

CBI ANALYSIS OF THE 2009 PRE-BUDGET REPORT

The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. With offices across the UK as well as representation in Brussels, Washington, Beijing and Delhi the CBI communicates the British business voice around the world.

CBI overall assessment of the 2009 Pre-Budget Report

There were two tests for this Pre-Budget report. First, would it increase the credibility of government plans to restore the public finances? Second, would it be a platform for job creation and economic growth? The government has failed on both counts. It is a serious mistake to impose an extra jobs tax at a time when the economic recovery will still be fragile. Increasing National Insurance contributions will hold back job creation and growth. There has also been little effort to further improve the public finance position. Indeed, the Pre-Budget Report states that the measures announced amount to a fiscal loosening rather than tightening.

There were some positive measures announced which will support business, including further support for SMEs, low-carbon, oil and gas exploration and a patent box. However, changes to the Climate Change Levy as well as previously proposed changes to pensions tax relief, business rates, landfill tax and Air Passenger Duty will increase burdens on business.

Table 1: Summary of the Pre-Budget Report 2009 measures¹				
£bn gain (+) or cost (-) to the exchequer	2009-10	2010-11	2011-12	2012-13
Main income tax and employee NICs changes ²			0.81	1.32
Employer NICs ³			2.35	2.47
High earners ⁴	-0.01	-0.04	0.00	0.50
Bankers tax	0.55			
Environmental measures ⁵		0.04	0.08	0.22
Supporting business ⁶		-0.15	-0.41	-0.16
Revenue protection ⁷	0.03	0.30	0.70	0.75
Total taxation measures	0.57	0.15	3.54	5.10
Strategic Investment Fund		-0.11		
Benefits uprating		-0.70		
Other spending to 'help people fairly' ⁸	-0.03	-0.37		
Support for military operations		-2.50		
Increase to public sector current expenditure			-7.70	-6.90
Other ⁹	-0.13	-0.21		
Total spending measures	-0.15	-3.89	-7.70	-6.90
Overall net impact of policy decisions	0.42	-3.74	-4.17	-1.81
¹ See Appendix A for details of policy announcements since Budget 2008.				
² Includes freeze in higher rate threshold from 2012-13, increase to primary threshold from 2011-12 and main rate increases.				
³ Cost is on top of measures announced in 2008 Pre-Budget Report (see Appendix A).				
⁴ Cost is on top of measures announced in 2009 Budget, which raise £7.3 billion by 2012-13 (see Appendix A).				
⁵ Includes changes to Climate Change Levy, fuel benefit, company car tax, biofuels duty and electric vehicles package.				
⁶ Mainly empty property rates temporary exemption, small companies rate deferral, bingo duty changes.				
⁷ Mainly financial products avoidance.				
⁸ Mainly extension of free school meals, local authority guideline rents, support for mortgage interest, warm front and greener boiler initiative.				
⁹ Mainly payments to Gurkhas and funding for Building Britain's Future.				
Source: HM Treasury, Pre-Budget Report 2009, Table 1.2				

A. Fiscal outlook

As expected, the headline public finance numbers show little change compared with those presented in the 2009 Budget, although there are some changes within the detail. The government is still aiming for budget balance in 2017-18 and projections remain based on optimistic growth forecasts for 2011-12 onwards. The Treasury still judges that 5% of output has been permanently lost as a result of the financial crisis. Net debt peaks slightly lower and slightly later, at 77.7% of GDP in 2014-15. Net capital investment has been revised up by a total of £16 billion between 2008-09 and 2010-11, mainly reflecting central government grants to public sector banks, but remains projected to fall to 1.25% of GDP by 2013-14.

The PBR continues to show fiscal consolidation commencing in 2011-12. The CBI is satisfied with the start date for the tightening, but has significant concerns about the pace and composition of tightening thereafter. The PBR reduced the estimated level of structural borrowing, and the Treasury itself states that "the Pre-Budget Report measures amount to a modest discretionary

loosening”.¹ Given that the overall level of borrowing is relatively unchanged compared with the Budget, it would have been preferable to use the slightly more benign fiscal position to accelerate the fiscal consolidation. Had the rate of fiscal tightening remained as set out in the Budget, structural budget balance could have been achieved a year earlier in 2016-17. We continue to believe that a faster rate of consolidation, with an earlier budget balance date, accompanied by a full Spending Review, would help prevent movements in sterling becoming volatile and would give financial markets greater confidence in the UK’s fiscal position. The behaviour of gilt markets following the Pre-Budget Report would seem to support our concerns.

