

1 March 2010

Rt Hon Alistair Darling MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Chancellor

Budget 2010: Enhancing fiscal credibility and fostering economic recovery

In recent months, the UK economy has showed signs of stabilisation, but if this is to be turned into a lasting and robust economic recovery, this Budget needs to focus on two critical objectives. First, to support economic stability, a fully credible plan for how to restore fiscal balance is urgently required. Second, we need to prioritise those policy measures that will help the economy adjust to the post-crisis environment and thus foster lasting economic growth.

The 2010 Budget needs to focus on the following:

1. Enhancing fiscal credibility

- A faster rate of fiscal consolidation, delivering current budget balance in 2015-16
- A more detailed plan for public spending with a lower trajectory for overall spending
- Raising public sector productivity through fundamental reform

2. Fostering the economic recovery

- Reducing barriers to employment
- Nurturing entrepreneurship
- Minimising cost burdens on business
- Promoting energy security and mitigating climate change



INVESTOR IN PEOPLE

Richard Lambert – Director-General

DL: +44 (0)20 7395 8001 DF: +44 (0)20 7836 0645 E: richard.lambert@cbi.org.uk

CBI Centre Point 103 New Oxford Street London WC1A 1DU

T: +44 (0)20 7379 7400 F: +44 (0)20 7240 1578 W: www.cbi.org.uk

Registered No: RC000139 (England and Wales) Registered Office: CBI Centre Point 103 New Oxford Street London WC1A 1DU

1. Enhancing fiscal credibility

Significant concerns remain about the UK's fiscal situation. The debate about the UK's AAA debt rating has, if anything, intensified since the PBR, particularly in the light of ongoing fiscal turbulence in the Euro area. With borrowing projections more or less unchanged since the 2009 Budget, we firmly believe that further measures are required to provide full fiscal credibility. A detailed plan for delivering fiscal consolidation remains the key to addressing concerns about the UK's public finances, and to supporting the macroeconomic recovery. Without such a plan, the UK is likely to experience elevated borrowing costs, exchange rate instability and reduced financial inflows, leading to lower productivity and growth.

An earlier date for budget balance

The 2009 Pre-Budget Report continued to plan for budget balance in 2017-18, in line with 2009 Budget plans. This was despite a downward revision to the level of the structural deficit, relative to the 2009 Budget estimates. As a result, fiscal policy was actually loosened in the PBR, rather than being tightened further, as we, and many others, had advocated. Had the planned rate of tightening remained as set out in the 2009 Budget, balance could have been achieved a year earlier in 2016-17. The CBI remains of the view that a target date for budget balance of 2017-18 is too far off to instil the credibility necessary to secure market confidence in the UK's public finance position. The bulk of the structural current budget deficit should be addressed within the lifetime of a parliament, with 2015-16 set as the target date for budget balance.

In our PBR submission, we stated that a more rapid reduction in the cyclically-adjusted budget deficit of 1.2% of GDP per year from 2012-13 to 2015-16 should be employed to deliver budget balance two years earlier in 2015-16. As a result of data revisions presented in the PBR, this has fallen to 1.0% GDP per year over the same period.

A more detailed plan for public spending with a lower trajectory for overall spending

Given the current heightened level of uncertainty, it is even more essential that public finance plans are fully transparent. While recognising that it is difficult to fix the full detail of departmental budgets when uncertainty about the public finances is so great, further detail of spending intentions is required, and we believe it would be helpful to publish the indicative figures that already underpin the headline spending totals.

The earlier date for budget balance should be achieved by further adjusting expenditure plans rather than through tax increases. The PBR changed the balance of fiscal consolidation to make it more tax rich than set out in Budget 2009, diverting resources toward current spending. A key objective of fiscal consolidation is that it must support whole economy productivity, thus enabling tax receipts to recover naturally. Relative productivity differences between the public and private sectors suggest that fiscal tightening would be more efficiently focussed on public sector spending cuts, rather than tax increases, particularly if it is then combined with productivity-improving changes in the public sector. And research by the OECD has found that corporate taxes are the most harmful for growth prospects.

In our Pre-Budget Report letter, we stated that capital investment is the essential building block for delivering higher productivity in both the private and public sectors. We continue to call for the sharp cuts in capital expenditure that are currently planned to be reconsidered as they risk further undermining the productive capacity of the economy which has already been hit by the financial crisis. Public sector investment has wider economic benefits and will also be essential for supporting the drive towards low-carbon. Capital spending must, therefore, be returned to 2.25% of GDP as soon as possible.

The achievement of budget balance in 2015-16 without substantial increases in the tax burden or capital spending cuts will require total current spending to fall by around 8% of GDP from its 2009-10 peak by 2015-16.

Raising public sector productivity

To deliver budget balance in 2015-16 without recourse to damaging tax increases will require a public sector pay bill freeze, changes to public sector retirement ages and lower pension costs, as set out in the CBI publication "*Doing more with less*". The public rightly expects high quality services, so it is imperative that the necessary spending cuts should be seen as the catalyst for long overdue reforms. Significant savings can be achieved by re-engineering the delivery of services and addressing inefficiencies in public sector supply chains, procurement processes and workforce management. In many areas the private and third sector can deliver better outcomes at lower cost – the best provider should provide.

