

# **Setting Business Free**

**Commerce Policy Paper**

**Policy Paper 59**





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# Summary

Liberal Democrats believe in freedom, choice and diversity. We believe that well-regulated competitive markets generally produce the best outcomes for society. We recognise that there is some need for government intervention in commercial matters: in circumstances where markets are failing to operate in the interests of consumers; where there is no alternative to monopoly networks; and to protect the consumer, environment and workers.

Good regulation is that which is no more – either in scope or duration – than is necessary to achieve the required result.

Where possible, we favour voluntary regulation by business. When legislation is unavoidable, we will introduce structural limits on both its scope and its duration. We will replace the existing system of regulatory impact assessments with one where the assessment is carried out consistently, and independently of the sponsoring department. We will also introduce the automatic inclusion in all new regulation of a sunset clause so that continuation after its initial period will depend on Parliamentary approval.

We will abolish the DTI with its incompatible functions of promoting and regulating business. We will establish a much smaller Department for the Consumer with responsibility for competition and consumer issues.

Many functions of the DTI will be transferred to other government departments:

- Energy will go to our proposed Department of Environment, Energy and Transport;
- Science and research will go to the Department for Education;
- Employment matters will go to the Department for Work and Pensions.

Others, such as business facilitation and promotion will be devolved to RDAs (pending the establishment of elected regional assemblies in England).

The minister in the Cabinet Office responsible for the Deregulation Unit will take on those purely business-related functions which have not been transferred to other departments. That post will have cabinet rank and act as the voice of business in government.

While regulators must be free from political interference in their day-to-day activities, they must be accountable to Parliament for their general policy direction. We will reform the structure of the regulatory bodies along the lines of the Bank of England Monetary Policy Committee. The appointment of senior regulators will be subject to parliamentary scrutiny. All regulatory bodies will be required to answer to a parliamentary select committee.

We will also introduce a statement of best practice in relation to regulation that will be for the Public Accounts Committee to promote.

Government's biggest impact on the success of business is in the creation and maintenance of the infrastructure of the country. Businesses need a skilled workforce, decent premises and a sound transport system. Without these, the environment for business becomes much more difficult. Liberal Democrats believe that government should focus on building up the infrastructure of the country to assist business rather than on handouts to business.

We consider that there is one area in which government tax and financial concessions to business are appropriate. The small business sector is the nursery of the economy and it is vital for the future prosperity of the nation that the right economic climate is established to give new and small businesses the opportunity to survive and grow.

Government regulation is a heavy burden on business but poses a particular threat to small businesses. Larger businesses are better able to cope with the regulatory burden since they can support administrative structures that small businesses cannot. We believe that government support for small businesses is in the interests of the economy as a whole. We will:

- Provide tax relief to small businesses to mitigate the effect on the business of the time spent on regulation and government bureaucracy;
- Introduce a uniform business rate relief below a prescribed rateable value;
- Establish one-stop shops where small businesses can both access all the information and deal with all the regulators relevant to their business;
- Review business regulations to establish a red tape holiday for small businesses in their first period of operation;
- Reform the structure of venture capital investment to increase the number of people participating in small businesses in this way.

Liberal Democrats will improve corporate governance by increasing the number of independent non-executive directors. We will clamp down on fat cat pay by making the votes of shareholders binding on such matters. We will also require the publication of voting records at company meetings.

Meanwhile, we will ensure protection of employees is enhanced. We will legislate for an offence of corporate killing. We will also give employees a statutory right to consultation on major issues affecting them.

Liberal Democrats have put the environment at the heart of our policies and principles. We continue to do so in commercial matters. We will take steps to encourage sustainable production and wealth creation by ensuring that the price of goods and services covers their external costs such as pollution. In this way businesses will be competing with each other on a fair basis without disguised taxpayer subsidies.

# Introduction

## Taking Pride in Economic Liberalism

1.1 The Liberal Democrats' 2001 General Election Manifesto *Freedom, Justice, Honesty* states:

*Liberal Democrats are committed to a free market economy in which enterprise thrives. Competition and open markets are by far the best guarantee of wealth creation. It is the Government's role to ensure the conditions under which innovation and competition can flourish and benefit the greatest number of people.*

1.2 Economic liberalism has a long history in the UK which our party and its historic predecessor, the Liberal Party, have done much to shape. The scrapping of tariffs and the campaign against the Corn Laws in the 1840s grew out of the determination of Liberals to move the country onto a free trade economic system. Gladstone's budgets swept away more tariffs. By the end of the nineteenth century, free trade was an established system with adherents from across the political system.

1.3 There was, however, a growing awareness of the need for government intervention in social and economic areas where the market itself was clearly not operating effectively. Concerns about the need to tackle poverty, gross inequality and maltreatment of workers led to the rise of social liberalism first seen in the Liberal government of 1906-15. The government remained committed to a market economy and liberal trade but combined it with intervention to end abuses and tackle inequality.

1.4 Economic liberalism had its opponents. The tariff reform campaign of Joseph Chamberlain at the start of the twentieth century rolled on for nearly thirty years until his son Neville introduced import duties on a wide range of products in 1932. The aim of imperial unity was, however, never achieved in the long run. The Empire

has long gone and Britain since joined a multilateral trading system based on GATT (now the WTO).

1.5 In the meantime, economic liberalism took a battering in Britain. Direct state intervention through nationalisation, and the creation of protected markets for products such as coal for electricity generation, ended competition in many sectors of the economy. Nationalised industries were seen as both a political and economic solution to Britain's economic problems, just as Chamberlain's tariff reform campaign had promised a solution to Britain's economic problems and challenges at the start of the twentieth century.

1.6 We have however gone through nearly a full circle, at the beginning of the twenty-first century few argue for government control or protectionism as the way forward. Instead, economic liberalism has found its day again.

1.7 Liberalisation is taking place across the globe. Markets are being opened up to competition and monopolies are being challenged. Protected markets have been eroded. International trade and capital flows have grown enormously (though, unlike the 19<sup>th</sup> century, present day liberalism does not accommodate large cross border labour migration).

1.8 This has not come without its costs. In the UK, areas formerly dependent on monolithic government owned industries which have now closed have often struggled to find a new, sustainable economic role. Secure employment in the public sector is less available. There are severe regional imbalances, particularly in the housing market, which make the population unable to move in response to painful structural change.

1.9 The process of liberalisation has not been completed. Heavily protectionist practices still exist throughout the western world where political lobbying has been most intense. In Europe, agricultural policy remains a huge burden on the consumer and the taxpayer whilst damaging the environment, excluding too many agricultural products from developing nations and not even protecting agricultural jobs. And the USA does not hesitate to use its economic power ruthlessly to protect domestic vested interests. Under the Bush administration, this has been seen in the steep tariffs imposed to protect American steel manufacturers and a massive expansion of farm subsidies.

1.10 Even in a liberal market economy, however, the government still has a key role. Liberal Democrats start with a bias in favour of market solutions but we recognise the need for intervention. The government needs to set a framework to ensure effective market competition takes place and, where this is not possible, to ensure that monopolies and network providers are regulated in the interest of the consumer. Market outcomes also need to be reconnected more closely with the long term interests of society, for example with regard to sustainable development and the protection of the environment.

1.11 Liberal Democrats also believe that a market economy is the best basis for wealth creation. Competition will push producers to be efficient with their own resources but also to be more finely tuned to the needs of consumers. Rip off practices will be much more difficult to carry out and to conceal where alternative suppliers operate.

1.12 Competition can help to create and redistribute wealth. Where economies of scale are not crucial to commercial operations there is scope for a large diversity of smaller operators, often owned by individuals or small groups. Diverse shareholding, including employee shareholding, broadens stakeholding and ensures ownership of wealth becomes more widely distributed.

1.13 The term economic liberalism has however been hijacked by some on the right. Thatcherism was allegedly about liberalisation yet the reality was that the Thatcher governments often created private monopolies out of public ones. And we now have a more complex society than was in the contemplation of our Victorian forebears, in which taxation is a legitimate device to provide societal benefits that a market will not, e.g. an efficient and integrated public transport system and proper educational provision for all. Modern Liberal Democrats believe that such interventions can occur within a liberal economy.

1.14 It is time for Liberal Democrats, while reclaiming and rejoicing in their heritage of economic liberalism, to set it in the context of the 21st century where a market economy is a desirable outcome but a market society is not.

