



The Growth Agenda

The self-employment option

Dr Madsen Pirie

Introduction: Slower and smaller growth

The government's strategy for cutting the UK deficit down to size and reducing the overhang of debt has been largely successful in convincing bond investors that the UK will behave responsibly and is therefore a safe place in which to deposit long-term funds.

This has given the UK government attractively low interest rates on its Treasury bonds. Whereas early in the crisis the yields were as high as Italy's at one stage, they are now among the lowest in Europe, comparable with those of Germany, and even lower at one stage.

Had the government followed what appears to be the Labour strategy, the debt and deficit reduction would have taken place over a much longer term, achieving only half of the targets intended over the lifetime of this parliament. The Labour claim seems to be that the extra debt in circulation would have boosted growth, presumably by allowing more people to remain in public sector jobs, by not imposing the same limits on wage increases, and because consumers, feeling more money in their pockets, would have been more inclined to go out and spend.

In fact, though, had the Chancellor not convinced lenders of Britain's serious determination to restore the nation's finances, bond yields would probably have felt the impact of a general loss of confidence, and been up towards the levels seen in Italy and Greece. This, in turn, would have triggered a collapse of investment, and with it the hopes of significant long-term growth.

As it is, the Eurozone sovereign debt crisis, coming on top of the original banking crisis, has caused the UK recovery to be slower and smaller than anticipated, leading in turn to more borrowing than expected, and more prolonged unemployment than was originally predicted.

The response in the Chancellor's Autumn Statement has been a series of government-led measures aimed at creating growth in key areas. These include the credit easing assistance for small businesses, with new sources of borrowing and guarantees, the infrastructure boost to capital construction projects, and they include the new government-backed indemnity scheme to make 95% loans available on new build houses.

These and the other proposals in the Statement are designed to put the government in the driving seat of economic growth, pushing activity forward in the areas it covers. These measures have been coupled with the new £1bn scheme to encourage the employment of young people through work experience placements, apprenticeships and subsidized employment.

There is insufficient confidence and investment from within the private sector, so government is stepping in with schemes of its own to fill the gaps. This is sub-Keynesian, and is subject to the same drawbacks that sub-Keynesianism always suffers. The government has no money; it simply rearranges money. It takes funds from the private sector by taxation, borrowing or inflation, and spends that money on public works. That same money, had it not been taken from the private sector, could have been spent on private works. It would probably have been spent more efficiently, too, in that the private sector responds to the signals of anticipated real demand, rather than go the priorities of politicians. The same money cannot be spent twice, and public spending pre-empt private spending.

The reason there is insufficient private economy activity to stimulate adequate growth levels is that government has made it too expensive. Given low levels of confidence and access to capital, private investors do not see ahead the

prospect of returns adequate enough to compensate them for the risks involved in entrepreneurial activity.

The reason that the prospects of returns are not there is largely because the whole process has been made expensive by the activity of government. As part of a strategy of growth, government should be looking to ways to lower the costs of private economic activity so that more of it will take place. Instead of pushing a myriad of schemes at it of government assistance and support, it should be looking at ways in which it can lower the costs of enterprise by lowering the costly demands it makes of those who engage in it.

If *Plan A* is the strategy to cut debt and deficit, then *Plan A-star* tacks on the programme of government incentives. What is also needed is *Plan A-double-star* to add measures that will make economic activity easier and more worthwhile. This means cutting both taxes and regulations.

Given the government's need for the revenues that can sustain its fiscal rectitude, the tax cuts need not be ones made across the board at great cost to public finances. Nor does deregulation need to be driven through for everyone. Both can be targeted at the sectors most likely to stimulate and sustain growth. In the UK this is that of small and medium sized enterprises (SMEs). Between them they employ roughly half the workforce, and crucially, they create two-thirds of all the new jobs.

Boosting the small and medium enterprises

The single most effective measure which government could enact to boost a pro-growth agenda from the private sector would be to allow all small and medium enterprises to treat their workers as self-employed people under contract. This changes the relationship between the two, because the self-employed person then becomes responsible for paying their own taxes and National Insurance. They would still be liable for taxes and insurance, but under the new rule the employer would pass on their contact details to HMRC, who would then contact the workers directly with their tax and insurance bills.