The CBI's proposals to spend public money more smartly, building on existing best practice, could lead to savings of over £130bn by 2015-16. In health, for example, better support in the community for those with long term conditions would increase patient satisfaction, improve health outcomes and reduce need for expensive hospitalisation. In local Government, new technologies and working practices are already saving money – through the merger of back office functions and rationalising IT and office space. However, more can be achieved by ensuring that all funding at local level is pooled to deliver the best outcomes possible – for example by providing personalised support across a range of services to help young unemployed or ex-offenders into work, reducing future spending on poor health and crime.

2. Fostering the economic recovery

One of the most important priorities for this Budget must be to deliver a robust and sustainable economic recovery. We strongly support the Government's "going for growth" strategy, which aims to maximise the UK's potential. The principles underlying this strategy must be at the heart of all Government's policy decisions. Tax changes in this Budget must therefore concentrate on reducing obstacles to growth, investment and employment.

Reducing barriers to employment

A large increase in the cost of employment for employers, at a time when unemployment will still be elevated, is ill-conceived. Other, less distortive methods of raising revenue should have been considered. The CBI feels strongly that imposing an extra tax on employment will jeopardise jobs and growth at a time when the economic recovery is likely still to be fragile. We urge you to reverse the decision to increase employer NI in April 2011 by 1% point.

Nurturing entrepreneurship and competitiveness

SMEs remain under considerable financial pressure during the ongoing credit crunch. There are a number of changes which we believe would make a material difference to this crucial sector:

- Make equity costs tax-deductible: this would promote a more balanced financing structure for UK companies, ensuring that financing choices are driven by commercial factors
- Reverse changes limiting the Enterprise Investment Scheme and Venture Capital Trusts to small businesses: These schemes should again be available to medium-sized companies
- Extend Entrepreneur's Relief on Capital Gains Tax for the holders of business assets to four years and raise the lifetime limit to encourage serial entrepreneurship
- Deregulate small mergers: Our view is that small mergers are disproportionately discouraged by the burdens of regulatory compliance in this area

The recent combination of changes to CGT, NICs, non-doms, personal taxation and the taxation of pensions have served to increase significantly the burden of tax upon more mobile wealth creators. The cumulative effect of these changes significantly increases marginal tax rates for those on high incomes, including entrepreneurs. We understand that those with the ability to pay should pay a greater share towards the required fiscal consolidation. However, we are concerned that, by significantly increasing marginal tax rates for highly mobile individuals, the UK will become a less attractive location for business activity, undermining the competitiveness of the UK and resulting in a loss of talent to other jurisdictions. There is a risk that the positive contributions such individuals bring to the UK will be lost without a significant increase in the tax take.

Minimising cost burdens on business

With oil prices much higher in 2009 than anticipated in the Budget, overall receipts from fuel duties and VAT will be higher than planned. However, fuel duty is planned to rise further, raising an additional £1.8 billion by 2011-12. This represents a significant increase in operational costs for business. The Government must take a more holistic approach to the setting of fuel duty, taking into account oil price fluctuations, environmental, competitiveness and revenue considerations.

As we said in our PBR submission, recent changes to air passenger duty are expected to yield £2.6bn for the Exchequer in 2011-12, a substantial increase from the £971m collected in 2006-07. Furthermore, from 2012 all flights arriving or departing from UK airports will be included in the EU Emissions Trading Scheme. The Government must therefore consider how APD will be modified from 2012.

Promoting energy security and mitigating climate change

We support the Government's efforts to increase the effectiveness of the North Sea fiscal regime. The Budget should broaden and extend the field allowance for investment for recovery of the UK's oil and gas reserves from technically and commercially difficult oil and gas fields including the fifth of our gas resources that lie to the west of the Shetlands. The offshore oil and gas tax regime must be rebalanced to maximise the use of our offshore energy resource for the benefit of the UK's energy security.

Targeted support from Government will help ensure that the UK makes the most of the transition to a low-carbon economy. For example, the Government should continue to provide support to households to encourage them to become more energy efficient. The boiler scrappage scheme has been a success, and should be extended, thus contributing further towards the UK's carbon reduction targets. This scheme could also be usefully extended to domestic appliances, helping households to replace older appliances with new, energy-efficient ones, further helping households drive down their energy bills.

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These are the CBI's key messages ahead of the 2010 Budget.

The economy is at a critical turning point in what has been a particularly sharp recession. The effects of the financial crisis will last sometime into the future, as lending flows adjust and the regulatory system changes. Decisions made this year will be critical for determining the future path for the economy and public finances. Through fiscal consolidation, public sector reform and growth-enhancing tax policy, we believe that the UK can be returned to a sustainable growth path.

This letter will be released to the press for publication in coming days.

Yours sincerely

A handwritten signature in black ink, appearing to read "Richard Lambert". The signature is written in a cursive, slightly slanted style.

Richard Lambert
Director-General