We are also concerned about some of ways in which the fiscal consolidation is to be achieved. In particular, increases in employer national insurance contributions seem especially ill-conceived, while public sector capital expenditure is still planned to fall sharply. The PBR states that one third of the fiscal tightening will be through tax increases, compared with around a quarter in the Budget. As set out in our PBR submission to the Treasury, our preference remains for a greater proportion of the fiscal tightening to fall on the less productive public sector, freeing up the private sector to drive the recovery.

Table 2: Changes in the public finances since the 2009 Budget Report							
£bn, nominal	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Pre-Budget Report 2009							
Money GDP	1,435	1,409	1,472	1,544	1,635	1,735	1,841
Receipts	532.4	498.1	530	576	617	656	694
Current spending	563.8	607	647	666	686	707	729
Net investment	45.3	49.5	39	29	26	22	23
Total spending ¹	627.8	675.7	707	716	734	752	776
Current budget	-50	-128	-137	-111	-91	-74	-59
Borrowing	95	178	176	140	117	96	82
Debt (end-of-year)	619	799	986	1,139	1,270	1,379	1,473
Difference from Budget Report							
Money GDP	-4	-3	12	-4	-9	-10	-
Receipts	2	2	2	-1	-3	-6	-
Current spending	-1	-1	2	0	-3	-5	-
Net investment	8	6	3	0	0	0	-
Total spending	7	4	5	-1	-4	-6	-
Current budget	2	4	0	0	0	0	-
Borrowing	5	3	3	0	-1	-1	-
Debt (end-of-year)	10	7	9	9	8	9	-
¹ Current spending, net investment and depreciation.							

Tax receipts are expected to come in slightly higher than expected in the short-term, in part due to the effects of recovery in the stock and housing markets on stamp duty receipts. VAT receipts have also been stronger than expected. However, further out, receipts are weaker, in part due to weaker CPI inflation expectations and the resultant effects on earnings growth and income tax receipts.

Public sector current expenditure is set to grow by an average 0.8% a year in real terms between 2011-12 and 2014-15 (excluding the time-limited expenditure announced in the PBR), which is

¹ HM Treasury Pre-Budget Report 2009 para. 2.72

slightly stronger than the Budget forecast for average real growth of 0.7% per year. However, total current spending in real terms is £27 billion lower than planned in the Budget between 2010-11 and 2013-14. Most of this reflects stronger estimates for the GDP deflator in the PBR: controlling for changes in the deflator, real cuts sum to £5 billion over the same period.

The PBR announced that, for 2011-12 and 2012-13:

- NHS near-cash front-line spending will be frozen in real terms
- near-cash funding for front-line schools will rise by 0.7% per year in real terms
- near-cash funding for 16 to 19 participation will rise in real terms by 0.9% a year
- near-cash spending on Sure Start Children's Centres will be frozen in real terms

However, this provides little indication of what the overall budget position for education and health will be during the next spending review period. A full Spending Review would have given departments a clearer idea of their ongoing budgetary positions, while providing markets with greater confidence in the government's commitment to fiscal consolidation.

Efficiency savings

On 7th December, the government published "Putting the frontline first: smarter government", setting out how the government intends to improve public service outcomes while supporting fiscal consolidation. This outlines how £12bn of efficiency savings will be achieved by streamlining government over the next four years. £9bn of the efficiency savings were announced when the Operational Efficiency Review reports were published alongside the Budget in March this year. This paper details how these savings will be achieved and also includes measures to release an extra £3bn of new efficiency savings per year.

In our PBR submission, we called for stronger cuts in public spending to underpin the required fiscal consolidation. The CBI believes the proposals to improve efficiency in the delivery of public services are a much-needed step in the right direction. We welcome the government's efforts in beginning to tackle public sector pensions, and its moves to bring an end to the rapid increases in the public sector pay bill. However, the government needs to be bolder in order to achieve the savings required to restore public finances. Much bigger sums could be saved through radical reform of the way public services are delivered. The public sector must learn to do more with less and modernise service delivery, by making use of new and proven technologies, increasing competition and improving workforce management. And the government should not shy away from further public sector pay restraint – freezing the public sector pay bill in 2011-12 and 2012-13 could save £19 billion.

