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I am writing to outline the CBI's priorities for Budget 2014. The priorities focus on how we can further rebalance away from consumption and towards investment and trade, building on robust growth in the next two years of 2.6% in 2014 and 2.5% in 2015.

The dramatic improvement in business confidence has already resulted in an increased appetite for investment. To translate this confidence into business investment, it is essential to provide policy certainty and to remove barriers to rebalancing. In particular, the Budget should:

1. Ensure competitive energy costs for British Business
2. Ensure that our tax system supports investment and exports
3. Support smaller and medium-sized businesses in accessing the finance they need to grow
4. Speed up asset sales to fund future capital investment and take concerted action to boost housing supply

To underpin longer-term investment intentions and to ensure that fiscal policy continues to support business growth, the CBI has also identified five medium term fiscal priorities. Maximising the growth impact of tax and spending within overall consolidation will be a critical component of a successful longer-term recovery.

Remove structural barriers to boost business investment

The CBI believes that business investment will grow by 6.6% in 2014 and 8.3% in 2015, but it will still be 9% below its pre-crisis peak by the end of 2015. The government should sharpen its focus on encouraging further growth in business investment to cement the recovery. The ratio of private sector investment to GDP in the UK has been lower than international competitors for decades. This indicates that low business investment is a structural problem which has been compounded by the impact of the financial crisis. Confidence is up amongst businesses, and to translate this into increased investment this Budget should address four structural barriers.

1. Ensure competitive energy costs for British Business

The UK energy market is going through its biggest transformation since privatisation, with significant levels of investment needed to keep the lights on and diversify our power mix. The newly published Energy Act is an important step towards delivering this private capital, and, together with a robust carbon price, should provide a strong signal to investors. However, our long-term investment needs must be balanced against the costs borne by both households and businesses. The UK currently faces a higher carbon price than its European counterparts as a result of the Carbon Price Floor (CPF) which was introduced last year. This is an important tool to promote investment but with continuing disappointment with the level of the EU ETS price, the CPF puts UK industry, particularly those that are energy-intensive and trade-exposed, at a considerable competitive disadvantage.

A two-pronged approach is therefore needed to address this. In the first instance, the government must continue to pursue a strong European carbon price through an ambitious and credible EU energy and climate framework for 2030, underpinned by a reformed EU Emissions Trading System (EU ETS). This is in order to support low-carbon investment and create a level playing field across the EU. Yet even under the most optimistic scenarios, the EU ETS price is likely to remain below that of the UK CPF out to 2020, therefore action is needed in the near-term to support industries impacted by this price differential.

<u>As such, the government should freeze the UK carbon price from 2015/16 in a way which minimises this divergence. The government should also commit to extending the energy-intensive industry (EII) compensation package for the pass-through costs of the EU ETS and CPF for the next Parliament. Further relief could also be provided by exempting inputs to electricity generated by Combined Heat and Power</u> – a technology which provides an important opportunity for some large energy users to improve their efficiency and cost-competitiveness – from the CPF. More broadly, the government should consider the cumulative impact of all policy costs, including the Renewables Obligation and the Carbon Reduction Commitment – which is due to increase this year – on UK businesses’ competitiveness, and explore ways to mitigate this over the longer term. This package involves a modest initial fiscal cost of £90 million in 2014/15, rising to just over £1 billion in 2018/19 based on no behavioural change.

2. Ensure that our tax system supports investment and exports

The tax system should stimulate investment among smaller and medium-sized businesses since the percentage of total business investment for companies in the UK with less than 250 employees is below the figure for the EU27. <u>The CBI proposes that the maximum limit of the Annual Investment Allowance should continue at</u>

£250,000 beyond its current deadline of 1 January 2015. This measure would extend a valuable form of support for capital spending in plant and machinery to support the new appetite for investment. Such a move would cost around £670 million in the fiscal year 2015/16 before rising to £754 million in 2018/19.

The lack of a capital allowance for structures and buildings since the abolition of the Industrial Buildings Allowance is making the return on investment for non-qualifying assets in the UK far less competitive than similar assets elsewhere. The UK continues to be let down by a historic underinvestment in infrastructure. While the World Economic Forum ranks the UK as the 10th most competitive economy overall, we rank 28th best for "Overall quality of infrastructure". The CBI proposes that capital allowances are extended to cover structures and buildings, in order to support private investment in areas such as energy and road networks.