The immediate effect would be to free up the employer from the burden of calculating and collecting PAYE and National Insurance. His or her workers would be paid the wage agreed for their services, but it would be payment to a contractor. The workers themselves would be told by

HMRC what their obligations were, and how and when to discharge them.

Employers could take on extra people on a self-employed basis without imposing any additional burden on themselves. This is critical at the smallest point, when the one-person business is considering hiring help. At present the obligation to calculate PAYE and NI is large enough to constitute a major deterrent, but if the extra hand were taken on as a sub-contractor, that burden would be minimized.

Changing the Treasury position

The Treasury and HMRC have made a policy for many years of trying to force as many people as possible out of self-employment. They have done this for convenience, finding it easier to deal with a single employer than to establish relationships with perhaps dozens of his or her employees.

While it is undoubtedly easier for the Treasury to deal with an employer-employee relationship than with parties engaged in mutual contracts, it also imposes huge costs on employers and potential employers. Given the delicate state of the UK economy and its low growth prospects for the immediate future, it is perhaps time to ask whether the convenience of the Treasury is worth what it costs the country.

It may well be that Treasury numbers would have to expand to cope with the extra workload and responsibilities, but the increased costs of this would fade into insignificance when set alongside the economic boost that would be generated in the private sector. There is no reason why revenue should be reduced by such a measure because the liability for tax and insurance will still be there. It may well be harder to collect that revenue than it is to have an employer work as an unpaid civil servant on the Treasury's behalf, but this does not pose insuperable problems.

It calls for a complete change in the Treasury's attitude to self-employment, and a corresponding change in the way it operates. Instead of trying to squeeze people out of self-employment, a reorganized Treasury would have a mandate to assist SMEs that wanted to go down that route. In place of its checklist of questions designed to categorize self-employed people as employees, it would need to produce guidance to help both employers and employees to adjust to their new status as contracting parties in a relationship.

Rather than confront the newly-designated self-employed with six-monthly bills, for example, HMRC might well take a leaf out of the book of local government, and encourage as many as possible to move onto monthly direct debit payments, as many already do for council tax payments. There are other imaginative ways in which the Treasury could cope with the changes required of it and the new demands made upon it. Any difficulties should be regarded not as obstacles which prevents such a change, but as problems to be solved so the transformation can be achieved.

Reducing the burdens

Such a measure will have far more effect than simply reducing the demands of the time and effort of employers of SMEs. An employer will have an entirely different relationship with self-employed contractors than he or she did with employees. Employers become readier to take on people on such a basis because it is also easier to let them go if it becomes financially necessary. Protection of employment regulations put all kinds of obstacles in the path of employers who might need to slim down their workforce, and it is partly in consequence of this that some choose never to expand it in the first place.

If SMEs can treat their workforce as self-employed under contract, they move out of the world of 'unfair' dismissals, of tribunals, of alleged discrimination and liability to fines and lawsuits. These tribunals impose huge costs on employers, particularly on small employers, costing them time to attend hearings and the cost of legal advice and representation. Many decline to contest cases because of the costs they impose, and this itself is a great disincentive to employing people in the first place, in addition to adding to the cost side of their balance sheet. They also add to costs in a less direct way. Employers who would prefer to hire, fire and promote on merit, find they have to consider instead whether they might be sued for racial or sexual discrimination or unfair dismissal if they did so.

Legislators in Britain and Europe, sometimes with good intentions, have sought to give protection to employees. Knowing little themselves about how employment works, they have succeeded in imposing on businesses all the compliance costs involved in meeting these new obligations. Large firms might handle this easily by having in-house departments to ensure they meet their legal requirements, and spreading the costs over perhaps hundreds or thousands of employees. For small and medium enterprises

it is different, and the costs of compliance can be large enough to add significantly to their wage bill.

Large firms can also cope more easily with the obligations of statutory sick pay. For a firm with a handful of employees, losing one of them off sick yet having to pay wages for up to 28 weeks might be an insurmountable burden. With self-employed contractors there is no such obligation. Self-employed people might be eligible for Employment and Support Allowance when off work, but this is not a cost imposed upon the people they contract with.