1.15 This paper sets out the Liberal Democrat approach to trade and commerce and our belief in economic liberalism. We aim to put the consumer into the driving seat and to ensure that wealth creation moves ahead in a competitive open market in a manner that is both enterprising and sustainable.

# Setting the Scene

## 2.1 Putting the Consumer First

2.1.1 A central premise of a liberal economy is that millions of consumers operating through markets will produce better outcomes than government bureaucrats or private monopolists.

2.1.2 As a party that believes in economic liberalism, the Liberal Democrats recognise that there are circumstances in which the government needs to intervene. A market economy completely liberated from rules and regulations could not function. Consumers, for example, need confidence to operate in the market and without a proper balance between powerful producers and individual consumers confidence could be adversely affected to the detriment of the economy generally. A clear example of this can be found in the provision of information about financial services. The large scale misselling of complex financial products - private pensions, endowments, with-profits life assurance, mortgages - through aggressive and misleading sales promotion has not merely caused consumer detriment but has undermined the willingness of the whole of society to save and prepare for retirement. A consumer must have the right to information about the consequences of purchasing a product or service. The government has a duty to ensure that this happens.

2.1.3 Liberal Democrats regard competition between rival suppliers as the best way to provide the customer with the goods and services they want and need at a price that best reflects the ability of the customer to pay and the provider to supply. Where this does not operate of its own accord, Liberal Democrats accept that regulation is required. The balance between regulation and deregulation however needs to be kept under review so that unnecessary burdens on business are avoided whilst ensuring customers have sufficient protection from unreasonable and unfair trading practices.

2.1.4 Regulation needs to be proportionate to the task it is intended to carry out. Nevertheless Liberal Democrats will regulate where competition between different producers and suppliers does not operate effectively or is inadequate. We will aim for more competition in markets, fewer monopolies, more information to help consumers make more choices and better protection against fraud, corruption and abuse of market position.

2.1.5 There will be some limited circumstances when competition between different networks is not possible. When a monopoly network is in place, regulation is required to provide the pressures on the provider that would otherwise come from market competition.

2.1.6 Red tape and unnecessary burdens should be avoided and therefore regulation should be kept under constant review and removed once it has served its purpose or is no longer relevant.

2.1.7 The UK has traditionally created very detailed regulations when implementing EU Directives. This is in marked contrast to some other Member States where the same aim is implemented by stating the ends to be achieved and leaving business to sort out for itself how best to achieve these aims. We will introduce that approach to future implementation of EU Directives thus avoiding the unnecessary excesses in, for example, the UK rules made under the Working Time Directive.

2.1.8 Government regulation in the UK is also forcing businesses to act as agents for the government, e.g. as tax collectors and social security handlers. The obligations flowing from the Working Families Tax Credit, stakeholder pensions and much else have recently been added to business obligations. These are huge burdens. In effect they act as a tax on business. The greatest burdens as government agents fall disproportionately on small businesses. Their overheads as a result of government requirements are far higher as a proportion

of turnover than those of big businesses with large turnovers. That is why we believe that firms should be financially compensated.

## **2.2 From Controls to Facilitation: the Role of Government**

2.2.1 Governments have traditionally seen their job as aiding business. Indeed, governments throughout the world and throughout recent history have intervened in a variety of ways to protect domestic business from foreign and often domestic competition. Tariffs and restrictions on imports have been used but are now subject to WTO disciplines. Nationalisation of some industries with the consequent creation of monolithic monopoly suppliers was a particular feature of British governments from 1945 until recently. Guaranteed markets and subsidies all played a role though EU and WTO rules limit the scope of these interventions.

2.2.2 Governments have long sought to pick winners and to finance prestige national projects. The creation of Concorde, for example, carried out in joint agreement with the French government, was a technological success that created the pride of the British and French airline fleets. Yet it was a financial disaster and the planes were virtually given away to British Airways when the company was privatised. The planes no longer even cover their running costs and are being withdrawn from service.

2.2.3 One of the consequences of the move towards economic liberalism is that such interventions are now regarded more critically. They distort international competition and resources, including taxpayers' money, are often invested in failing or inefficient projects. Crude subsidy and protection is now largely precluded in the UK. But more subtle forms of intervention are provided for under the Industrial Assistance Development Bill (2003) which raises the level of money the government can give to business as financial aid from £2.7 to £6.1 billion to be spent over the next twenty years. The uses of this money are

largely unspecified by the legislation which means there is a worrying lack of accountability. Some of the purposes such as Small Business Loan Guarantees and regional venture capital funds are not controversial but the overall value of this level of assistance is unproven. Liberal Democrats would require the spending of such money to be transparent and fully published. In the absence of any clear indication of how or why the extra funding is required or to be spent, the sums should also be scaled back.

2.2.4 Government intervention to prop up failing industries is invariably wrong though there is a good case for helping workers and regions adjust as has occurred with the steel, coal and car industry closures and redundancies. But in general it is not the role of the government to bail out failing businesses. A recent example of direct government intervention in the economy, which was opposed by Liberal Democrats, can be seen in the bail-out of British Energy.

2.2.5 It is however generally accepted that the government has an obligation in cases of a systemic failure. In many financial markets, regulation is required to ensure that major institutional failure is avoided and that confidence is maintained. Working transport links are a key component of a successful economy. No government could contemplate the transport system collapsing. The intervention by the government in 2002 to take over collapsed Railtrack and its replacement with a not-for-profit company Network Rail was along the lines proposed by the Liberal Democrats. A decent transport system, a skilled workforce, quality public services are all matters that directly affect the ability of business to operate. The government has a role in ensuring that adequate investment is made in these for reasons of long-term growth though the DTI has no significant role in any of these.

2.2.6 The small business sector is the nursery of the UK economy. Small firms employ a substantial proportion of the workforce. They are important wealth creators. They are the opportunity for individuals to become stakeholders. Their growth is vital for the future prosperity of the

nation. A key role of the government is to nurture the best environment for small businesses to establish and grow by their own endeavours. Small businesses face many hurdles and many do not survive their first year of operation. The effect of

regulation on small businesses can be disproportional in comparison to large firms. The benefits of a healthy small business sector to the economy as a whole justifies a limited degree of special treatment.

# Abolition of the Department of Trade & Industry

3.0.1 The Department of Trade and Industry is responsible both for promoting industry and for regulating it in the interests of consumers. These two roles are not only incompatible, they have inherent contradictions. We believe that the interests both of business and the consumer are best served by separating the functions of poacher and gamekeeper.

3.0.2 In addition, within the DTI there are functions dealing with education, research, science, energy, standards and measurements, registration of companies, insolvency, industrial relations, intellectual property, employment, innovation and international trade as well as consumer affairs and business promotion and support.

3.0.3 Many of these functions work in parallel with the responsibilities of other departments, for example the flexible working provisions which affect the work of the Department of Work and Pensions. This leads to unnecessary duplication of resources and the need for inter-departmental liaison when it would be far more efficient if one department dealt with the matter. It also results in additional reporting burdens on businesses when they have to report essentially the same information to two different government departments.

3.0.4 Liberal Democrats believe that government closer to the people is better government. When it comes to such matters as economic development, we believe that regional differences mean that this function is better performed at regional level. At present, the DTI has a number of regional offices which to some extent overlap with the existing Business Link network. This is a further example of both inefficient use of public resources and a service that is unfriendly to the needs of its users.

3.0.5 Liberal Democrats will abolish the DTI thus simplifying and clarifying the role of government in relation to business, saving

costs for both business and government and setting business free from unnecessary red tape.

## 3.1 Department for the Consumer

3.1.1 This department will be responsible for ensuring that the open market operates successfully and in the interests of consumers. It will carry out the competition and consumer protection functions currently within the DTI. Since most of these functions are already undertaken by government agencies it will be a small department. The Minister's primary tasks will be to appoint the heads of the agencies and set their budgets. Both these matters will be subject to parliamentary scrutiny by a Consumer Select Committee. In addition it will continue to be responsible for providing information to consumers to help them understand and access their rights. We envisage the continuation of the model of the online Consumer Gateway.

3.1.2 The principal agencies for which the department will be responsible are: the Office of Fair Trading; the Competition Commission; the Food Standards Agency which will be transferred from the Department of Health; OFCOM which will be transferred from DCMS; and the Financial Services Authority, which will be transferred from the Treasury.