In addition to supporting capital investment, the UK's tax regime must not be a barrier to British businesses establishing networks which lead to inward investment and exports. The UK's Air Passenger Duty (APD) rate is the highest air passenger tax in the EU and has seen significant increases in recent years. As a result, the World Economic Forum's (WEF's) competitive index ranks the UK's airport taxes and charges as the second least competitive in the world. At a minimum APD rates should be frozen, and this proposal would cost approximately £95 million in foregone revenue in the first year. As a next step, the government must review the future of Air Passenger Duty – especially in relation to long haul where the impact is most distortive, dis-incentivising the start-up of routes to high growth emerging markets. Changes here could boost the commercial viability of new direct connections to a wider range of destinations from airports across the UK, providing exporters with the means to expand to new markets.

More broadly, policy must also ensure that exporters have the support they need to fulfil their international ambitions and improve the prospects for net trade in the UK. UK Export Finance has made welcome progress by re-gearing its offer for medium-sized businesses, but must now act to drive traffic to its new package of support.

3. Support smaller and medium-sized businesses in accessing the finance they need to grow

Small and medium sized businesses must be able to access the right type of finance in order to grow. Credit supply and demand is improving in line with the recovery, but a number of structural inhibitors remain in the UK finance market. Action is needed to remove three of these barriers in order to allow growing businesses to access the finance they need from a diverse range of sources.

First, action must be taken to address the historic gap in the availability of patient capital and longer-term finance. Equity finance is used by just 3% of SMEs in the UK, well below the EU average of 7% and the likes of Sweden and Norway at 36% and 40% respectively. To encourage greater utilization, government schemes must work alongside private sector sources of finance to provide the right incentives for investment in equity. For example, the Seed Enterprise Investment Scheme (SEIS) has helped to promote a vibrant market for business angel investment worth around £850 million per annum in the UK and should be made permanent. This is likely to cost around £100 million per annum in the medium term.

Half of businesses considering equity finance said that they would be encouraged to use equity finance if the investment was longer-term. Therefore, the government should build on welcome reforms such as the abolition of stamp duty on shares in AIM-listed companies to incentivize a move away from an over-reliance on traditional short-term debt finance. One example of a reform which could encourage longer-term investment horizons and tap the underutilized retail investment market would be to provide relief for investing in individual equity holdings after 5 years. The CBI estimates that applying relief from Capital Gains Tax could cost approximately £720 million in 2014/15 before rising to £840 million in 2018/19.

Second, action should be taken to promote choice and competition in banking. The CBI supports the Treasury's proposals to increase access to SME credit data and the move to create a new payments regulator. These are examples of supply-side measures which can both help finance providers make better credit decisions and remove barriers to entry to the banking market. The government could take further steps to review other barriers including the level of collateral held at the Bank of England to access the payments system and the required level of regulatory capital for new banks.

Third, action should be taken to get the right regulatory environment in place to support innovative new forms of lending. For example, retail bonds are an important alternative source of capital, but this market has simply not been tapped in the UK by smaller firms, due to the existence of high compliance costs. The Government should work with regulators to ensure that the UK does not 'gold-plate' EU legislation such as the Prospectus Directive in order to provide clarity and consistency for issuers while minimising the cost burden. Similarly, the crowd-funding and peer-to-peer lending market is rapidly expanding. While regulation from April 2014 will bring certainty to the market, it must be proportionate to avoid stifling this fast-growing source of finance.

4. Speed up asset sales to fund future capital investment and take concerted action to boost housing supply

In the National Infrastructure Plan 2013, the government outlined that it had identified a target of asset sales worth £20 billion between 2014 and 2020 in order to fund an increase in capital spending. While some examples were listed such as the partial sale of the student loan book, a more specific timetable for projected asset sales is needed. As many of these sales as possible should be realised before the conclusion of this Parliament in order to stimulate further investment in infrastructure and housing supply.

On housing supply, we welcome the steps which the government has taken to stimulate demand in the housing market and improve mortgage availability through policy measures such as the ‘Help to Buy’ scheme. A recovery in the housing market has helped to support a recovery in the construction industry with output recovering over 2013. However, concerted action is urgently needed to boost the supply of housing and to encourage the investment in new homes needed to support the regeneration of local economies and deliver for a growing population.

The CBI supports a holistic package to address policy issues at each stage of the housing cycle – access to public sector land for development, planning reform to boost building, and stimulating investment by institutional investors in housing stock. On access to public sector land, commitment to list public property holdings on a Rightmove-type site provided welcome transparency for developers on land held by central government. But this approach needs to be extended to all parts of the public sector, including local authorities and non-departmental bodies. On planning, national planning policy dictates that local authorities set aside five-years’ land supply for housing to meet the needs of a growing population and to send clear signals to housebuilders. They must be held accountable for meeting this obligation, provide clear information on their plans, and work with their neighbouring councils to ensure sufficient homes are built in the right places to serve the whole local economy.