Fiscal Responsibility Bill

Details of the Fiscal Responsibility Bill announced in the Queen's Speech were published alongside the PBR. These include the Fiscal Consolidation Plan (FCP) which requires that the government:

- halves public sector net borrowing as a share of GDP over four years from its forecast peak in 2009-10. The Government is setting a target in secondary legislation enabled by the Bill, for borrowing to be 5.5% of GDP or less in 2013-14;
- reduces borrowing as a share of GDP in each and every year from 2009-10 to 2015-16; and

- ensures that public sector net debt is falling as a share of GDP in 2015-16.

These are described as “binding targets” and require the government to explain its progress towards the targets in its financial statements to Parliament. However, the only repercussion arising from failure to meet the targets is to explain to Parliament why the targets have not been met.

The CBI has proposed the creation of a Fiscal Policy Committee (answerable to Parliament) to scrutinise the government’s public finance and economic forecasts, including the underlying assumptions. This would move beyond the current role of the NAO in auditing Budget assumptions. Another key policy that could increase the transparency of the public finances would be to take greater account of economic growth risks in the forecasts, e.g. by moving to probability bands for the GDP forecasts.

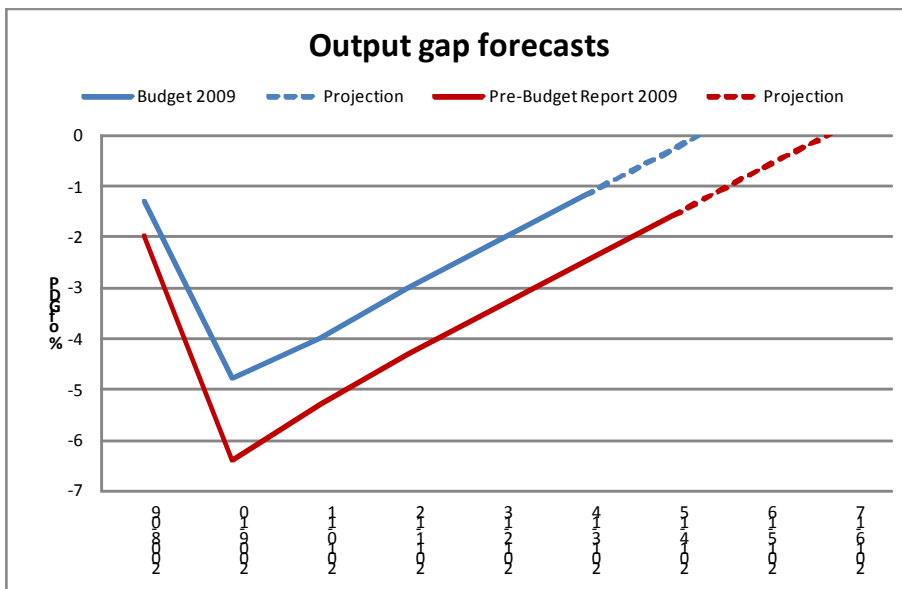
The CBI’s preferred rules (which we submitted alongside our 2008 Pre-Budget Report proposals) to replace the golden and sustainable investment rules are:

- Over a nine-year period, centralised on the current year, the government should aim to balance the current budget, and limit total borrowing to an average of 3% of GDP.
- Surpluses generated from GDP being above trend should be used only to improve the public sector financial balance, i.e. spending should not be increased in response to a financial surplus.

Economic assumptions

Table 3: Comparison of CBI and HM Treasury GDP forecasts				
Annual % change		2009	2010	2011
CBI:	September	-4.3	0.9	N/A
HM Treasury:	December	-4.75	1 to 1.5	3.25 to 3.75
	April	-3.75 to -3.25	1 to 1.5	3.25 to 3.75

The Treasury has significantly revised its forecast for 2009 to a contraction of 4.75% compared with its previous expected contraction of 3.5%. However, forecasts for 2010 and beyond remain unchanged. The forecast horizon has been extended one year to 2014, and shows economic growth averaging 3.5% a year for four years (the public finance forecasts are based on a more “cautious” growth rate of 3.25% per year). A straight line projection of the output gap suggests it will close somewhat later than projected in the Budget.



Source: HM Treasury/CBI

The Treasury's assumptions for the recovery, particularly the expectation for growth in 2011, appear optimistic. The lagged effects of the financial crisis are expected to persist in the short to medium-term, making the achievement of robust economic growth particularly challenging, even with a substantial output gap. This has implications for the public finances: a more gradual recovery would leave borrowing higher than the Treasury currently expects, particularly from 2011-12 onwards.

