SRC COMMENTARY ON SCOTTISH GOVERNMENT'S DRAFT BUDGET 2017-18

ABOUT SRC

Retail is an exciting, diverse and dynamic industry undergoing transformational change. The SRC is at the forefront – enhancing, assisting, informing and shaping. Our mission is to make a positive difference to the retail industry and to the customers it serves. Our broad range of stakeholders demonstrates how retailing touches almost every aspect of our culture. The SRC leads the industry and works with our members to shape debates and influence issues and opportunities that will help make that positive difference. We care about the careers of people who work in our industry, the communities retail touches and competitiveness as a fundamental principle of the industry's success – our 3Cs.

In addition to publishing leading indicators on Scottish retail sales, footfall and shop vacancies in town centres, our policy positions are informed by our 255-strong membership and determined by the SRC's Board.

A RETAIL INDUSTRY IN TRANSITION

A thriving and successful retail industry is a great route to better paid jobs, more private sector investment[1], and additional tax revenues for the public sector. It also keeps down prices for households, supports communities[2] and helps everyone saving for a pension[3]. The industry is crucial to supporting Scottish businesses, with billions of pounds of Scottish products exported by retailers every year to the rest of the UK and beyond. Just as importantly the industry provides a key market for many other indigenous suppliers, from logistics companies moving products to electricians and plasterers resolving issues in physical stores. The multiplier effect of retail on the Scottish economy is measured in billions.

The industry has changed more in the past five years than it did in the previous fifty. The industry is one of the most dynamic and innovative, accounting for 13% of all new firms formed last year. This innovation can be seen through significant new investment in online retailing, in-store technology and order points, home delivery and logistics capabilities, click and collect services, digital customer loyalty and payment arrangements, and new and refreshed own-brand products. The industry is in the midst of a customer led revolution, and all of its investment - from new ways of working to sharpening prices – is because customers are changing and demanding it.

However, these are testing times for the industry. Retail sales growth has consistently been at a low ebb over the past two years albeit it has picked up over the past quarter. Retailers are working

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[1] 14 per cent of private sector investment in the UK comes from the retail sector including investment in buildings, vehicles, software and hardware
[2] Independent research shows that the public rate retailers as the top sector for getting involved in their local communities
[3] 4 per cent of dividends into pension funds come from the retail industry

ever harder to maintain let alone grow sales, at a time of profound structural[4], economic and regulatory change for the industry. Retail is currently Scotland's largest private sector employer, employing 252,000 people directly, 13 per cent of the private sector work-force. However recent official data highlighted a drop of 10,000 posts in the industry in Scotland over the past seven years. During the same period there were 1,700 fewer shops[5], a 7 per cent reduction. Meanwhile net profitability in the industry has halved to around 3 per cent of the value of sales[6]. Embracing these changes and becoming more productive requires retailers to invest in new technology (both software and hardware), a higher skilled workforce, revamped warehouses and transformed logistics capabilities.

INTRODUCTION

The Finance Secretary is right to note that the Scottish Government's spending is now much more reliant on the performance of the Scottish economy. This will become more so once half the revenues from VAT are assigned to Holyrood in a couple of years' time, and reinforces the need to support private sector investment as well as consumers. After all, consumer demand has often proven a more reliable source of growth than other drivers of demand.

In our submission[7] ahead of the Budget the SRC called for no additional tax rises on consumers or on businesses, and the Finance Secretary appears to have heard that message.

The SRC and Government have a shared interest in improving the conditions for our industry to thrive and prosper, and to help retailers keep down the cost of shopping for consumers. We remain keen to work with Government to deliver a more coherent approach to policy making and to help the industry fulfil its potential.

BUDGET DECISIONS

Income tax

We fully concur with the Scottish Government's assessment that "household budgets are already under strain"[8] and therefore the decision not to increase the three income tax rates was the right one. Household disposable incomes are set to be challenged over the coming 18 months by likely further rises in inflation, rising council tax and higher employee pension contributions (in Spring 2018 and again in Spring 2019). A 1p increase across the three existing income tax rates would have taken £475 million out of consumers' pockets, equivalent to almost two percent of total retail sales in Scotland, at a time when margins are low and when 252,000 people in Scotland reply on the retail industry for employment.

Council tax

The level of council tax affects household disposable incomes and the planned reforms are set to increase council tax in 2017-18, up to £181 million in total[9]. Hopefully this leads to a more durable and sustainable tax. Future tax rises must take into account the impact on consumer spending and the cap on future rises seems sensible.

