



18 March 2009

Rt Hon Alistair Darling MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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Dear Chancellor

CBI proposals for the 2009 Budget: Looking beyond the recession

Since the PBR, the economic outlook has deteriorated significantly. Our February forecast shows economic activity contracting by 3.3% this year and remaining static next. Beyond that, the recovery is likely to be a gradual and protracted affair. Public sector net borrowing is set to peak above 10% of GDP, while unemployment is on course to reach three million in 2010.

Beyond the recession, the drivers of economic growth will almost certainly be different to the recent past, with consumer and government spending expected to be more constrained. So business investment, exports and import-substitution will need to make a much greater contribution to economic growth than over the 1997-2007 decade. A great deal of private as well as public sector investment will anyway be needed to support UK competitiveness, help the transition to a low-carbon economy and secure the nation's future energy and infrastructure needs.

Fiscal policy therefore needs to be shaped to support international competitiveness. It follows that the tax burden in general, and the business tax burden in particular, should be prevented from rising further not just through the recession but during the recovery and beyond.

If this is to be achieved, a radical reform in the approach to public service delivery will also be required, to enable overall public spending to be reined back without unacceptable harm to the UK's economic and social policy goals. Public sector investment must be protected, with the necessary savings found from the current expenditure budget. And fiscal policy should be used where appropriate to support the shift to a low carbon economy.

The 2009 Budget should therefore be shaped with two over-arching goals in mind:

- A. Specific tax and spending policies will need to support competitiveness, employment and investment, both through the recession and permanently. That will require:
 - Reversal of key recent business tax decisions
 - Select temporary measures to accelerate the shift to a low carbon economy
 - Further initiatives to preserve and improve human capital through the downturn
 - Delivery of public sector capital projects.

- B. Households, businesses and international investors must be reassured that the public finances will be restored to health in a timely fashion, without undue damage to the nation's economic and social well-being. That will require:
 - Avoidance of any further significant fiscal stimulus
 - A freeze in non-interest current expenditure for several years after 2010/11, to minimise the need for competitiveness-threatening tax rises and capital budget cuts
 - A renewed emphasis on public service modernisation, to ensure that public service quality can continue to improve in future despite the necessary budget constraint.

A. Supporting competitiveness, employment and investment

Supporting business confidence and holding down costs

Over the medium term, the tax burden will need to be reined in and the system re-shaped, to support international competitiveness, business investment and expansion, enterprise and innovation. The CBI will continue to engage with government in the months and years ahead, on corporation tax reform (following on from our 2008 Tax Task Force report) and all other aspects of taxation affecting business.

But for this Budget, three tax announcements should take priority. First, **the employer NICs rise planned for 2011 should not go ahead** at that stage. That move would take the rate to 13.3%, up from 10% in 1997. It would hit business just 12 months before the introduction of compulsory employer pension contributions, and at a time when unemployment will still be very high. A decision to abandon the increase would improve job prospects before as well as after the planned date of introduction, due to the immediate impact on employer confidence and associated business plans.

Second, the system of **business rates relief for empty properties should be restored to the pre-2008 position**. At the very least the government should use its reserved power to increase reliefs by 50% to support struggling firms. In a declining market where it is difficult to sell, or re-negotiate new leases, empty rates harm firms' ability to cut costs and maintain

output. We have evidence of firms scaling back investment, and in places making redundancies, to pay for these liabilities, and are also aware of five million square feet of property that has been demolished as a result. The policy also disincentivises development of new premises, particularly in regeneration areas, because of the added cost should the new properties remain unoccupied on completion. The risk of future property under-supply, and associated inflationary pressures, has therefore been exacerbated.

Third, there should be **no RPI-driven adjustment to the business rates multiplier** over the next two years. This would save financially-strapped businesses from the 5% rise scheduled for this April, which is set to cost just over £1bn in 2009/10. But the RPI-driven drop in bills otherwise due in April 2010 (of around 4.4% based on the CBI's RPI forecast) would not then apply, leaving only a very modest net exchequer cost in that year. Subsequent exchequer cost could be eliminated altogether, by allowing the multiplier to revert to where it would otherwise have been from April 2011.

These measures taken together would cost the exchequer around £2bn in 2009/10, £1bn in 2010/11 and £3½bn in 2011/12 – on average costing only a little over 0.1% of GDP a year.