The CBI's most recent forecast was published on 23rd September and is due to be updated on 21st December.

B. Specific measures affecting business

Tax increases

National Insurance: It was announced in the 2008 Pre-Budget Report that national insurance rates would increase by 0.5% points in 2011-12, raising a total of £5 billion, of which £2.5 billion would come from employers. This has now been doubled for employers and employees, so that the business employment tax burden will increase to £5 billion from April 2011. The CBI feels strongly that imposing an extra tax on employment will jeopardise employment and growth at a time when the economic recovery is likely to still be fragile.

It is important to recognise that taxes on business will ultimately be borne by the resident working population, as wages and employment adjust in response. But crucially, the adjustment process in could also involve a loss of business investment. This reflects the ability of capital to relocate across borders, not only allowing the tax 'incidence' to be shifted onto resident working households, but also squeezing the capital stock – and associated productivity and affordable pre-tax wages – in the process.

Climate change levy: The PBR also detailed a reduction in the discount from the Climate Change Levy available to companies involved in Climate Change Agreements from 80% to 65% from 2011. It is estimated that this represents a £50 million tax increase on energy intensive sectors (a 70% tax increase). This move is not welcome and will hit companies in manufacturing and engineering industries such as chemicals, ceramics and steel that have made significant strides to reduce their emissions through Climate Change Agreements (CCAs), imposing an additional cost burden when

they can least afford it. The CBI calls on the Treasury to adopt an alternate approach (which industry had presented to the government) that would ensure that the Climate Change Levy was compliant with the EU Energy Taxation Directive but that the 80% CCL discount for Climate Change Agreements is maintained. It is vital to maintain a sensible regime for encouraging not discouraging industrial energy efficiency.

It is also disappointing that the opportunity was not taken to remove the anomaly whereby nuclear and CCS power generation is subject to the climate change levy despite being low carbon. This would be a sensible change that reduces the uncertainty for investment in new nuclear and CCS.

Landfill tax: Proposed changes to landfill tax would force many businesses currently paying £2.50 per tonne to landfill inert waste, to pay £48 per tonne from 2010-11 and £72 per tonne from 2013-14. This could also perversely disincentivise environmental friendly behaviour as economic models for long term investment in recovery and recycling would be thrown off balance by the government's proposal.

Business rates: The CBI had proposed a way of smoothing the forthcoming increases in business rates for some companies to ease the adjustment process during the current climate. The CBI is disappointed that Government has not taken this 'cost neutral' opportunity to relieve pressures on businesses that are struggling. In the current climate businesses need to see as little increase in their costs as possible.

Pensions tax relief: The April 2009 Budget restricted tax relief on pension contributions for those earning over £150,000 from 2011-12, and made employer contributions to schemes taxable for the first time from the same date. This change exposes those affected to double taxation on their income – often totaling marginal tax rates of 70% or more. The impact of these changes will be to significantly increase administration burdens on defined benefit schemes, as they are forced to calculate individual contribution rates for employer contributions for the first time – an exceptionally difficult task, and then to calculate appropriate tax bills based on assumptions about the future.

The Chancellor's announcement in the PBR that the restrictions will now include those with a relevant income of £130,000 worsens the regrettable change announced in the Budget. By significantly expanding the group of employees affected, the Treasury has exacerbated the problem. The likely outcome of the changes is a flight of higher earners from pension schemes, significantly damaging board and management engagement with pensions issues.

Financial sector: A new, temporary payroll tax is being imposed on the banking sector at a rate of 50%. This will be payable on bonuses above £25,000 awarded during the period from 9th December 2009 to 5th April 2010 to employees engaged in banking activities. All discretionary and contractual awards will be caught, except where the payer has no discretion on the amount because of a contractual obligation which existed prior to the PBR announcement. We urge Ministers to consult fully on the details to minimise any compliance burden, ensure that the measure is properly targeted and limit damage to the UK's competitiveness as a financial centre.

The government must take care that any action taken in regards to the financial sector must be on an international basis to avoid driving talent from the UK. There are now a number of overlapping initiatives around remuneration in the financial sector, including the FSA code of practice, Walker Review, legislation in Financial Services Bill plus international and European requirements. With the hasty announcement of this one-off tax there was no opportunity for consultation on how it would work which has caused confusion as to its intended targets and scope. With tax receipts permanently affected by the financial crisis, the government must avoid counterproductive tax changes which could actually reduce overall tax revenues by driving individuals and businesses offshore.