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[4] E.g. 20.6% of all non-food retail sales are online
[5] Scottish Government's Annual Business Statistics published August 2016
[6] 'Retail 2020: Report 3 Solutions – the journey to better jobs', BRC, September 2016
[7] 'Open for business: growing a more productive and competitive Scottish economy', SRC August 2016
[8] P1 of Budget document
[9] P90 of Budget document: £111m from re-basing the tax plus up to £70m from the 3% cap on increases (p89)

Business rates
The commitment to continue to at least match the business poundage rate with that which exits in England is sensible. That said, it needs to be seen in the content of the 2017 rating revaluation which will have differential impacts on certain parts of the economy and certain geographies. For example, we are already hearing early indications and growing alarm from some members' that as a result of the draft valuations which have just been published that their total rates bills could leap by over 30% for those premises operating in and around Edinburgh.

The extension of the Small Business Bonus is a welcome recognition of the need to keep down costs for firms, however we are mindful that three quarters of retail employment in Scotland is within firms which currently receive no relief.

The Finance Secretary appears to be adding further complexity to the existing rates system with promises of further reliefs for rural areas. As we highlighted in our submission to the Barclay Review, the current rates system is opaque, unwieldy and only seems to function through myriad exemptions and reliefs that continue to grow as an overall proportion of the total income from business rates. We question how sustainable this is and how effective it will be, as the local discretionary rates relief[10] introduced last year has only been used by one out of the 32 local authorities.

Whilst we recognise the Finance Secretary is somewhat limited by the available levers on business taxation, this continued complexity will only deepen unless fundamental reform of the rates system occurs. This is something that must happen following the Barclay Review reporting next summer.

Large business rates supplement
The decision to continue to at least match the headline poundage rate in England is sensible, which makes it all the more disappointing that Scottish Ministers have fumbled the opportunity to comprehensively reverse this year's doubling of the Large Business Rates Supplement. The doubling of the Large Business Supplement is emblematic of the many problems with rates as a whole, with little regard paid to trading conditions or the changes affecting industry, no consultation or indeed economic impact analysis underpinning it. Making it more expensive to operate on our high streets is also at odds with the Scottish Government's Town Centres Action Plan, and simply raises the hurdle for attracting commercial investment.

As public policy continues to drive up labour and property costs, retailers are looking ever more closely at shifting their investment towards their online presence, especially given falling technology costs and greater digital capability. Ultimately this could mean less rates revenues for government, as we have seen with the 1,700 shop closures over the past seven years.

The Finance Secretary has at least acknowledged our concerns by seeking to increase the supplement threshold which will remove some modest-sized premises from this extra tax, and we await fuller details of the value of this. This move does however implicitly acknowledge a problem with the doubling of the supplement, and comes a mere nine months after its introduction. Clinging to and prolonging this Scotland-only rates surcharge ensures 21,000 commercial premises including many shops will continue to pay higher business rates than they would in comparable

[10] Which became available to councils to use in October 2015 under the Community Empowerment Act

premises down south. The fact that the doubling of the supplement took no account of trading conditions makes it all the more pressing that the Barclay Review of Rates delivers a modern and fit for purpose rates regime that flexes with the economy and moves away from ad hoc extra levies or surcharges.

The Budget document references the Scottish Government's Economic Strategy, and we note the change in the language and move towards a more honest description of the rates system since the Strategy was published early last year, taking into account the subsequent doubling of the Large Business Supplement. No longer are Ministers talking of having "the most competitive business rates scheme in the UK", instead according to the Budget document they are pursuing instead a "highly competitive business rates regime"[11], which implicitly recognises that for one in ten firms in Scotland the rates bill is higher than elsewhere in the UK.

Apprenticeship levy

Retailers have a strong record on training and career progression, with many providing a wide range of apprenticeships in diverse areas such as logistics, warehousing and food preparation alongside many other accredited or job related qualifications. The decision in the Budget to establish a £10 million flexible workforce development fund with a portion of the receipts from the Apprenticeship Levy is the right one, and the concept of a flexible skills fund is something we proposed in our own Position Paper on the Apprenticeship Levy this summer. Firms will start paying for this UK-imposed levy from April and so while this move is promising we await early details of the fund and whether levy-payers will be able to directly claim from it.

Infrastructure

We support a shift towards use a greater proportion of government spending on GDP-enhancing digital and transport infrastructure and housing. The former is especially important given the profound shift in shopping habits and the amount of investment that retailers are making into online shopping technology and associated skills and logistics capability. Our Scottish Retail Sales Monitor for November found that 27% of non-food retail sales were undertaken online.

Scottish Retail Consortium
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[11] Page iv, Budget document