3.1.3 Sectoral regulators that have concurrent competence with the Office of Fair Trading in competition matters will be accountable for their exercise of those competencies through the new department.

3.1.4 The Minister for the Consumer will act as the voice of the consumer in government.

## **3.2 A Cabinet Office Minister for Business**

3.2.1 Liberal Democrats recognise the need for business to have its concerns taken into account by government. We would establish a Cabinet rank post within the Cabinet Office to be responsible for not only the Deregulation Unit as at present, but also a number of functions carried out currently by agencies that are accountable to Parliament through the DTI. These are functions that cannot sensibly be devolved and would not be appropriate functions for the new department, such as Companies House, the Insolvency Service and the Patent Office.

## **3.3 Other Departmental Changes**

3.3.1 The transfer of other functions from the DTI will further lighten government .

- Energy will be transferred to the Department of Environment, Energy and Transport.
- Employment matters will be transferred to the Department for Work and Pensions which will also be required to observe a liberal deregulatory approach.
- Research will be transferred to the Department for Education.

3.3.2 The Treasury currently exercises influence and power far beyond the remit of stewardship of the economy and the raising of revenue for government expenditure. Too much is now driven by the Treasury. A Liberal Democrat government will therefore need to restrict the powers of the Treasury. A central feature will be the creation of an independent body accountable to Parliament (comparable with the Monetary Policy Committee of the Bank of England) which will monitor and evaluate fiscal policy, in particular the nature and structure of taxation.

## **3.4 Greater role for RDAs**

3.4.1 We will devolve most government activity in promoting business to the regions.

3.4.2 Regional government exists already in England: it consists of appointed boards, trusts and quangos including regional development agencies (RDAs). RDAs are involved in the economic development and regeneration of their own regions.

3.4.3 Each English region currently has a voluntary appointed body (Assembly) made up mainly of local authority representatives but also of economic and social stakeholders. RDA boards are currently appointed by central government but Liberal Democrats will give the Assemblies the right to veto individual appointments to the boards. RDAs will be required to answer to the assemblies for their actions, plans and strategies.

3.4.4 We anticipate that over time each region will choose to have its own elected assembly and government. Once established, a regional assembly will take over responsibility for the RDA within its area. Liberal Democrats will end central government interference in regional economic development.

3.4.5 In the mean time, we will reform RDA boards so that they are more representative of the regions in which they operate. This will ensure that there is a voice for small businesses as well as large employers within RDAs. We see the involvement of a broad range of stakeholders as essential to economic development and prosperity.

3.4.6 The budgets for the Small Business Service, business promotion and facilitation currently managed by the DTI will be devolved to RDAs. Regions will thus be able to establish within a national and European framework their own regeneration and business development strategies through the RDAs.

## 3.5 Regulating the Regulators

3.5.1 Currently, regulators in the UK are inadequately accountable. It would be inappropriate to allow regulatory bodies to be subject to political intervention on operational matters. Regulators in that respect must be free to get on with the job they were set up to do. The policy direction however needs to come from Parliament which should lay down the principles by which regulatory bodies should operate.

3.5.2 We would ensure that each regulator is subject to strategic (but not operational) ministerial direction, and accountable to a Select Committee which will be able to question directly the chief staff of the regulatory bodies on the model of the Bank of England and the Monetary Policy Committee. The regulators (the Chairman of

the OFT and Competition Commission; Directors General of OFSEM (our proposed regulator for the sustainable energy market), OFWAT, OFCOM, FSA etc) would be nominated by the responsible departmental minister and then interviewed and vetted by the Select Committee. If there were a dispute, the Minister would prevail but the Select Committee would publish any criticism.

3.5.3 The regulators would be available to be regularly interviewed by the relevant Select Committee on the basis of the annual report, any major controversial decision or issue of significant public importance.

3.5.4 The Public Accounts Committee would establish procedures of good practice to ensure common standards of transparency and scrutiny between the regulators.

# Regulation Versus Deregulation

4.0.1 Regulation is a burden on business and should be kept to a minimum. Liberal Democrats will therefore focus regulation on the key areas outlined in this chapter. We believe the government should justify new regulations and the continuance of others. We will therefore require the publication by the government of an impact assessment for each major new regulation at the same time as the publication of the regulation itself. These regulatory impact assessments must be made consistent between government departments and should be carried out by an agency removed from day to day government control. We will also put a sunset clause on all new regulations. Any requiring renewal will be brought to Parliament where Ministers will be required to justify their continuation.

4.0.2 Furthermore, while respecting the fundamental distinctiveness of the British common law system, Liberal Democrats would move towards drafting regulations that implement EU Directives in broad purposive terms rather than, as at present, in detailed prescriptive ones. Regulation would become more flexible and permissive.

4.0.3 There are three main areas in which Liberal Democrats recognise the need for government intervention in the economy: enhancement of competition; regulation of network monopolies; and protection of consumers, workers and the environment.

## 4.1 Enhancing Competition

4.1.1 Our primary objective is to enable the mechanisms of the market economy to work effectively. Ensuring markets are competitive will form the main thrust of regulatory activity. This entails, for example, strong anti-trust legislation to counter monopolies and cartels. There has been a spurt of legislative action in this field. The Enterprise Act (2002) completes the process of making the competition authorities independent of day-to-day political interference and provides strong powers to act against cartels and to

stop mergers which reduce competition. We support these measures while recognising that strong domestic competition policy is not yet matched by effective anti-monopoly policy at an international, especially global, level.

## 4.2 Network Monopolies and the Post Office

4.2.1 The characteristics of network services such as the railways, electricity, water and arguably the Post Office collection and delivery system make competition difficult to achieve. While there is a role for competition, there is no sense in duplicating the network itself. We consider it appropriate to regulate the terms of access to the network so that effective competition takes place at the service delivery level.

4.2.2 The task of network regulation is to balance the potentially conflicting objectives of control over monopoly prices and maintaining investment; and encouraging competition whilst maintaining a universal (or in the case of the railways, widespread) service.

4.2.3 The DTI has direct responsibility for running the two distinct networks within the Post Office. The first, the collection, sorting and delivery system is a publicly owned monopoly, Royal Mail. This now has a degree of commercial freedom together with an independent regulator. It is subject to a limited degree of competition designed to reconcile the need for greater efficiency and innovation with the obligation to supply all parts of the UK with a letter service at a uniform price (Universal Service Obligation or USO). The commercial freedom is necessary to remove the crippling effect of Treasury control. Previously the government had for many years siphoned off almost all profits which had prevented the Post Office from making new investment to respond to

the growing competitive challenges of fax and email.

4.2.4 The Post Office now faces some tough decisions. It is making large losses. Competition with its core network seems likely to make the problem worse financially and threatens to undermine the USO. Liberal Democrats believe that there is a role for increased competition to be phased in by European Directives to ensure access to the Single Market for British businesses. In order to maintain universal delivery new commercial entrants should pay a levy towards the USO.

4.2.5 A more contentious issue is privatisation. The current hybrid status of a commercial, publicly owned network is arguably not delivering either a commercial approach to business or a strong sense of public service. Liberal Democrats have argued that a fully independent entity – along the lines of a mutually owned public interest company – would be an ideal answer. But we are increasingly coming to the view that a privatised Post Office – with a USO and a regulator – on Dutch lines could have a better chance of succeeding than the present structure.

4.2.6 An entirely different set of issues concerns the Post Office network of sub post offices. Liberal Democrats have campaigned strongly against the precipitate and large-scale closure of post offices under the so-called Urban Reinvention programme (most post offices are in effect being subsidised to remain open). This is almost entirely a consequence of the 40% or so loss of income consequent upon the introduction of ACT (the automated credit transfer of benefits and pensions to bank accounts). Technology must not and should not be stopped from yielding efficiency gains but there is no justification for the bureaucratic obstacles being placed in the way of those who wish to continue to use the Post Office. Far more can be done to help Post Offices generate new income streams by developing general practitioner advice services on suitability of financial products especially for people on low incomes.

## **4.3 Intervention to Protect Consumers, Workers and the Environment**

### **Consumers**

4.3.1 Consumers must be free to make their own choices about the goods and services that they purchase. That freedom depends on the information that affects each decision being readily available and understood. With complex products, like pensions and insurance, consumers need the relevant information about competing products to be supplied in a manner that facilitates comparison. In other cases, including pharmaceutical products, technical information needs to be presented in readily comprehensible language. We believe that this is best dealt with by voluntary industry codes of practice. Only where such codes do not result in an effective flow of information to consumers should government then intervene.