Supporting business

A number of announcements of welcome announcements were made, many of which the CBI had called for in its submission to the Treasury ahead of the Pre-Budget Report:

The **HMRC Business Payment Support Service** will continue while the **Enterprise Finance Guarantee Scheme has been extended by 12-months** making an additional £500 million of lending available to small and medium-sized enterprises. There is also a new Growth Capital Fund, along with the £325 million UK Innovation Investment Fund. The CBI welcomes the extension of business cashflow support during this period of difficult financing conditions.

The **temporary increase in the threshold for empty property rate relief** is to be lifted to £18,000 and extended by one year to April 2011. The CBI welcomes the extension of this relief, and the fact that the threshold for it has been increased in line with revaluation increases generally. However, companies with larger empty properties will continue to be eligible for business rates. We continue to call for the system of business rates relief for empty properties to be restored to the pre-2008 position

The **increase in the Small Companies' Rate of corporation tax has been deferred** to April 2011. This is the 2nd time it has been deferred. The CBI welcomes this further deferral which will allow smaller companies greater flexibility to adjust to the challenging business climate.

Infrastructure UK (previously announced in Building Britain's Future on 29th June 2009) is being set up to help facilitate private sector investment in infrastructure, and ensure that publicly-funded infrastructure is appropriately prioritised. The CBI welcomes these measures designed to develop and improve the infrastructure of the UK through better stakeholder coordination and a more strategic approach to projects. However, we remain extremely concerned about the extent to which capital spending is being cut back beyond 2010-11.

A **Patent Box** is to be set up, levying a reduced rate of corporation tax on income from patents from April 2013 to encourage companies to maintain and increase their investment in R&D in this country. It will be of particular benefit to companies in business sectors where new products can be linked to a small number of patents. These sectors include chemicals, pharmaceuticals and biotechnology. A positive impact from the patent box will depend critically on maintaining an internationally competitive R&D tax credit scheme. The government intends to consult with business ahead of Budget 2011 on how this will be designed. This is accompanied by additional funding of £200 million for the Strategic Investment Fund. The CBI welcomes the announcement of a Patent Box, which we called for in our PBR submission, including the intention to consult with business on its design. We note, however, that it is not due to come into effect until April 2013, and that it has a "steady state" cost of £1.3 billion.

Eligibility for the **young persons guarantee** will be brought forward by 6 months, while workers over the age of 65 will qualify for the working tax credit after 16 hours work a week rather than 30 hours. Measures to support employment are welcome in the current climate, hence our disappointment at the announcement of a further increase in the tax on employment, employer NICs.

Phasing-in of auto-enrolment into pensions: The Chancellor's announcement that the major reforms to the pensions landscape introduced by the Pensions Act 2008 will be phased-in over a number of years is understandable, if unexpected. Pensions reform is already being rolled-out over time, so a short delay should not damage the programme overall. For businesses, the administrative burdens introduced by complex auto-enrolment rules are significant, and the government should take its time to get the processes right before employers become subject to the

duty. Small firms – which will be the engine of the economic recovery – will value the extra breathing space this short delay will bring. For savers, the reforms will primarily benefit those with a long period left in employment who have time to make up savings later. For the public finances, it is right that the government looks to make savings where possible without damaging existing pension arrangements or the overall policy intention.

Public sector pensions: We welcome the government's statement that public sector pensions should become more broadly in line with those offered in the private sector. The cap-and-share reforms which will cap employer contributions in a number of public sector schemes are a step forward, particularly when combined with requirements to increase employee contributions from higher-earners. But while these reforms are a welcome step, they do not go far enough. The fundamental problem is still a lack of transparency, and cap-and-share schemes do not encompass the full range of the schemes' costs. The government should set up an independent commission to establish the cost of the schemes and the best way to keep them affordable over time – one which will be fair to those who are already approaching retirement, and give younger public sector workers the time to make appropriate plans.

Support for low-carbon growth: The pre-Budget report contained a package of measures aimed at supporting low-carbon growth for the future, much of which we have actively been calling for in our recent reports, much of which was summarised in our June Climate Change Tracker:

- £200 million to support low-carbon industries via the Strategic Innovation Fund and European Low-carbon Investment Fund;
- £150million further support for vulnerable households through Warm Front;
- £50million for a new incentive for green boilers to benefit 125,000 households;
- Support for four carbon capture and storage demonstration projects;
- Commitment not to tax income from feed-in tariffs;
- Company car tax exemption for electric cars for 5 years and first year capital allowances on electric vans.