Accelerating the shift to a low carbon economy

The policy regime should foster the move to a low-carbon economy, both by removing existing disincentives to 'green' investment and through positive incentives. Targeted initiatives could be introduced in this Budget to help firms and households make low-carbon choices, and ensure that the UK can take a lead in developing low-carbon solutions. **Scrappage schemes**, at a relatively modest exchequer cost of around £500 million, would encourage the replacement of old inefficient vehicles and domestic appliances with the latest efficient models, bringing forward consumer and business spending and helping to reduce carbon emissions.

An enhanced Low-carbon Buildings Programme, of some £500 million, would help households and firms invest in higher-cost energy efficiency measures such as solid wall insulation and energy management systems, as well as small-scale renewable heat technologies ahead of the introduction of a renewable heat incentive in 2011. Some £500 million for **low-carbon research and development** should also be injected into the Technology Strategy Board to fund large-scale projects that will help make the UK a more competitive low-carbon economy.

Preserving and improving human capital through the downturn

Investing in skills will help business remain competitive in the short-term and position firms to capitalise on the economic upturn. Training is also a productive use of downtime for employees moved to shorter working hours. But as with all business investments, training is under pressure. We welcome the recent increase in flexibilities within the **Train to Gain programme** for SMEs. These flexibilities should now be extended to all firms.

We are all particularly concerned about prospects for students graduating this year and next. The government should, therefore, consider **additional financial support for students**

undertaking master's degree courses – particularly in the science, technology, engineering and mathematics ('STEM') field where, taking potential skills shortages into account, the future benefits for the UK economy look to be the greatest.

To help individuals at all skill and income levels stay in contact with the world of work, further improvements to the operations of **Jobcentre Plus** would be helpful. It is essential that the newly-unemployed do not slip into long-term unemployment, with a wide range of negative outcomes for society.

These important measures to support employer training, graduate skills and the job-matching process should cost no more than £400m for each year of operation. A further allocation of £250m would allow 21,000 STEM subject masters students (compared with a present UK-domiciled intake of 12,000) to each receive £12,000. And an extra £150m per annum for welfare-to-work support, equivalent to 8% of the 2008 Jobcentre Plus staff budget, would allow for a realistic step-up in resources in the face of this year's likely 40% increase in unemployment.

Pushing forward with public sector capital projects

The CBI welcomed the Pre-Budget Report announcement that £3bn of capital spending was to be brought forward from 2010/11. Given evidence of **PFI projects** stalling in the face of credit constraints, the measures announced on 3rd March to safeguard infrastructure investment are also welcome. They should enable key projects to progress, protecting jobs in the construction and services industries. The existing plans must be fully and speedily delivered.

Looking further ahead, the Pre-Budget Report showed that net public sector capital spending will be frozen in cash terms at its 2010/11 level, falling as a share of GDP to 1.8% by 2013/14. This would compromise the UK's economic prospects, and the ability to deliver public services, for many years to come. **The previous policy, of holding net public investment at 2¼% of GDP, should be re-established.** A strong economy requires fit-for-purpose schools, hospitals, digital communications and transport; a failure to maintain and renew the nation's essential infrastructure would be short-sighted.

The government must also maintain its **commitment to the partnership model**, and not be tempted to fall back on traditional design-and-build approaches. The many benefits of PFI and other partnership approaches include better long-term planning, increased financial transparency, and risk-sharing that creates incentives for improved services. High quality, value-for-money infrastructure and services are the result. The government should also expand the use of successful non-PFI PPP models, such as Local Education Partnerships, to deliver the benefits of a partnership approach.

B. A strategy to restore the public finances to health at minimal economic and social cost

Avoiding a further significant fiscal stimulus in this Budget

You may well be tempted to consider a further fiscal stimulus, through tax cuts or extra spending or both, possibly on the scale of the PBR package. We would advise strongly against that. It should be recognised that a very significant fiscal stimulus is already in place, of over 3% of GDP if the ‘automatic stabilisers’ are taken into account.

With borrowing already set to exceed 10% of GDP, net debt on course to double between March 2008 and March 2012, and the annual interest bill headed for £60bn, the short-term effectiveness of any plausibly affordable fiscal package must be doubtful, while the long-term costs would be very real. A further significant addition to borrowing could only exacerbate the pain caused by future fiscal consolidation over a protracted period. It might simply promote increased saving on the part of households, and greater caution on the part of businesses, in anticipation of future tax bills.