4.3.2 In some very limited circumstances businesses do provide services of particularly significant community benefit. For example, pharmacies act as a de facto extension of the health service. Closure of a pharmacy often means the end of this service in a community. This increases the burden both on people who cannot easily travel to the nearest alternative and on the local GP service. Pharmacies currently benefit both from restriction on dispensing prescription drugs and from regulation supporting retail prices charged for the sale of non-prescription drugs. This is an example of the true cost to society of the provision of a service being reflected in the price charged to consumers. Liberal Democrats oppose the current proposals to deregulate in this area.

4.3.3 The new regime of consumer protection introduced by recent legislation including the Financial Services and Markets Act, the Enterprise Act and the Competition Act gives considerably enhanced powers to the consumer protection authorities which they are now beginning to use. We particularly welcome the introduction of Stop

Now orders which can provide a speedy and effective remedy against unfair traders.

4.3.4 However, there are still three major weaknesses at present in the consumer protection field. First, good legislation often cannot be enforced at a local level because trading standards services are under-resourced. Following the abolition of the DTI we would redirect resources to enhance the effectiveness of the trading standards service.

4.3.5 Secondly, there is no over-arching provision to deal effectively with the dozens of scams and abuses which operate within the letter, but not the spirit, of the law. Examples include aggressive doorstep selling, cowboy builders and estate agents who fabricate other offers to pressure house buyers to increase the price that they will pay. The European Union is currently framing a general duty to trade fairly with consumers throughout the Single Market. Liberal Democrat MEPs are pressing for this general but absolute and enforceable duty to replace hundreds of complex, prescriptive regulations that exist at present. Business would then be free to introduce industry codes of practice that would be more appropriate, responsive and flexible than current regulation. Consumers would have the security given by the law if the codes of practice failed to produce fair markets.

4.3.6 Thirdly, there are some well-established monopolist and oligopolist practices that have not been tackled, as they should have been, by the competition authorities or the government. The Cruickshank Report made a strong analytical case that there is systematic excess profit within the bank clearing system but the government has so far failed to introduce the regulatory intervention which the Report recommended and the Government promised.

## **4.4 Protection of Workers**

4.4.1 An employer can potentially have considerably more power than an individual employee particularly in the non-unionised environment that now prevails in the private sector. Liberal Democrats believe that it is proper for the government to set a regulatory framework government that ensures fair treatment in the workplace particularly in relation to health and safety matters.

## **4.5 Protection of the Environment**

4.5.1 It is longstanding Liberal Democrat policy that environmental considerations must be at the heart of all decision-making. We believe that government intervention to ensure that this happens in business is necessary and justified.

# Sustainability

5.0.1 In a genuinely free market economy, the full cost of the production of goods and services is covered by the price charged to the customer. Those manufacturers who are able to reduce costs will be more competitive and more likely to gain a larger share of the market for their goods.

5.0.2 At present however, all costs are not in practice included in the prices charged for many goods and services. Many activities and manufacturing processes generate costs that are borne by taxpayers rather than purchasers. The most significant cost not directly covered in the price paid is that of pollution.

5.0.3 Tackling pollution at source requires a mix of regulation and fiscal measures under the polluter pays principle. In this way the relevant consumers will meet the true cost of pollution. The market will have an incentive to move towards cleaner activities and reduce pollution.

## 5.1 Carbon Tax

5.1.1 In a previous policy paper (*Agenda for Sustainability*), Liberal Democrats have argued the case for a carbon tax. Instead of the cumbersome, complicated and inefficient Climate Change levy, a tax will be levied upstream on the carbon content of primary fuels. We continue to support that policy.

## 5.2 End of Life Directive

5.2.1 Liberal Democrats welcome the continuing implementation throughout the Single Market of the general principle of making the manufacturer responsible for the safe disposal of a product at the end of its useful life. This obligation will push manufacturers to include the cost of disposal in the price of goods. An incentive is thus created to include as high a proportion of recyclable components as possible.

5.2.2 The implementation of the EU Directive has been handled badly by the UK and other national governments and continues to cause substantial problems. Insufficient thought was given to the implications of the End of Life Directive and a mountain of fridges has accumulated.

5.2.3 The position in relation to vehicles is even more serious since the government has given into pressure from the car industry and put responsibility for disposal onto final owners. The manufacturer's responsibility for disposal only comes into operation in 2007. Currently, vehicles that come to the end of their useful lives have no scrap value, indeed, disposal companies often charge for disposal. Many vehicles have therefore been abandoned by their final owners and local authorities are paying for recovery and disposal. In effect this is acting as a subsidy by the general community to the motor industry.

5.2.4 We would consult with manufacturers and local authorities with a view to bringing forward the date when vehicle manufacturer responsibility for disposal comes into force.

## 5.3 Tradable Emissions

5.3.1 Capping the level of production of certain types of pollutants and then selling rights to produce them puts a price directly on unsustainable activities and creates an incentive to switch to cleaner, more sustainable activities. Since pollution knows no international boundaries international agreements are necessary to establish limits on and markets for tradable emissions. We would continue to push for the international ratification, implementation and expansion of the Kyoto Agreement and its successors.

## 5.4 Aviation

5.4.1 Over the past few decades, aviation has grown substantially. Liberal Democrats

believe that, applying the polluter pays principle, the sector should pay the full costs of its impact on the environment. This must include the effect on transport infrastructure of passengers travelling to and from airports.

5.4.2 Environmental taxation needs to be applied to aviation fuel to encourage the use of more fuel-efficient aircraft.

5.4.3 The aviation market is badly distorted by the system of landing charges which in effect subsidises airlines at major UK airports and by the government's own anti-competitive practice of grandfathering landing slots, thus favouring certain major airlines. Liberal Democrats would auction these slots, raising substantial revenue and ensuring that a fair price is paid for a scarce resource.

5.4.4 Liberal Democrats will start work soon on the details of aviation policy and a full

policy paper will come before conference in September 2005. This will look in more detail at how aviation can cover the cost of the environmental damage it causes through mechanisms such as aviation fuel tax or landing charges based on market demand.

## **5.5 Energy White Paper**

5.5.1 The Government published its Energy White Paper in February 2003. Liberal Democrats believe that there is much that is worthy in the paper as it aims to increase sustainable supplies of renewable energy in the future. It is, however, shallow on how the targets are to be achieved. Liberal Democrats are currently working on a separate energy policy paper which will come to conference at the same time as this commerce paper.

# Employee Rights

6.0.1 The Liberal Democrats will shortly begin preparations for a policy paper on trade union and employee rights. That paper will be put before conference in spring 2005. It will consider in detail the matters raised in this chapter.

6.0.2 Our current policy is based on several broad principles: basic human rights need to be recognised; the labour market must be flexible, the workforce is a company's main resource and minimum standards for the employees of a firm must be maintained.

6.0.3 There has been a major workforce transformation in the last two decades. The combination of Conservative legislation on trades unions and structural change towards services from manufacturing industry has left the private sector largely non-unionised. Private sector workers' rights are now being defended primarily through regulation rather than union bargaining. The cost of complying with regulation is becoming a major issue, especially for small businesses and for large, mobile international ones. By contrast, unions retain significant negotiating power within the state sector where the employer – at one remove – is the public.

6.0.4 The use of regulation to reinforce employees rights has to be balanced against the cost since raising the cost of labour will, other things being equal, reduce employment. There are wider social factors to be considered and there are several areas in particular where workplace rights are under-developed or insufficiently protected.

## 6.1 Health and Safety

6.1.1 The most important of regulation is health and safety. There has been a big improvement in recent years but, still, some worryingly large figures: 280 workers were killed at work in 2000/1, and 22,400 seriously injured. Only 9% of the reported serious injuries were investigated. Of those deaths investigated, only 33% led to prosecution, and only 11% of major injuries. Prosecutions mostly took place in magistrate's courts (87% of major injuries; 40% of deaths) where penalties usually involve a derisory fine averaging around £10,000. The major remedies here are in the field of enforcement rather than new laws (a remarkably high percentage of prosecutions – well over 90% - succeed). The Health and Safety Executive needs to have the resources to investigate accidents properly. At the same time its inspections – which have fallen sharply in recent years – should be thorough but efficient, operating through a one-stop shop principle, without the duplication of visits reported by many businesses.

