

**Richard Lambert speech to the North West Annual Dinner  
1 April 2009**

I want to talk tonight about the radically changing relationships between Government and business here in the UK – changes that are going to have a fundamental impact on all of us in this room.

Some of them are obvious, some less so. Some are unwelcome; others could be a platform for economic recovery and stability.

All of them represent big challenges - and some opportunities - for businesses of every kind. And so they are going to be right at the very centre of what will be preoccupying CBI members in the years to come.

I'd like to suggest that there are six main drivers of these big changes, which are still gathering momentum and which have some way to go.

The first comes as a direct consequence of the credit crunch.

Who could have imagined two years ago that the British taxpayer was shortly to become the dominant shareholder in major parts of the banking system? Yet for reasons we all understand, this is exactly where things stand today.

The Government was a reluctant nationaliser – we saw that in the time it took to grasp the nettle of Northern Rock, and bring it into public ownership. Its investment in the banks is held at arms length, and is intended to be temporary.

But its support is conditional – most notably, on the commitment to lend new money. And these hands-off relationships may be tested, as a deepening recession forces the banks to make painful decisions about lending and cost savings. And it's hard to see how these shareholdings are going to be unwound any time soon.

The banks are not the only recipients of taxpayer support, although they are by far the biggest. Over at the Department of Business, Lord Mandelson's favourite joke – I've heard it several times – is that he is not in the business of picking winners: his problem at the moment is the long line of losers trying to pick him.

Faced with an unmanageably steep and rapid fall-off in demand, numbers of what would normally be perfectly viable businesses are struggling to keep their heads above water, and turning to the Government for help.

Thus we've been reminded just how important the motor manufacturing industry is to our economy, with well over 800,000 people directly or indirectly depending on it for jobs. So far there has been lots of talk about possible help for the sector, but precious little action. And there are similar stories elsewhere.

It's vital to do everything possible to ensure that viable businesses will be in a position to prosper once more when the recession comes to an end.

But with public borrowing running up to horrific figures – heading to an annual rate of 10 per cent or more of gross domestic product – there are limits to what the national balance sheet can support.

The second driver of change is also a consequence of the worldwide shock, and it's potentially even bigger and longer lasting than the first.

Over the past 30 years, the default position in a growing number of economies around the world has been the Reagan/Thatcher approach: governments bad: markets good.

But that response is inevitably being challenged in the wake of the catastrophe that has hit the financial markets, and has surged out across whole economies.

Perhaps the most potent witness to this change is Alan Greenspan, former Chairman of the US Federal Reserve - and the maestro of the financial markets over that twenty-year period when they seemed to rule the world.

He recently confessed to being in what he called “a state of shocked disbelief” about the failure of the “self interest of markets to protect shareholder equity.”

In other words, the system on which he built his reputation had failed, and in so doing had undermined public confidence and trust in markets more generally.

You've been able to see the results in the streets of London over the past few days. Very large numbers of people are worried about their savings

and their jobs, and are understandably furious about what they see as the obvious causes of this mess.

There are bound to be economic and political consequences.

Regulation of the financial markets will become more intrusive. And the free-wheeling Anglo American approach to active shareholding will be challenged.

When you read that Jack Welch, the former chief executive of GE and the high priest of this particular kind of capitalism, has suggested that the concept of shareholder value was “the dumbest idea in the world”, you realise that things have changed rather dramatically.

The more that citizens feel insecure about their prospects, the more likely it becomes that politicians will seek to strengthen their control over markets.

And the problem is that damaged reputations in the financial sector are contagious. Opinion polls show that what’s happened in the City is already having an impact on trust in business more generally.

We can’t afford to let this go unchallenged: we have to demonstrate every day that a healthy society is built on a healthy business sector – and vice-versa.

That has to be a task for all business people in the year ahead.

The third driver for change started to become apparent here in the UK a couple of years ago, and has been given fresh impetus by the events of the past 12 months.

That’s the ideas that are now being developed by politicians of all parties, along with a number of business leaders, for a new approach to industrial policy.

The very idea of an industrial policy has been practically illegal in the UK for the past 30 years, so dreadful were the policy errors made in its name back in the 1960s and 70s. But industrialists like Sir John Rose of Roils Royce have recently been asking the question: are we sure that relying so heavily on market forces always secures the best outcome for the country? Given the way even the US Government intervenes so heavily in industrial development, are we happy to be the odd one out?

Lord Mandelson is busy developing ideas about what he calls "industrial activism". He takes what he calls a pragmatic view about markets, and is not trying to develop national champions. But his ideas do involve taking a more strategic look at different sectors of the economy, and bringing all government policies to bear on raising economic activity rather than seeing everything through the prism of the business department.

This is potentially interesting and appealing stuff. It *would* be good to have a vision of what kind of an economy we want to have in ten years time and what it's going to take to get from here to there – whether it's in terms of progress in skills, tax policy, innovation, regulation, infrastructure and so on.

And it *would* be good to have a clear idea of where our comparative advantages as a trading nation lie, and what needs to be done to enhance them.

The low carbon economy is a case in point. The UK has the capacity to be a serious player in the manufacture of electric vehicles, what's needed is for the industry to produce a credible road map identifying strengths and weaknesses – and for judicious public funding to support the necessary technology. That's industrial activism.

But of course there are risks here as well. The temptation will always be to take a top down view, and to overestimate the capacity of government to support successful businesses or business sectors. Sometimes there's a distinct touch of *All our Yesterdays* and old-fashioned corporatism about these discussions, and that's certainly something we have to defend against.

Market failures – some real, and some only perceived – are the fourth reason that government is getting more heavily engaged in the way that business works.

The obvious *real* example is climate change – what Nick Stern has described as the biggest market failure in history.