Finally, policymakers can do more to attract institutional investment in the private rented sector. Estimates suggest that by 2018, 1 in 5 households will live in private rented accommodation, meaning that the private rented market will become an increasingly significant part of the UK housing market. To ensure that institutional investors can play a full role in delivering housing supply, existing government policies must be delivered including increasing the roll out of the Private Rented Sector Guarantee Scheme. Moreover, the government should take action to tackle the tax burden which institutional investors face when contemplating investment decisions in the private rental sector. This includes, for example, the impact of VAT rates on repairs and renovation on post-investment returns.

5. This package should be implemented in a fiscally neutral way

The economic upturn has supported tax revenue growth, which, combined with the government’s necessary fiscal consolidation plan, is driving a steady reduction in the public sector net deficit. We expect this to fall from £105.3 billion in 2013/14 to £92.6 billion 2014/15 and decline further to £80.1 billion in 2015/16 (both broadly in line with the OBR’s forecast). However, as of now, deficit reduction is less than half complete. Therefore, it would be prudent for this business investment package which initially costs just under £1 billion in 2014/15 rising to just over £2.8 billion by 2018/19 (accounting for less than 0.4% of government spending or tax revenue) to be fiscally neutral, financed by offsetting savings. Reforming public services through making shared services the norm and opening up markets to new ideas and ways of working would enable some of these savings to be realised in the short to medium term. This package should be financed through savings in current spending with proceeds acquired from the divestment of non-core assets committed to capital expenditure in the future.

In the overall fiscal and tax mix, it is important that the government maintains incentives to save for the future, in particular the maintenance of pensions' income tax relief and the tax-free lump sum. Further limitations to either of these will progressively undermine certainty amongst savers – a vital ingredient to encouraging long term saving. Likewise, the removal of NICs relief on employer pension contributions would reduce the incentive for firms to do more on pensions than the statutory minimum.

The five fiscal priorities for business in the UK

The Spending Round 2013 outlined the scope of the fiscal consolidation required beyond the end of this Parliament. At the same time, pro-business and pro-growth policies need to be considered within this context in order to stimulate investment and job creation over the medium to longer term. The CBI has outlined five policy priorities for business in the UK which should be delivered as part of continuing fiscal consolidation. These priorities are:

Develop a competitive tax environment

In 2015 the UK will have a Corporation Tax rate of 20%, the joint lowest statutory tax rate in the G20. However, there are further steps to be taken if the UK is to continue to develop an internationally competitive tax regime. For example, the review of the business rates system must produce recommendations to reduce the burden which the current system presents. In addition, over the longer term the government must build on recent good progress made to reduce National Insurance Contributions when improved public finances permit, in order to support job creation. Moreover, international tax rules need updating to reflect today's changing global business environment. The CBI supports the multilateral efforts at the G20 and OECD to modernise international tax standards which increase cross border trade, investment and jobs, while also protecting tax bases.

Prioritise capital spending, particularly on infrastructure

The private sector should be encouraged to invest more in infrastructure. However, government capital spending must be stepped up to improve the capacity and efficiency of publically owned infrastructure. Under current government plans Public Sector Net Investment (PSNI) is scheduled to decline from 1.6% to GDP in 2014/15 to 1.3% of GDP in 2018/19. At a minimum, public investment should be maintained at its current share of GDP.

Develop vibrant, competitive markets in our public services which reduce costs and improve delivery

Vibrant, competitive public service markets support fiscal consolidation by reducing costs, and improving services. However they need government to overhaul its commercial skills. At present, many public bodies lack the capabilities necessary to manage their supplier markets effectively, frustrating necessary reform and raising costs for all involved. Skills are weakest before and after formal procurement processes: pre-procurement demand and needs analyses can be weak, and post-procurement contract management is often an afterthought. For its part, the contracting industry must build public confidence in its ability to deliver, and so the CBI is working to build sector consensus on transparency measures.

Protect spending on science, research & development, and technology

Public funding for research, development and innovation can help to catalyse private investment, by UK and foreign-based companies, boost the UK's profile as a destination for foreign-direct investment, and contribute to future growth. Science spending should be protected in real terms for the remainder of the fiscal consolidation plan. Furthermore, with the critical importance of supply chain collaboration to the UK's industrial strategy, the Government should commit to funding AMSCI for the long-term and encourage greater participation from a wider array of industries.

Through a simple and relevant training system, ensure that UK businesses and young people have access to the skills to succeed

As the UK returns to growth, we are already seeing skills shortages return as a brake on business productivity. This makes it more important than ever that the outputs of our skills system align with the needs of industry. Business believes the government has taken a significant step towards a demand-led skills system by committing to route public funding for apprenticeships through the employer. Progressing this means phasing and piloting the transition, allowing retention of provision that firms find useful and insisting on simplicity. To bear full fruit of this reform, the government should at least retain the current level of support for the apprenticeship programme.

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