6.1.2 We believe that there should be a new criminal offence of corporate killing. Companies as well as individuals would be liable for the offence without any need to prove intention on the part of the controlling mind of the company. We would also raise substantially the fines payable for lesser health and safety offences leading to personal injury of staff or customers.

## 6.2 Minimum Wage

6.2.1 The Minimum Wage model adopted in the UK – a modest minimum set on the basis of advice by the Low Pay Commission to reflect overall economic conditions – has worked well in practice. We favour a continuation of the present arrangements but would extend the full minimum wage to those aged 16 to 21 fully in work unless they are on apprenticeship or training schemes.

6.2.2 There is, however, growing pressure to look afresh at the regional dimension since there are big disparities between labour market conditions in the south east and other regions. Notwithstanding the practical problems we believe that elected devolved bodies in London, Scotland, Wales, Northern Ireland and English regional assemblies when they come into existence should be free to set an additional weighting above the national minimum wage on the basis of advice from the Low Pay Commission where it can assemble appropriate regional data. The scope for regional variations is not large – if it were there would be migrations of low wage jobs from, say, parts of London to the surrounding counties – but, since we argue for a move to greater regional public sector pay differentials, it would be logical to allow this development to take place.

## 6.3 Flexible Hours

6.3.1 The most important recent advance in working conditions is flexible working: giving workers, especially women with caring responsibilities, the right to request flexible hours for work. The legislation is sensibly balanced to allow for employers to make reasonable refusals if business conditions demand it, especially in small companies where cover is difficult to secure. An arbitration system exists to reconcile differences. We support this policy.

## 6.4 Workforce Consultation

6.4.1 The government has been less progressive in respect of worker consultations. Good management does not need legislation to enforce consultation; it consults as part of good management. But there are too many companies that don't do it, like Vauxhall, for example, who rewarded workers, some with a lifetime of service, by sacking them with an announcement over the radio. The government is right to resist a one size fits all European model of worker consultations but wrong to refuse to take any

action; a statutory requirement that workers be given notice of major decisions affecting their livelihoods is not unreasonable where commercial confidentiality permits. Liberal Democrats will introduce it.

## 6.5 Strikes

6.5.1 We welcome the emergence (where it occurs) of a modern unionism which is able to act effectively for individual workers and to press management on issues like health and safety, training and flexible working while giving constructive support to innovation and more efficient working practices.

6.5.2 There remain, however, a few bastions of union militancy in privately owned utilities (the railways) but especially in the public sector. In some areas militancy and strike actions do arise from crass and bullying management which is just as much in evidence in the public as the private sector. But, in others, militant behaviour is unreasonable and causes serious detriment to third parties, that is, the general public. The upsurge of strikes in the railways, the underground and the fire service has raised the issue of whether there should be further rules regarding the right to strike, particularly in emergency and/or economically essential services. There is no absolute right or wrong in this debate; the rights of workers to withdraw their labour has to be balanced against the safety and wider interests of the general public. There is a legal bar on strike action for the police and the armed forces already; and there are emergency powers which could be used to cross picket lines in disputes like that raging in the fire service. Particularly bearing in mind the unhappy history of government attempts to legislate prescriptively in this area we suggest caution. But mechanisms need to be strengthened to head off strike action when the consequences for the public are potentially very serious.

6.5.3 We therefore propose ministers should have powers to enforce compulsory arbitration though the results would not be binding. Such arbitration would provide a means of restraining unreasonable and

precipitate action. The appropriate minister would only invoke compulsory arbitration where there is both a safety issue and an

issue of national economic importance; if this fails to work in practice, the route of binding arbitration may have to be considered.

# Corporate Governance

7.0.1 In our 1995 policy paper *Investment, Partnership, Sustainability*, we said:

7.0.2 *“The culture of short-termism must change. Those companies that operate in a globally competitive market need to take a strategic view of their direction. It is profoundly in their self-interest, and also in the self-interest of their investors, to take a long-term, rather than a short-term, view.*

7.0.3 *“There is no simple way of achieving such goals: the changes required are a process, not an event. Legislation by itself can only have a limited effect – existing company law points directors towards long-term sustainable growth in value, not maximising short- term profits.*

7.0.4 *“To this end, Liberal Democrats endorse the aims of the Final Report of the Royal Society of Arts’ Tomorrow’s Company Inquiry, which argues that all relationships with stakeholders must be measured, developed and positively managed, to maximise a company’s sustainable value over the long term. It highlights the importance of qualities such as loyalty, trust and respect for the individual and argues that intangible factors, for example intellectual property, innovation and quality, are the strongest determinants of competitive success.”*

7.0.5 Since then, much water has flowed – in the right direction - under the bridge of corporate governance; most of it as we (and the *Tomorrow’s Company Inquiry*) then advocated.

7.0.6 We warmly support the proposals of the Company Law Review, and in particular:

- The proposed statutory statement of directors’ duties;
- The proposed Operating and Financial Review for listed companies, which would go beyond historical financial outcomes to include stakeholder relationships within a far deeper treatment of a company’s purpose, strategy and key

drivers of performance, as well as social, ethical, community and environmental issues;

- The proposed requirement for listed companies to publish their accounts on the web in the first instance so as to make it easier for shareholders to propose resolutions for discussion at Annual General Meetings.

7.0.7 A new Companies Act should put these proposals into law as soon as possible. Recent corporate scandals have highlighted the need for a thorough review of corporate governance, and in particular of the respective roles of non-executive directors (NEDs) and auditors.

7.0.8 The former has been well handled by the Higgs Review, which recently recommended that half the directors of listed companies should be independent, and made further recommendations to toughen up the roles of chair, senior independent director and key board committees. Higgs rose above his somewhat narrow terms of reference, and has set down a most welcome framework for holistic corporate governance. He was right in particular to point out the cronyism which disfigures much of the appointment process of NEDs, resulting in amongst other things, an unacceptably low proportion of women and ethnic minorities on British boards; and to attack excessive remuneration (especially in cases of poor performance), and the inappropriateness of granting options to NEDs.

7.0.9 We accordingly believe that the Higgs proposals, which operate on a comply or explain basis, should with only minor alterations, become part of the Combined Code on Corporate Governance for listed companies. But we go further by saying that if, after a reasonable transitional period, it transpires that the volume of explanation exceeds that of compliance, then mandatory provisions may be needed on at least the key points.

7.0.10 As regards auditing, we accept that, not least for reasons of quality service, there should not be a rigid separation between accountancy firms providing audit services on the one hand and performing advisory work on the other. At the same time there has to be a means to prevent conflicts of interest through under valuation of audit work. We also support requirements for the rotation of audit partners.

7.0.11 We support the end of self-regulation and the creation of a tough independent regulator of the accountancy profession. The regulator should provide clear guidance - including restrictions - about the provision of non-audit services by the auditor.

7.0.12 We also welcome the introduction by the government of the new regime for directors' remuneration to deal with fat cat pay, but would make shareholders' votes in this regard binding upon company boards. We have a lot of sympathy with the Bill proposed by Tory MP Archie Norman designed to stop large pay-outs to failed executives but believe this is better achieved by ensuring that shareholders understand and affirm the contractual terms on which their managers are employed. At present shareholders can vote on remuneration packages but the votes are not binding. We will make the vote binding. Shareholders should be represented on remuneration

committees by a majority of non executive directors. Workers will also be represented.

7.0.13 We believe that institutional investors should take a more pro-active interest in their investee companies, not least in the interests of their ultimate beneficiaries; in this regard, we welcome the recent Statement of Best Practice by institutional investor bodies. Finally, we welcome the increasing growth in Socially Responsible Investing, and the ongoing debate relating to Corporate Social Responsibility.

7.0.14 There are, however, a number of serious and complex policy issues which need to be addressed as to the entire operation of the investment sector, and the need for transparency and accountability by financial institutions. At the very least, there should be a formal Code of Practice governing their operations including the publication of their voting records. The Code should also cover fund managers' suitability for appointment, training, remuneration and nature of contact with companies in which their funds are invested. Annual reports of financial institutions should publish relevant information on the Code. In this context, we welcome the Inquiry established by The Centre for Tomorrow's Company under the chairmanship of Sir Richard Sykes, not least as its mandate is to take a holistic overview of its remit. We will return to this topic following its report.

