker.	Same as the soft levelling approach, but Employer NICs is transformed into a 'transaction tax' to be paid by anyone using the services of any worker, self-employed or employee.	Same as the soft levelling approach, but Employer NICs is recalibrated as a 'Payroll tax plus' with employers paying a levy for all workers they employ plus independent contractors.	Remove Employers NICs altogether and plug the gap in the government's finances with an increase in wealth taxes, such as Capital Gains or Inheritance Tax.
Advantages	May partially reduce bogus self-employment, given workers have nothing to gain from being financially complicit in a misclassification.	A significant simplification that would also reduce the incentives for misclassification of workers. It would raise extra tax revenue.	This would raise extra revenue, and would dampen the incentives for bogus self-employment. It technically passes the some of the tax burden onto consumers.	As before, it would raise extra revenue (although less than the transaction tax) and dampen the desire among employers to misclassify workers.	Fairer in the sense that the tax burden is shifted from earned income to unearned income, which is often (but not always) the result of good fortune.
Limitations	It would leave the self-employed marginally worse off, and would not raise a significant amount in extra tax receipts.	The self-employed would be left significantly worse off (paying a rate closer to 20-25%) and would be a mammoth political sell.	The self-employed may end up swallowing the new tax themselves. It could also lead to a surge in black economy activity that goes off the books.	It would not affect self-employed workers in B2C markets who sell directly to households (e.g. tradesmen and women) rather than businesses.	Wealth is more mobile and thus more difficult to tax. It is also a challenge to unpick forms of wealth that have been borne from earned income.

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RSA
Action and Research Centre

8 John Adam Street
London WC2N 6EZ
+44 (0)20 7930 5115

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