Societies won't curb their greenhouse gas emissions without incentives and penalties to do so. That's why governments just about everywhere are thinking about ways of putting a price on such emissions, either through a cap and trade system or a tax.

That's why they are struggling to find ways of developing expensive new technologies like carbon capture and storage – vitally necessary if the world is to continue to burn coal, but much too expensive for industry to provide without subsidy.

And that's why they are introducing a host of new regulations and incentives to curb motor car emissions, for example, or to save energy in the home. What business needs above all here is the three C's: policies that are clear, consistent and credible.

Then there are what I think of as *perceived* market failures: two examples here being obesity and binge drinking.

There's no doubt that these are serious and very complicated social problems. Some politicians in all parties increasingly seem to think that the best way to tackle them is by forcing companies to do the heavy lifting, through the way that they price, advertise or formulate their products.

And of course businesses *do* have important responsibilities to develop and sell their products in an appropriate way. But they are not arms of the state, and they can't do the job by themselves.

Obesity and binge drinking are not market failures. Rather, they have to be addressed through a broad combination of social, health, and economic policy.

So this is somewhere to push back on government intervention.

The fifth explanation for a changing relationship between government and industry is to be found in our national infrastructure needs, above all in the area of energy security.

Throughout its industrial history, Britain has been energy independent, first thanks to coal, and then to offshore oil and gas. But that picture is now changing rapidly as the UK continental shelf runs down. And this at a time when we need to rebuild roughly a third of our electricity generating capacity in the next twenty years, as well as develop a large renewables industry more or less from scratch.

Unless the Government acts decisively, two alternatives are likely. One is that the lights will start to go out in six or seven years time. The other is

that we will have another dash for gas, with perhaps 80 per cent of our total energy needs coming from this one source – much of it derived from places where you wouldn't want to go on holiday.

Avoiding these unpleasant outcomes will require massive investment of private capital, much of it coming from abroad. This will only be forthcoming if there is certainty about the direction of government policy, a robust price for carbon, a clear planning and regulatory structure, the right regime for tax and intellectual property, and the skills that will be needed to bring all this new kit to market.

And there may be more. Just a week ago the former chief executive of BP, Lord Browne, was reported as saying that “competition has been the guiding star of UK energy policy since the 1980s, and it worked well while there was a surplus of energy infrastructure capacity. But price competition is now failing to deliver the new, more diversified infrastructure that we urgently need to bolster energy security and meet our climate change targets.”

He went on to argue that energy security and climate change mitigation are public goods, that won't be recognised by the free market. Achieving them would require a new framework of rules, laid down by the state.

So here's another vital area where the government and the business sector are becoming increasingly intertwined.

Thus far, I've been talking about the state moving into the business sector. My sixth and final driver of change is moving in the opposite direction, and stems from the serious and rapidly deteriorating state of the public finances.

Back in the autumn, at the time of the Pre Budget Review, the Treasury forecast that the growth in public spending in the next three-year cycle would have to be contained to just over 1 per cent a year in real terms – or roughly a third the average rate of growth since Labour took office a dozen years ago.

That looked tough. But since then, the numbers have got considerably worse.

So the public purse is going to be under enormous pressure for the foreseeable future, and the Government is going to *have* to develop new

and innovative ways of meeting rising public expectations for the delivery of services.

We may well be approaching some kind of a watershed, where we will have to ask radical questions about the proper size and role of the state.

Among other things, that has to mean further engagement by the private and voluntary sectors. Provided the right standards of quality and value for money can be achieved, the state should become a commissioning agency, indifferent as to whether services are delivered by the public, private or the third sectors.

We are going to need new and innovative ways of allocating risk, and of developing robust public private partnerships.

So here again, government and business are going to find themselves working together in ways that are different from the past.

Looking at the big picture, there will be big risks in this new world.

The risk of governments trying to pick winners, and everything which that implies in terms of the inefficient allocation of capital and the stifling of competition.

The risks of growing protectionism, as national governments compete to shield their industry from economic volatility and change. In the trading world, beggar my neighbour is a game that no one can win.

There are also risks to the way our labour markets work, as governments seek to protect workers from the forces of change. The UK's flexible labour market, along with its flexible currency, are strong reasons for thinking that its economy will recover more rapidly from today's troubles than will those of its big European neighbours.

They both have to be defended.

Above all there is a risk that, in taking the steps that will be necessary to correct the excesses of the past few years, we will forget about the fundamental benefits of the market economy. Forget that for all its flaws and messiness, this is by far the best way we know of allocating capital and helping to lift people out of poverty all around the world.

But there will be opportunities as well as risks in this changing world.

For example, the CBI's Climate Change Board – made up of senior executives from all around our membership – is rightly convinced that only by working closely together can government and industry empower consumers to make the choices that will be necessary to develop a sustainable and prosperous low carbon economy in the future.

Our Public Service Strategy Board is equally passionate in its belief that the private sector could be playing a much bigger part in the efficient delivery of quality public services.

More generally, most of our members agree that a more consistent – even strategic - approach by Government to the policies that effect business – tax, skills, intellectual property, infrastructure and planning and the like – could bring enormous economic benefits.

So for positive as well as negative reasons, we at the CBI are determined to be right in the middle of this emerging debate about the proper role of government, and its relationship with business.

The ground rules under which the two have operated over the past 30 years are changing, and not on a temporary basis.

It's our job to develop the arguments that will help to turn this into an opportunity for a better and more prosperous future for our country.

My sense is that the role of a business organisation like ours has never been more important than at this time of extreme uncertainty and change.

Your support and encouragement gives us the voice that we need to get our points across. And for that, as well as for your guidance and your friendship, we thank you all very much indeed.