# Promoting Small Business

8.0.1 Small businesses are crucial to the success of the UK economy. They are the cradle for the large businesses of the future and employ a considerable proportion of the workforce. To have a vibrant small business sector, the spirit of enterprise should be nurtured in all sectors of the community, enabling everyone who wishes to, to embark on their own enterprise regardless of age, ethnicity or gender.

8.0.2 The Liberal Democrats are dedicated to encouraging enterprise so that people are able to use their own skills, ideas and knowledge to prosper.

## 8.1 Facilitation by Government

8.1.1 The government has a dual role to play in facilitating business. It must first of all create an environment in which business can prosper, which means providing the backdrop of a financially stable and successful economy, coupled with sound infrastructure, in terms of good transport links and skills training. Moreover it must develop an environment in which services are accessible to small business and at competitive rates, including banking and insurance services.

8.1.2 Banking costs have been notoriously costly and insensitive to small business. The Cruickshank Report demonstrated the extent of over pricing by the leading clearers and following a report by the competition authorities some limited action has been taken though it falls short of the comprehensive improvement to the clearing network recommended by Cruickshank.

8.1.3 Many small businesses have been put at a severe disadvantage by the escalation of charges for employee and public liability insurance. There are several contributory factors but the growing costs of no win, no fee litigations is a factor. Another is the disinclination of the insurance industry, dominated by a handful of firms, supplying

insurance to millions of customers, to introduce policies, like car insurance, which reward good no-claims performers and penalise repeat claims. The government will need to rectify the market failure if the industry does not do so voluntarily.

8.1.4 Not just in relation to the banking and insurance sector but elsewhere, small business is often in a vulnerable position in relation to monopoly or semi-monopoly suppliers (e.g. newsagents and independent petrol retailers) or oligopoly purchasers (supermarkets versus small farmers). The competition authorities must pay special attention to these cases.

## 8.2 Business Support

8.2.1 Most small businesses neither receive nor expect direct help from government. Liberal Democrats support the concept of a national Small Business Service (SBS) which would advise government ministers on all matters, including legislation and the impact of taxation, relevant to the SME sector. The national SBS would be independent of any specific department in its day to day operations though its budget would come via the minister responsible for business issues. Such independence would allow the service to take on a powerful remit and to truly act as the champion for the SME sector though it will have to account for its actions by publishing an annual report and senior staff will be answerable to the Small Business Select Committee we propose below.

8.2.2 The Small Business Service will be the key provider of advice to businesses and therefore its structure and delivery must be decentralised. Liberal Democrats will achieve this through Regional Development Agencies that will provide one stop shops for all advice and assistance required by small businesses. These will link to the one-stop information portals recently introduced throughout the Single Market by the European Commission. They will be based initially on the existing network of Business

Link outlets. Outreach advisers could also be based part of the time in business incubation and nursery units which local authorities will be encouraged to develop.

8.2.3 The main regulators dealing with businesses, such as the HSE and the Environment Agency, will also have a presence in each one stop shop. The aim is to provide the full range of advice, information and expertise required for those wishing to set up in business, expand existing concerns or take advantages of trading opportunities elsewhere in the Single Market.

8.2.4 Where elected regional governments are created, the RDAs will become directly accountable to them.

8.2.5 A strong link needs to be created between education and skills training and the business community, with vocational and on-the-job training being given more formal recognition by the business sector. Such recognition would create a greater incentive for employers to provide training, and for employees to engage in it; thus creating a more skilled workforce. We support the introduction of an extended Right to Study for 16-19 year olds without a Level 3 qualification, in order to help the 15% of 16-19 year olds in work but not in formal learning to get the occupational or work-based training they need. But it needs to be applied flexibly in small firms for whom the release of staff, even for desirable objectives, often presents commercial problems.

## **8.3 Regulation, Red Tape and Small Business**

8.3.1 Specifically for small business, we would establish a single Small Business Inspectorate through which other inspection bodies would operate to streamline the inspection process for small businesses. Every SME will have a named general inspector who will visit them to assess compliance in relation to all aspects of regulation. The inspector will be encouraged to work in partnership with businesses in order to achieve compliance, although they will have the reserved right to issue immediate orders or to call in further specialist inspectors from existing regulators such as the Health and Safety Executive, Trading Standards as necessary. However the named general inspector, will continue to be the point of contact for the small business, and will liaise with the business and the specialist inspector. Businesses will be assisted with compliance through the adoption of the comply as complete principle, which supports the idea of providing easy to understand guides to businesses covering all areas of regulation so that they are able to check whether or not they are complying with regulation.

8.3.2 The DTI currently operates a huge range of assistance programmes for business. This situation is complicated and confusing. The budgets for these should be devolved to RDAs which shall be given responsibility for establishing their own streamlined programmes within an overall framework set by the government.

8.3.3 We will, however, reform RDAs to make them more representative of the stakeholders of the region and will bring them under the umbrella of the elected regional assemblies once they are established.

8.3.4 As already noted, businesses of all sizes face a bewildering array of government regulation and red tape. Businesses in their first year of existence are at their most vulnerable. Liberal Democrats will therefore task the Small Business Service with carrying out a review of all regulation beyond

basic safety requirements, with a view to setting a red tape holiday for the two years of operation for a small business.

## **8.4 Taxation and Small Business**

8.4.1 The current system of taxation is overly complex, and provides a barrier to business growth. We would work towards creating a simpler system of taxation, which does not act as an additional burden on business. In particular we would support a simplification of the current VAT system.

8.4.2 As an interim measure to provide instant relief for small businesses a business rates allowance will be introduced, which will act in the same way as a personal tax allowance, providing rate relief for businesses with a rateable value below a prescribed level.

8.4.3 We would cut down on the administration currently demanded by the Inland Revenue, as much of it is repetitive or unnecessary. In effect, businesses are acting as tax collectors for the government and this is a burden especially for small

businesses. To compensate businesses, at least in their early years, for the burdens they carry on behalf of government, we would allow businesses to claim a tax allowance for regulatory compliance. One possible mechanism could be allowing, for example, a business to retain the first 20% of income tax paid by the first employee up to an annual cap of £1,000 for a period of five years. This could assist small businesses which, when wishing to take on a first employee, are faced with considerable set-up costs. The costs, particularly in time of taking on further employees becomes proportionally less of a burden. It would be reasonable therefore to establish this tax retention scheme only for the first employee and for a limited period. This is only one of several possible ways that we are considering of offsetting the costs of bureaucracy.

8.4.4 Liberal Democrats are keen to ensure the concerns of small businesses and their role within the economy are understood generally by MPs. To facilitate this and to give Parliament the opportunity to scrutinise government actions in this area we would set up a Small Business Select Committee.

# Government Involvement / Non-Financial Aid in UK Business Promotion

## 9.1 Starting Point

9.1.1 We have already noted that the UK government is limited by what it can do by international treaties and national laws. Attempts to create UK national champions have frequently failed. Nor is it consistent with a liberal outlook on free markets and the efficient allocation of resources. The existence of government golden shares has continued in some companies – BAe Systems and BA – the dangerous idea that the government has some political obligations to protect them from their commercial competitors. This practice has now been ruled by the European Court of Justice to constitute illegal state aid. We do not think it appropriate for government to manipulate or participate in the market in either manner. Neither picking winners nor bailing out failing businesses is the proper function of government.

9.1.2 The following are the areas Liberal Democrats accept as being appropriate for government assistance:

- Negotiating voice;
- International treaty negotiation;
- Legislation drafting.

9.1.3 This is about setting the rules of the game and making sure that UK producers and consumers are not disadvantaged in the international arena. A prime role for central government and one that the UK traditionally does well. Whilst government should not be beholden to commercial interests business views have to be taken on board, and are vital to make sure that international agreements and national legislation are workable. There remains the grey area of how far should government get involved in issues of implementation and interpretation affecting British companies which come before the international judicial machinery—e.g. over US discriminatory action on steel imports at the WTO, ECJ court cases over EU legislation, lobbying etc. This will need to

be judged on a case-by-case basis, with an inherent bias towards non-involvement.