A similar process applies to maternity and paternity leave. People who are self-employed have to manage without such benefits. They do it by organizing their lives so they can cope with the birth of a child. It is not a cost imposed upon their employer. It is because the associated costs of these benefits might fall on a small employer that such employers have to take it into account before deciding whether to employ someone in the first place. By allowing small employers to have self-employed staff, the benefits no longer count as an impediment and a disincentive to employment.

Holiday pay is another statutory cost imposed upon employers. Fully employed workers have to be paid for 5.6 weeks annual leave, with part time workers having entitlements on a pro rata basis. Self-employed people can claim no such rights from the people they form contractual relationships with, so the costs of their holidays fall on themselves instead of any employers. This is yet another case in which the large firm with huge numbers of employees can absorb the costs of this, but the small employer might find the obligation a disincentive to employing extra people in the first place.

Lowering the cost of job-creation

The aim of allowing SMEs to have their workers treated as self-employed is to lower the costs of employment for small and medium firms, without affecting the relationships that large firms have with their employees. The aim, quite simply is to allow the private sector to generate so many jobs of this type that large numbers will be drawn out of unemployment and become net taxpayers, earning money and paying tax and insurance, rather than being without work and dependent on various types of benefit. It is to turn them into contributors to the economy and to public funds instead of being recipients dependent on public funds.

Those genuinely seeking jobs without success sometimes assert that “the jobs are not there.” In many cases they are correct. The jobs are not there because they are too expensive. Given the economic climate, not enough people are prepared to risk the investment and the effort, given the costs that have to be met and the burdens borne before they can start to make any return from it.

Many of the obligations imposed upon employers by successive governments amount to a form of taxation. They impose costs on the business which the employer is legally obliged to pay. It is a form of taxation which politicians like because they are credited with the benefits to which employees are entitled, but not often given the blame for the costs which ultimately, but often invisibly, fall on the employee.

To an employer these extra costs form part of the wages pool, and are monies that would otherwise be available to be paid in wages. The employer's contribution to National Insurance, for instance, forms part of his or her total wages bill. Because it is paid to the government it cannot be paid to the employee, but the myth is sustained that somehow this cost is borne only by the employer. The employee contribution to NI is seen on the wage slip as a deduction, but the employer contribution comes from wages that might have been paid, and therefore does not show.

In vibrant economic times people invest and create jobs because they can gain a return by doing so. They are not currently doing so in sufficient numbers because the costs of doing so, coupled with the risks, tip the balance against enterprise. The result is that the jobs are not created and the unemployment total rises and remains high.

Self-employed or unemployed

Allowing SMEs to treat their workforce as self-employed will dramatically lower the cost of their labour as well as reducing the time and effort they have to expend on compliance. The choice is not one between employed status with its attendant benefits and self-employed status without them. For many people it is a choice between not being in a job that has benefits attached or being in a job that has self-employed status. It is not so much the difference between employed and self-employed, but between unemployed and self-employed.

An attractive feature of the proposed change to allow SME staff to be self-employed is that it can be done quickly. If all of the burdens placed on employment were to be approached one by one, they would involve vast uses of Parliamentary time, and each obligation would have its body of supporters determined to retain it. By offering the opportunity to opt for staff with self-employed status, most of the government-imposed burdens on small employers could be tackled in one move, and one that could be implemented in a fairly short time.

The EU dimension

The immense body of employment regulation to which the UK is subject as a result of its membership of the European Union applies for the most part to employed status, and does not cover self-employed people. A move towards self-employment in SMEs would therefore free firms from the need to comply with the minutely-detailed and intrusive regulation that derives from Brussels. The UK could effectively deregulate many of its small and medium enterprises without compromising its adherence to European law. A move to free SMEs from EU regulation would otherwise involve taking on the EU bureaucracy and law courts.

There is little doubt that the proposal to permit self-employed status to SME staff could be implemented, and could mostly done so in compliance with our European commitments. The case for doing it is that it would unleash enterprise in the private sector and create hundreds of thousands of new jobs. It is the second star to be added to the Coalition Government's 'Plan A.' To fiscal rectitude and government incentives for growth in key sectors it would add a massive spurt in private growth.

Boosting growth to reduce deficit and debt

Ultimately the deficit and debt will need growth to reduce their levels and their significance. Allowing self-employed status for SME staff is the single most powerful tool that could bring about the levels growth that could do that.