These measures provide further support to help build up low-carbon industries in the UK and build up demand for energy efficient and other low-carbon transport, which is very welcome.

Oil and gas: The government also announced measures to encourage the recovery of the UK's oil and gas reserves, including allowing some of the most technically demanding and commercially difficult fields (high pressure high temperature HPHT) in the UK continental shelf to be eligible for the field allowance which could support the recovery of up to 300 million additional barrels of oil and gas. Further technical changes were announced to ensure the effectiveness of the North Sea fiscal regime in supporting investment. The CBI welcomes these changes and encourages the government to continue to work with industry to maximise the ability of the UK to maximise production from our oil and gas reserves. Industry is continuing to discuss with government the case for any fiscal support for investment in the largely underdeveloped area west of the Shetland Islands that could contain up to 20% of the UK's remaining reserves.

APPENDIX A

Table 4: Summary of all policy measures¹			
£bn gain (+) or cost (-) to the exchequer			
	2009/10	2010/11	2011/12
Business rates measures ²	-1.06	0.37	0.34
Capital allowances: temporary rise	-1.64	-0.19	0.38
Other tax measures 'supporting business' ³	-0.48	-1.06	-0.78
Employer NICs rate rise			2.46
End of VAT on staff hire 'concession'	0.25	0.25	0.25
NICs: S2P White Paper reforms	0.29	0.30	0.34
Main income tax and employee NICs changes ⁴	-3.80	-4.13	-2.67
Other tax measures to 'help people fairly' ⁵	-0.22	-0.09	-0.17
'Green' tax measures ⁶	-0.52	-0.56	-0.35
Fuel duty increases ⁷	0.60	1.78	2.25
Income tax increases: higher earners ⁸	0.10	2.22	4.52
VAT reduction	-7.80		
Alcohol duty rises	0.58	0.57	0.61
Other tax measures to 'ensure sustainability' ⁹	0.42	0.42	0.42
'Revenue protection' measures	0.33	0.41	0.46
Total taxation measures	-12.95	0.28	8.07
Car scrappage scheme ¹⁰	-0.40		
Strategic Investment Fund	-0.40	-0.35	
Building Colleges for the Future	-0.20		
Public sector capital spending accelerated	-2.55	2.91	
Employment-related spending ¹¹	-1.31	-2.41	-0.31
Social benefit measures ¹²	-1.54	-0.96	-0.36
Support for housing supply ¹³	-1.09	0.69	
Other spending to 'help people fairly' ¹⁴	-0.14	0.01	
Support for low carbon technologies	-0.16	-0.07	
Support for energy and resource efficiency	-0.22	-0.06	
Value for money savings		5.00	5.00
Total spending measures	-7.99	4.77	4.33
Overall net impact of policy decisions	-20.94	5.06	12.40
<p>¹ All new measures announced between Budget 2008 and Budget 2009, plus those announced in that Budget or earlier but only taking effect April 2009 or later. ² Exchequer cost of 'concessions' on the regular bill increase and on previously-announced changes to empty property rates and backdated bills. Local supplementary rates may add further to future bills. ³ Mainly loss carry back and foreign profits, plus deferral of the previously-announced small company tax rate rise and 'income shifting' rule changes. ⁴ Includes self-employed NICs. ⁵ Mainly stamp duty land tax holiday, ISA limits and inheritance tax threshold. ⁶ Mainly company car tax and landfill tax, plus 'concessions' relating to previously-announced increases in air passenger and vehicle excise duties. ⁷ Including abolition of biofuel duty differential. ⁸ Including freeze on pension contribution limits. Revenue raised increases to £7.3 billion in 2012-13 due to the lagged effects of self-assessment. ⁹ Tobacco duty and gambling taxes. ¹⁰ Car scrappage scheme extended by £100 million in September. ¹¹ DWP funding, employment guarantee for under-25s and redundancy pay. ¹² Mainly pensioner and child-related payments and credits, housing benefit, Social Fund and mortgage support. ¹³ Including spending measures in the September 2008 housing package. ¹⁴ Of which Armed Forces accommodation and Warm Front most significant.</p>			
<p>Based on HM Treasury 2009 Budget Report tables A1, A2 and A11.</p>			