## 9.2 Issue Education

9.2.1 There are numerous issues that need to be explained to business outside the excitable glare of media attention. Recent examples include Y2K and the Euro. Whatever one's views are on the Euro, it is important that, if a decision to enter were made, business should be prepared for the transition. Websites and mailing shots have to be used appropriately. In extreme circumstances (e.g. the UK introduces the Euro) limited assistance should be made available for clearly defined periods only.

## 9.3 Regulatory Assistance

9.3.1 We propose elsewhere in this paper the creation of one-stop shops to help firms deal with all regulations applied to them. Run under the direction of RDAs, they will be set up mainly with new and developing businesses in mind. However their services will be available to other businesses as well. They will provide information online through Knowledge Management systems. One stop shops will also provide advice on regulatory paperwork, basic examples of employment contracts, and lists of specialists for further problems and so on. Frontline feedback can be fed back to the government to spot contradictory or superfluous regulations which can be re-examined.

## 9.4 Regional Policy

9.4.1 The folly of trying to deal with regional imbalances by bribing foreign investors is well illustrated by the fiasco of LG, the Korean electronics company, which quit South Wales five years after receiving £100 million from the government. With the decline of consumer electronics and telecommunications in the current manufacturing recession, some of the UK's employment black spots like Clydeside, Merseyside and Tyneside have recently boasted success in attracting inward investment especially in new services such as call centres and processing centres (information factories). They have available low skill labour with land available to build easily and cheaply the units required to house such businesses.

9.4.2 Given the rise of India and other low-cost countries that combine English-skills with high levels of education and extremely low costs the future of these information factories in the UK is looking uncertain. Barring extreme political insecurity (an Indo-Pakistan war for example) it is likely that globalisation will see China and India developing their competitive advantage in (respectively) labour intensive manufacturing and services. The world will evolve into a situation where goods are made in China and services provided from India. This is not something that Liberal Democrats resist since it will ultimately help to lift millions of people out of poverty, but it could have a major effect on specific parts of the UK. Yesterday textile mills, tomorrow call centres.

9.4.3 This then leaves the question as to how best to assist depressed regions. Whilst Liberal Democrat policies around education and infrastructure are vital to the long-term ability of our economy to create and retain high-skill, highly-paid jobs the emphasis is on the long term. In the shorter term assistance to adjust is needed to limit the social side-effects of the loss of key local employers. In addition, steps are needed to reverse the unhealthy long-term trend in the UK towards continued demographic and economic drift towards the South-East.

Nationally, the government has a role in using its planning powers to stop the imbalance in infrastructure – airports for example – widening even further.

9.4.4 The role of regional government in tackling divisions is important. The relative success of bodies like the Scottish Development Agency and the Highlands and Islands Development Board suggests a model for using local knowledge and commitment that could be extended elsewhere. Regions should be free to draw up their economic development strategies. Businesses will look for the right location based on availability of a skilled workforce, good transport, easy access to major markets, and the availability of premises and good support services. Short-term tax concessions and grants are unlikely to promote a stable long-term future.

9.4.5 Liberal Democrats would devolve expenditure currently carried out by the DTI to RDAs working to the mandate of regional assemblies.

9.4.6 There is scope for some pump priming in terms of tax or business rate concessions in some limited circumstances. Regional administrations could be allowed to use these in limited circumstances whilst recognising the costs and dangers of a bidding war.

## 9.5 International Trade Promotion

9.5.1 It has traditionally been assumed that one of the roles of government is to promote the exports of British companies abroad. The mercantilist assumptions behind this policy have always been questionable and are all the more so now that it is increasingly difficult to define British companies. The FCO claims a key role in promoting UK companies and products abroad. Nearly 1,500 FCO staff equivalents (including DTI and private sector secondees) are engaged in commercial and investment work (about 350 UK-based and just over 1,100 locally-engaged). This effort is backed up by strong Ministerial and Royal involvement and

interest, and typically attracts FCO high-flyers.

9.5.2 Historical focus has been on supporting manufacturing, and given the high level of government input required and the relative competitiveness of the sector in the UK, this has tended to focus on encouraging arms sales. Promoting arms sales – especially to developing and emerging economies – frequently gives rise to conflicts between companies and national interests and is not an appropriate aim for British civil servants and we would end such activity.

9.5.3 One specific way in which trade promotion occurs is via the Export Credit Guarantee Department. It breaks even but is not expected to operate on a fully commercial basis. Providing guarantees to cover insurable losses is arguably not an area in which the government should be involved especially as it is arms exporters that primarily benefit from this activity even though they do not require such government support. Liberal Democrats would therefore cease to provide export credit guarantees to arms exports saving an estimated £250 million a year. There is a serious question mark over whether the government needs to be in the business of providing credit guarantees at all. Indeed we see no reason why ECGD should remain in the public sector.

9.5.4 More broadly, many major non-arms manufacturing companies are no longer British. It is reasonable to question how much support the British government should be giving to what are effectively large, multi-national companies. For example, helping Mittal buy Romanian steel works could be viewed as wholly inappropriate use of taxpayer's money. Trying to focus on production in the UK (made in the UK) is nonsense in a world of sophisticated and flexible supply chains – not because it does not happen but because nimble, well-connected multi-nationals are at least as likely to take advantage of this as purely British firms.

9.5.5 Succeeding rounds of GATT have pushed services to the fore and this is an

area of British expertise. Once again – apart from in the legal world relatively few of the service companies based out of the UK are British. And those legal firms would probably be better served by legislation to ensure that British commercial law remains a cornerstone of the international system.

9.5.6 Government contracts are increasingly on offer around the world (whether through privatisation, contracting-out, public-private partnerships) and occasional HMG support may be important in closing such deals or providing bidder credibility. This should be used selectively as it is an area open to abuse – however it would be naïve to insist that UK government would simply ensure a level playing field by not becoming involved.

9.5.7 Deploying a Rolls-Royce service to sell Minis seems inappropriate and reduction in the level of British commercial assistance would free up valuable resources (more in human than financial capital). There would be space to refocus resources from mainstream OECD missions (in markets where Government assistance should not strictly be necessary in properly functioning markets) to emerging markets (where information may be harder to find, assistance more useful and implicit HMG involvement critical). It would also end the ludicrous situation where the UK cannot afford to staff Embassies on the world's flashpoints (e.g. Central Asia) because we need huge resources in, say, Berlin.

## 9.6 System Guarantor of Last Resort

9.6.1 There are occasions when the government has to intervene to prevent the collapse of one company leading to widespread collapse. The fate of Railtrack shows that there are some services that the UK government has to guarantee. There is a delicate balancing act between heading off disasters before they occur (hence limiting the cost to the taxpayer) and introducing moral hazard in the management of such firms (if they go bankrupt, then shareholders lose everything). In our view British Energy was a good example of a company which should have been allowed to proceed to administration to minimise taxpayers' exposure, with government assuming the responsibilities associated with nuclear

safety and decommissioning but not the commercial side of the business.

9.6.2 Government support is also necessary to prevent a collapse in the economic infrastructure. A major banking failure for example could cripple the economy and government remains, as it should, lender of last resort to the major clearers. We note the gradual extension of government responsibility for insurance underwriting, largely for terrorism risk. The government should not be providing insurance which can be secured through the market (as is the case with aviation and animal health) but circumstances will arise where an industry of economic importance could collapse because risks are not insurable, and there may possibly be a role for government in such cases.

# The Availability of Financial Capital

## 10.1 Background

10.1.1 A key ingredient for a successful UK economy is a broad and deep market for financial capital. Financial capital must be available in sufficient size, in a variety of forms (debt, equity, hybrids, etc.) and through a sufficiently diverse set of distribution methods to accommodate the range of companies operating in the UK. The cost of capital must be as competitive as possible whilst still allowing providers to earn sensible risk-adjusted rates of return. We must also ensure that the retail financial market operates efficiently as this increases the opportunity for individuals to convert real estate into capital for investment in the economy.

10.1.2 The financial services sector is one area where UK firms and the City of London are strong and play a leading role on the international stage. Liberal Democrats appreciate the contribution of the sector. There is little the government needs to do to maintain this position but much it could do to harm it. The adoption of the Euro by the UK would help to keep the UK at the forefront in international financial services, a point acknowledged in the Chancellor's evaluation of the five tests.

10.1.3 Lastly, financial markets pose specific problems for policy makers because the consequences of failure have spill over effects across the economies that are unique. Liberal Democrats support the Bank of England in its pivotal role in ensuring stability and its ability to act as a lender of last resort.