Overall, considerable support for the economy is in pipeline, from monetary, financial and fiscal policy actions as well as currency and commodity price shifts. The best policy would now be to clearly communicate this, alongside the governments’ policy strategy and timetable, with the aim of bolstering business and household confidence. Should more policy support be required, then further monetary easing – as well as other action still necessary to unblock the flow of finance and credit – would be preferable to another costly fiscal package.

Reining in public sector current expenditure once the recession is past

To help restore confidence, a clear and credible fiscal plan needs to be set out now. This should show the current budget returning to balance within a handful of years of the commencement of the economic recovery, with as little reliance as possible on further tax rises. That will require a substantial reappraisal of the projected path for current spending, with net public sector capital spending re-prioritised to grow in line with GDP.

Current budget balance could be broadly achieved by 2015/16, without resort to further tax rises, if total public sector non-interest current spending were frozen in money terms from 2011/12 onwards, at the presently-planned 2010/11 level. If by contrast such spending were to grow at 3¾% per year after 2010/11, as in the PBR, then discretionary tax rises building to over £100bn per annum would be needed to achieve balance on the same timescale. Significant tax rises would act as a formidable barrier to private sector investment and net exports, at a time when these will need to play a crucial role in driving the economy forward. But the potential ‘pain’ from spending restraint could be considerably reduced if there is a robust but flexible approach to pay, decisive action to address public service pension costs, and a radical reform of public services.

A renewed emphasis on modernisation to deliver higher quality and cost-effective public services

The CBI has consistently pushed the case for transformation and continuous improvement in the delivery of universal, high quality public services. But with several years of severe budget

restraint ahead, the need for each pound's worth of public spending to be as effective as possible – on a long-term sustainable basis – is more important than ever.

Most public services have benefited from much-needed infrastructure investment. But the perception remains one of entrenched problems in fields as diverse as crime, schools, healthcare, policing and welfare. A fundamental change of approach to delivery, centred on a **step-up in competition and contracting**, could over the longer term help to deliver the quality of service that we would all like to see – yet achieve significant cost savings at the same time. For example, freeing police officers and teachers from back office functions would improve delivery of service.

There are good examples of the success of competitive contracting:

- Prisons built under the PFI have been delivered on time and to budget, and continue to deliver high quality service provision with low re-offending rates, with savings of £40-60m per annum.
- Savings from competition in defence support services are in the region of 20-25%.
- In hospital domestic services, competitive tendering has reduced costs by 34%, with savings of this magnitude achieved by both in-house and private sector contract winners.

To maximise savings potential the government should commit to a **level playing field between public, private and voluntary providers**. Where competition is unfair, spending will be directed away from the best producers. By contrast fair markets create an incentive to invest and innovate in the creation of new technologies and new service models. Public procurement decisions should therefore take into account comparable pension costs, apply VAT rules consistently, measure running costs accurately and properly account for depreciation.

The potential gains from competition can be further magnified by **innovative practices**. Public service contracts must ensure that the best use is made of new technology. Local government is adopting private sector practice by shrinking workplaces, with more employees working remotely and full use of e-business.

Meanwhile, the **Operational Efficiency Programme** review proposals must focus on cutting waste and inefficiencies over the long-term. We cannot emphasise enough that savings should be achieved primarily through the competition and contracting route, not through straightforward but crude cuts in procurement budgets. It would be short-sighted to cut resources allocated to ensuring that procurement processes are efficient and effective and that contracts deliver long-term value for money. It is especially important that the OEP is not used to cut the budget for capital projects.

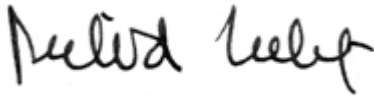
Significant short-term savings are nevertheless available: savings from the sharing of corporate services and reduced procurement delays are worth almost £2½bn per annum. The joining-up of commissioning programmes between the DoH, DCSF and DCLG should be extended across the public sector.

These are the CBI's key messages ahead of the Budget. They should be considered alongside the more technical submissions on detailed tax issues that we are submitting separately.

We believe that if the economy is to be stabilised, it is critical to underpin confidence, of businesses, investors and households. That belief underlies all of our proposals for this year's Budget. The budget will need, above all, to support competitiveness, employment and investment, improve our skills base and demonstrate that the damage to the fiscal position that this recession has caused can and will be rectified, through radical reform of public spending, without delay.

I look forward to discussing these issues with you.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard Lambert', written in a cursive style.

Richard Lambert
Director-General