## 10.2 Key Aspects of the Liberal Democrat Approach

10.2.1 We remain cautious regarding government interference and will suggest this only when the case is strong. We are fully aware that frequently even well-intentioned legislation can result in serious unintended consequences and distort efficient markets.

10.2.2 One unfortunate example of this lies in the investment by UK pension funds in venture capital. An over-reaction by the government to the failure of the Maxwell pension schemes led to the creation of a formula which has resulted in under-investment by UK pensions in private equity and venture capital. This is despite the fact that London is overwhelmingly the centre for venture capital practitioners in Europe.

10.2.3 The creation of a single regulator, the Financial Services Authority (FSA), was a sensible step forward. The initial unwillingness to divide the role of Chief Executive Officer and Chairman and the limited direct accountability to Parliament however undermined the checks and balances the FSA is keen to propagate amongst the firms for which it is responsible. Liberal Democrats would separate these two positions and make both subject to confirmatory hearings by the Select Committee.

10.2.4 One of the key assumptions behind the FSA was that there would be a twin peaks approach, differentially between a lightly regulated wholesale sector and a more closely regulated retail sector. The distinction has become blurred. Consumers lacked sufficient protection and the FSA was slow to grasp the extent and damage caused by misselling of endowments, split-investment trusts and the mismanagement of Equitable Life. By contrast there are growing reports of excessive bureaucracy in the wholesale sector.

10.2.5 The government could do more to ensure that the equity and debt capital markets operate more efficiently. The government should play a more active role in ensuring that our European partners comply with existing single market legislation, thus bringing to firms across the EU the benefits of a large capital market. Moreover, the UK should more actively urge its partners to accelerate the remaining areas of harmonisation required to create a truly single financial market—the Euro is only one important aspect of this. We strongly support the work of Liberal Democrat MEPs in ensuring that the forthcoming Prospectus Directive does not bear down harshly on smaller companies.

### **10.3 Availability of Finance to Consumers**

10.3.1 From our vantage point the market seems vibrant and works well. Competition from non-UK firms and the opening of the mortgage-backed securities market has been a big factor in bringing about gradual and constructive change. Moreover, the non-property related consumer finance market has also improved measurably. Interest rates for credit card lending, for example, which had hovered at around 30% per annum, are now at levels that seem more consistent with the degree of risk involved. Such changes were not legislated but stemmed from more intensified market competition from both inside and outside the UK as well as naming and shaming of companies abusing their position.

10.3.2 Our view is that the competition authorities must be actively involved in removing or regulating the remaining barriers to competition in the bank clearing and credit card markets. Government also needs to protect consumers from unscrupulous practices but there needs to be a sustained effort to ensure that transparency of pricing continues to be a focus of the regulators.

## **10.4 Business credit**

10.4.1 We have cited already the problem of high cost of credit for small business and the need, identified by Cruickshank and the competition authorities, for curbs on manipulative practices in the banking sector.

10.4.2 At the larger end of the market conditions are strong and improving. The corporate debt market in the UK has grown substantially and companies are accessing capital in an efficient fashion. The plethora of foreign banks operating out of the City has meant, at the margin, that mid-sized and large companies get an undue amount of attention from foreign banks. Aside from the Liberal Democrat government commitment to ensure the City maintains its commanding position there is little we would propose in this regard.

10.4.3 As with the availability of debt capital to large companies there appears no significant problem with respect to access to equity capital for business as it relates to large companies. Large UK companies are, if anything over-served by a surfeit of corporate finance firms of all shapes and sizes.

10.4.4 The market for venture capital (VC) equity investment is far less efficient than it could be especially when compared to the most developed market in this regard, the United States. We also believe that the lack of breadth of the UK VC market causes even greater problems for young companies aspiring to be successful firms. In the US a rather systematic approach to investment rounds helps ensure that young companies are funded all the way through to an initial public offer (IPO). Different firms have strength at funding different stages of development and have become competent at adding value at their respective stage. In the UK, and to an even greater extent elsewhere in Europe, companies that have been funded for a round or two find it rather difficult to find further rounds of development to take them through to an IPO or large trade sale. The government should encourage the venture capital market but otherwise avoid

meddling as this can prove counter-productive.

10.4.5 Government does have a vital informational role to play in appraising participants of its view that attractive investment opportunities exist in certain areas, if in fact they do. Pushing further to achieve more progress on the single financial market, as noted above, will be a vital factor in creating a large and liquid small company listed market. While the Alternative Investment Market (AIM) is not yet NASDAQ, it has made substantial progress which we applaud. AIM is now, by far, Europe's leading small company market. Other informal technology-based markets for shares are developing throughout the UK, a trend we find encouraging and support.

10.4.6 However, at the smallest end of the market there is still a shortage of available capital. Entrepreneurs are normally forced to take out mortgages to fund new enterprises and this may at times be a highly inappropriate source of risk capital. Moreover, the home-owning population is limited. Thus there is a need to find other sources of risk capital. Existing schemes benefit the wealthiest investors with tax benefits for investment up to £100,000. VC trusts, because of their complex rules, similarly advantage sophisticated investors with access to expensive advisers. Such schemes have been minimally successful and have failed to do much to foster entrepreneurship in the economy. Liberal Democrats propose to restructure these incentives in a way that is revenue neutral

and is less likely to be a tax loophole for a few wealthy people. One option is to have a much smaller annual tax credit of up to £3,000 per annum for every single individual over 18 years of age for investment in a legitimate registered small business. For following on with further investments into the same company this would increase to £4,000 per annum. In exchange all future investment in currently existing schemes would cease, although investments already made would be protected. The beneficial impacts of this scheme would be as follows:

- Far greater participation in investment in small business by the UK population. This could have powerful spin-off benefits.
- Benefits from the tax code would be extended to a broader section of the population—not only the wealthiest.
- Critically, small investors might bring to small, young businesses more than their money. They could bring contacts, experience and other informal assistance so value to growing companies. This social capital is seriously under-exploited in the UK today.
- Finally, by putting in place a higher limit for following on with further investment in the same company in subsequent years will encourage investors to back growing companies beyond the first round.

10.4.7 The details will need to be refined and the practical feasibility established but the principle of a more broadly based system of encouraging venture capital financing is one which we wish to pursue.

# Research Funding

11.1 In the current financial year (2003/4) the DTI is planning to spend around £2 billion on science and research. Much of the day-to-day responsibility for this expenditure rests with the semi-autonomous research councils.

11.2 We believe that support for blue skies scientific research is one of the core functions of government and it is important that it is safeguarded from misguided attempts to pick winners. Placing business people in charge of research councils is superficially attractive but wrong. Business will benefit in the long run from a strong science base in which funding follows top quality scientists pursuing their own ideas and subject to the discipline of peer review. There are no short cuts and there is a danger that self-interested business people will steer research to meet their immediate preoccupations.

11.3 The Liberal Democrat approach is to seek plurality of funding with a variety of research councils and private foundations, steering away from the emphasis on a few research universities.

11.4 We need to have central government sticking to funding the science base. Meanwhile, devolved government will play a much bigger role in applied science promotion, working with local universities, FE colleges and businesses both to help promote and fund small high-tech businesses and, probably the greatest need, to help SMEs upgrade performance so that they can go upmarket and use modern design/technologies to compete in terms of quality.

*This paper has been approved for debate by the Federal Conference by the Federal Policy Committee under the terms of Article 5.4 of the Federal Constitution. Within the policy-making procedure of the Liberal Democrats, the Federal Party determines the policy of the Party in those areas which might reasonably be expected to fall within the remit of the federal institutions in the context of a federal United Kingdom. The Party in England, the Scottish Liberal Democrats and the Welsh Liberal Democrats determine the policy of the Party on all other issues, except that any or all of them may confer this power upon the Federal Party in any specified area or areas. If approved by Conference, this paper will form the policy of the Federal Party, except in appropriate areas where any national party policy would take precedence.*

*Many of the policy papers published by the Liberal Democrats imply modifications to existing government public expenditure priorities. We recognise that it may not be possible to achieve all these proposals in the lifetime of one Parliament. We intend to publish a costings programme, setting out our priorities across all policy areas, closer to the next general election.*

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*Note: Membership of the Working Group should not be taken to indicate that every member necessarily agrees with every statement or every proposal in this Paper.*

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